

NOTES

LIABILITY OF ATTORNEYS FOR LEGAL OPINIONS UNDER THE FEDERAL SECURITIES LAWS

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A legal opinion or an opinion of counsel is a formal written document prepared by an attorney at a client's request which expresses the lawyer's informed understanding of the law as it applies to a transaction or a specific aspect of a transaction.¹ In the securities area in particular, the rendering of legal opinions has become an important component of an attorney's work.² In registering a security which will be offered to the public for the first time, an opinion of counsel concerning the legality of the offering must accompany the registration statement when it is filed with the Securities and Exchange Commission (SEC or Commission).³ Moreover, legal opinions are frequently sought by parties in securities transactions which do not require filing reports with the Commission, but which involve issues concerning compliance with securities laws.⁴ A legal opinion has often been called a "passkey" to a securities transaction⁵ because the attorney's opinion regarding the applicability of certain securities regulations may determine whether the securities will be sold.⁶ Thus, in reliance on the professional opinions of securities attorneys, millions of dollars of securities permanently enter the trading markets.⁷

At common law, an attorney's duty to exercise reasonable care in rendering legal opinions ran only to the client.⁸ Because the client had engaged the opining lawyer and because they had a contractual relationship — referred to as privity — only the client could sue an opining attorney for negligent performance of his duties.⁹ Even after the passage of the federal securities laws, the courts and the SEC imposed sanctions and civil liability against an opining attorney only when the lawyer was an active participant

¹ *Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions*, 14 PAC. L.J. 1001, 1005 (1983); Landau, *Legal Opinions Rendered in Securities Transactions*, 8 INST. ON SEC. REG. 13, 13 (1977); BLACK'S LAW DICTIONARY 985 (5th ed. 1979).

² See Fuld, *Lawyers' Standards and Responsibilities in Rendering Opinions*, 33 BUS. LAW. 1295, 1316 (1978); Fuld, *Legal Opinions in Business Transactions: An Attempt to Bring Some Order Out of Chaos*, 28 BUS. LAW. 915, 915, 945 (1973); Gruenbaum, *Corporate/Securities Lawyer: Disclosure, Responsibility to Investors and National Student Marketing Corp.*, 54 NOTRE DAME LAW. 795, 804 (1979); see also *Commissioner Sommer's Speech on the Emerging Responsibilities of a Securities Lawyer*, [1973-1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,631, at 83,688 (Jan., 1974) [hereinafter cited as Sommer].

³ Schedule A of the Securities Act, 15 U.S.C. § 77aa(29) (1982), provides that an opinion of counsel regarding legality of an issue is required to be continued in registration statements filed under the 1933 Act.

⁴ Opinions of counsel are often rendered in connection with issues of exemptions from registration requirements of the Securities Act; rules under the Exchange Act concerning trading in securities, the validity or nature of securities (that is, whether something is a security); or corporate matters relating to a securities transaction (that is, the corporate status of the issuer). See *Report By Special Committee on Lawyer's Role in Securities Transactions: The Association of the Bar of New York City*, 33 BUS. LAW. 1343, 1350 (1978); Note, *Attorneys' Liability To Third Parties For Corporate Opinion Letters*, 65 B.U.L. REV. 415, 417-20 (1984) [hereinafter cited as Note, *Attorneys' Liability*].

⁵ For example, if an attorney provides a legal opinion that securities are exempt from the registration requirements of section 5 of Securities Act, the securities are sold without registration with the SEC. If an unfavorable opinion is given, the stock is usually not sold. See Gruenbaum, *supra* note 2, at 798-99; Shipman, *The Need for S.E.C. Rules to Govern the Duties and Civil Liabilities of Attorneys Under the Federal Securities Statutes*, 34 OHIO ST. L.J. 231, 267 (1974); see also Sommer, *supra* note 2, at 83,689.

⁶ See authorities cited *supra* note 5.

⁷ See authorities cited *supra* note 5.

⁸ This rule was first adopted in *National Savings Bank v. Ward*, 100 U.S. 195, 200 (1879).

⁹ See, e.g., *National Savings Bank v. Ward*, 100 U.S. 195, 206 (1879); *Hodges v. Carter*, 239 N.C. 517, 519, 80 S.E.2d 144, 145-46 (1954); see also W. PROSSER & W. KEETON, *TORTS* 667-68 (5th ed. 1984) [hereinafter cited as W. PROSSER].

in a plan to defraud investors.¹⁰ In contrast, where an opining attorney was not a principal in the overall scheme to defraud, and functioned only in a professional capacity advising clients, no sanctions were imposed.¹¹ As a general rule, therefore, an attorney who was guilty of negligence or misfeasance not amounting to fraud in a securities transaction was exposed to liability only in the form of malpractice actions brought by injured clients.

This traditional limitation on the liability of an opining attorney under common law and the federal securities statutes was inexorably linked to the historic view that a lawyer owed an "unremitting loyalty" to the interests of the client.¹² Under this view, a lawyer's responsibility was to act in a manner which would best advance the interests of the client.¹³ Thus, traditionally, both the securities bar and the regulatory agencies considered the role of an opining securities attorney to be similar to that of a scrivener, whose function was simply to frame the client's ideas in the proper legal form.¹⁴

During the 1960's and the early 1970's, the American Bar Association (ABA), the SEC, and the courts began to take a more expansive view of the role and responsibilities of an opining securities attorney.¹⁵ Because of the importance of legal opinions in the securities area and the need for the investing public to be able to rely on these opinions, the Commission and the courts began requiring opining securities attorneys to take a more objective and independent role in rendering legal opinions.¹⁶ Thus, opining se-

¹⁰ See, e.g., *Katz v. Amos Treat & Co.*, 411 F.2d 1046, 1053 (2d Cir. 1969); *United States v. Benjamin*, 328 F.2d 854 (2d Cir.), cert. denied, 377 U.S. 953 (1964); *SEC v. A.G. Bellin Corp.*, 171 F. Supp. 233, 235-36 (S.D.N.Y. 1959); *In re Morris MacSchwebel*, 40 S.E.C. 347, modified, 40 S.E.C. 459 (1961); *In re James DeWitt*, 38 S.E.C. 879 (1959); *In re Marshall I. Stewart*, Securities Act Release No. 4829 (April 29, 1966).

¹¹ See, e.g., *Nicewarner v. Bleavins*, 244 F. Supp. 261, 266 (D. Colo. 1965); *Woneman v. Stratford Securities Co.*, [1957-1961 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,034, at 93,460 (S.D.N.Y. 1959). For law review articles supporting this traditional view of opining lawyers' liability, see *Jenkins, Attorney Liability Under the Federal Securities Laws*, 2 J. CORP. L. 505, 510 (1977); *Leiman, Liability of Attorneys Involved in the Preparation of Disclosure Documents*, 13 INST. ON SEC. REG. 277, 278-79 (1982); *Lowenfils, Expanding Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties*, 74 COLUM. L. REV. 412, 413-16 (1974); *Rowe, Potential Liability Under the Securities Laws for Rendering Legal Opinions*, in *OPINION LETTERS OF COUNCIL* 347 (1984).

¹² See *Freeman, Liability of Counsel for the Issuer*, 24 BUS. LAW. 635, 639 (1969); *Frank, A New Look at the Ethics of the Corporate Lawyer*, 26 CLEV. ST. L. REV. 337, 338 (1977); *Jenkins, supra* note 11, at 506-07, 510-11; *Lowenfils, supra* note 11, at 415; *Patterson, The Limits of Lawyers' Discretion and the Law of Legal Ethics*, 1979 DUKE L.J. 1251, 1251-55; *Sommer, supra* note 2, at 83,689.

¹³ See authorities cited *supra* note 11; see also *American Finance Co.*, 40 S.E.C. 1043, 1049 (1962).

¹⁴ See *Johnson, The Expanding Responsibilities of Attorneys In Practice Before the SEC*, 25 MERCER L. REV. 637, 637-41 (1974); *Leiman, supra* note 11, at 277-79; *Sommer, supra* note 2, at 83,689-90.

¹⁵ See *Frank, supra* note 12, at 334-41, 345-50; *Leiman, supra* note 11, at 278-29; *Lowenfils, supra* note 11, at 418-19; *Patterson, supra* note 12, at 1251-55; *Rowe, supra* note 11, at 370; *Sommers, supra* note 2, at 83,689-90. For other statements by SEC Commissioners, see *Mathews, Liabilities of Lawyers Under the Federal Securities Laws*, 30 BUS. LAW. 105, 116-21 (1975) [hereinafter cited as *Mathews, Liabilities of Lawyers*]; see also *MODEL CODE OF PROFESSIONAL RESPONSIBILITY* EC 7-3, 7-4 and 7-5 (1979); *ABA Comm. on Ethics and Professional Responsibility, Formal Op. 335* (1974).

¹⁶ See *Leiman, supra* note 11, at 278-79; *Sommer, supra* note 2, at 83,687-90; see also *SEC v. Frank*, 388 F.2d 486, 488-89 (2d Cir. 1968); *In re Emmanuel Fields*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,407, at 83,174 n.20 (June 18, 1973).

curities attorneys were no longer viewed as owing loyalty only to the interests of their clients. Instead, these attorneys were now perceived as also having a duty of protecting the interests of the investing public.¹⁷

With this more expansive view of the role and responsibilities of opining securities attorneys under the federal securities laws, the courts and the Commission began to broaden the scope of liability of attorneys for rendering opinions in the securities area.¹⁸ Both the SEC and injured investors brought actions with increasing frequency against lawyers as well as their clients when they believed that the attorneys had aided their clients in illegal transactions.¹⁹ For the first time, the courts and the SEC were willing to impose legal sanctions and civil liability against opining attorneys who had acted solely in a professional capacity as advisors to their clients.²⁰ In fact, during this time period, the Commission and the courts imposed sanctions on attorneys for simple negligence in issuing opinions.²¹ Moreover, during the 1970's, the SEC also asserted that securities attorneys not only had a duty to advise clients not to engage in fraudulent activities, but also if a client refused to follow this advice and intended to violate the securities laws, the lawyer had a duty to resign and to notify the Commission about the client's conduct.²² According to the SEC, a lawyer's failure to "blow the whistle on a client" constituted a violation of the securities laws.²³

Today, however, the SEC and the courts appear to have retreated from the positions they took regarding the potential liability and ethical responsibilities of an opining attorney under the securities laws.²⁴ While the Commission and the courts will still impose liability on an attorney who acts solely in an advisory capacity issuing opinions for a client, mere negligence by a lawyer in rendering opinions will not suffice for sanctions or civil liability to be imposed on the attorney.²⁵ For an opining attorney to be subject to liability under the securities laws today, the Commission or a private party must show

¹⁷ See authorities cited *supra* notes 13 and 14.

¹⁸ For a discussion of this increasing liability in the context of SEC injunctive actions see *infra* notes 199-204 and accompanying text. See *infra* notes 321-48 and accompanying text for a discussion of this issue in the context of Rule 2(e) disciplinary actions. See *infra* notes 401-24 for a discussion of this pattern in actions brought by private plaintiffs to recover damages under the federal securities laws.

¹⁹ See *supra* note 18.

²⁰ See *supra* note 18.

²¹ See, e.g., SEC v. Coven, 581 F.2d 1020, 1028-29 (2d Cir. 1978), *cert. denied*, 440 U.S. 950 (1979); SEC v. Universal Major Indus. Corp., 546 F.2d 1044, 1047 (2d Cir. 1976), *cert. denied sub nom.* Homans v. SEC, 434 U.S. 834 (1977); SEC v. Spectrum, Ltd., 489 F.2d 535, 541-42 (2d Cir. 1973); *In re Carter and Johnson*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,175, at 82,180 (Mar. 7, 1979) (trial).

²² This view of securities attorneys' duties was first put forth by the SEC's filing of the *National Student Marketing* complaint. SEC v. National Student Marketing Corp., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,360, at 91,913-15-17 (D.D.C. Feb. 3, 1972). For a discussion of the SEC's filing of this complaint and the litigation which followed it, see *infra* notes 218-63 and accompanying text.

²³ *National Student Marketing Corp. (complaint)*, at 91,913-15-17; see also Gruenbaum, *supra* note 2, at 796-98; Lipman, *The SEC's Reluctant Police Force*, 49 N.Y.U. L. REV. 437, 462-68 (1974).

²⁴ See, e.g., SEC v. Haswell, 658 F.2d 698, 699-700 (10th Cir. 1981); *In re Carter and Johnson* [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (Feb. 28, 1981) (appeal).

²⁵ See, e.g., SEC v. Haswell, 658 F.2d 698, 699-700 (10th Cir. 1981); Stokes v. Lokken, 644 F.2d 779, 783-84 (8th Cir. 1981); *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. ¶ 82,847, at 84,167 (appeal).

that the lawyer knowingly or recklessly issued an erroneous legal opinion which substantially assisted the perpetration of a securities fraud.²⁶ Similarly, the SEC has abandoned its position that securities attorneys' duty to the investing public includes an obligation to report a client's fraudulent activities to the Commission.²⁷ Instead, the opining lawyer must take appropriate steps to avoid being co-opted into the fraudulent activity.²⁸ As in other areas of the law, if the attorney is unable to convince the client to rectify the fraud, he has a duty to resign.²⁹

This note will examine the evolution in opining securities attorneys' liability which has occurred during the last twenty years and will provide practitioners with an indication of the extent of their potential liability today. It will focus on the three principal types of actions which may be instituted against opining securities attorneys under the federal securities laws: (1) a civil injunctive action brought by the SEC seeking to restrain an attorney from further violations of the federal securities laws; (2) a Rule 2(e) disciplinary proceeding instituted by the SEC under which an attorney can be temporarily or permanently denied the privilege of practicing before the Commission; and (3) a civil action brought by a private litigant seeking recovery for damages allegedly suffered because of an attorney's violation of the provisions of the federal securities laws. The note will describe and discuss each of these actions in the context of the recent evolution of the potential liability of opining attorneys. Finally, it will discuss the impact of this evolution of potential liability on practicing securities lawyers and the investing public.

The first section of this note presents an overview of the three principal types of actions which may be brought against opining securities attorneys under the federal securities laws. The traditional limits on the liability of opining lawyers under these actions will be discussed in the second section of the note. The third section analyzes the expansion in the potential liability of opining securities attorneys in these three types of actions which occurred during the 1970's. In addition, this section examines the current rejection by the SEC and the courts of the expanded liability imposed on opining attorneys in the preceding decade. The fourth section of the note analyzes the impact which this evolution in potential liability has had on practicing securities lawyers and the investing public. This note concludes that the current standard of liability provides protection for the interests of investors, without having a chilling effect on the actions of opining lawyers in the securities area.

²⁶See, e.g., *T.J. Raney & Sons v. Fort Cobb, Oklahoma Irrigation Auth.*, 717 F.2d 1330, 1333 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Admiralty Fund v. Jones*, 677 F.2d 1289, 1295-96 (9th Cir. 1982); *SEC v. Haswell*, 658 F.2d 698, 699 (10th Cir. 1981); *Cronin v. Midwestern Oklahoma Dev. Auth.*, 619 F.2d 856, 862 (10th Cir. 1980); *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1204-10 (W.D. Mo. 1983); *In re North Am. Acceptance Corp. Securities Cases*, 513 F. Supp. 608, 628-29 (N.D. Ga. 1981); *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (appeal).

²⁷See, e.g., *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,172-73 (appeal); see also *Lawyers' Disciplinary Proceedings Before the SEC*, [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,089 at 84,800 (Jan. 13, 1982) (speech by SEC General Counsel Ed Greene) [hereinafter cited as Greene].

²⁸See, e.g., *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,172-73 (appeal).

²⁹*Id.* See also Friedman, *Reflections on Carter-Johnson*, 13 INST. ON SEC. REG. 297, 297-98 (1982); Kronstein, *The Carter-Johnson Case: A Higher Threshold for SEC Action Against Lawyers*, 9 SEC. REG. L.J. 293, 293-96 (1981).

I. THE THREE PRINCIPAL TYPES OF ACTIONS WHICH MAY BE BROUGHT AGAINST AN OPINING SECURITIES ATTORNEY UNDER THE FEDERAL SECURITIES LAWS

Under common law, an opining attorney could be subject to an action in tort for legal malpractice.³⁰ With the passage of the federal securities laws, three new potential sources of liability for opining securities attorneys were created: (1) an SEC civil injunctive action; (2) a Rule 2(e)³¹ disciplinary proceeding; and (3) a civil action brought by a private litigant for damages suffered because of violations of the securities laws. This section of the note will describe the essential elements of each of these actions and the potential consequences of these actions on lawyers.

A. SEC Injunctive Actions

An opining securities attorney may be subject to civil injunctive actions brought by the SEC to restrain a lawyer from further violations of the federal securities laws. Pursuant to section 20(b) of the Securities Act of 1933 (Securities Act)³² and section 21(d) of the Securities Exchange Act (Exchange Act),³³ the SEC is authorized to bring civil

³⁰ See Landau, *supra* note 1, at 27; see also Freeman, *Opinion Letters and Professionalism*, 1973 DUKE L.J. 372, 377-87 [hereinafter cited as Freeman, *Opinion Letters*]; Wade, *The Attorney's Liability for Negligence*, 12 VAND. L. REV. 755, 762-65 (1959); Note, *Attorneys' Liability*, *supra* note 4, at 428-33. Legal malpractice consists of failure of an attorney to exercise the care, knowledge, skill, and diligence ordinarily possessed and generally recognized by members of the legal profession. When failure to exercise such care proximately caused damages to an individual it gave rise to an action for negligence in tort. See, e.g., *Smith v. Lewis*, 13 Cal. 3d 349, 358, 530 P.2d 589, 593, 118 Cal. Rptr. 621, 627 (1975); *Lucas v. Hamm*, 56 Cal. 2d 583, 591, 364 P.2d 685, 689, 15 Cal. Rptr. 821, 825 (1961), *cert. denied*, 368 U.S. 987 (1962); *Hodges v. Carter*, 239 N.C. 517, 519, 80 S.E.2d 144, 145-48 (1954).

³¹ Rule 2(e), 17 C.F.R. § 201.2(e) (1984), 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 (15 U.S.C. § 77a to 80b-20), or the rules and regulations thereunder.

Id.

³² Section 20(b) of the Securities Act, 15 U.S.C. § 77t(b) (1982), provides in part:

Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States or United States court of any Territory, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond . . .

Id.

³³ Section 21(d) of the Exchange Act, 15 U.S.C. § 78u(d) (1982), states:

Wherever it shall appear that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this chapter, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such a person is a member or a person associated with a member, the rules of a registered clearing agency in which such person is a participant, or the rules of the Municipal Securities Rulemaking Board, it may in its discretion bring an action in the proper district court of the United States, the United States District Court

injunctive actions against any person currently engaged, previously engaged, or about to engage, in any acts or practices that constitute violations of the provisions of these statutes or the rules or regulations promulgated thereunder. To obtain a permanent injunction, the Commission must prove by a preponderance of evidence³⁴ that a statutory violation has been or is about to be committed and that, in the view of the defendant's past conduct, a reasonable likelihood of future violations of the federal securities laws exists.³⁵ Upon appropriate proof by the SEC, a court will issue an injunctive decree commanding the defendant to permanently refrain from committing acts that violate the federal securities laws.³⁶ Thus, at least theoretically, an injunctive suit is a preventive or deterrent action aimed at protecting the public from further injury or harm.³⁷

SEC civil injunctive actions have generally been brought against opining attorneys for alleged violations of section 10(b)³⁸ of the Exchange Act and Rule 10b-5³⁹ promulgated pursuant to the Exchange Act, and section 17(a)⁴⁰ of the Securities Act.⁴¹ Section

for the District of Columbia, or the United States courts of any territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provisions of this chapter or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

Id.

³⁴ *Steadman v. SEC*, 450 U.S. 91, 96 (1981); *SEC v. First Fin. Group of Texas*, 645 F.2d 429, 434-35 (5th Cir. 1981). For a good discussion of the requisite standard of proof in SEC actions for injunctive relief, see Casenote, *SEC Actions for Injunctive Relief in Securities Fraud Cases*: *SEC v. First Financial Group of Texas*, 23 B.C.L. Rev. 1529 (1982).

³⁵ *United States v. W.T. Grant Co.*, 345 U.S. 629, 633 (1953). Although the *W.T. Grant* case was brought under the antitrust laws, the same standard is applicable in cases arising under the federal securities laws. See, e.g., *SEC v. Haswell*, 658 F.2d 698, 699-700 (10th Cir. 1981); *SEC v. Bausch & Lomb, Inc.*, 565 F.2d 8, 18 (2d Cir. 1977); *SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044, 1048 (2d Cir. 1976), *cert. denied*, 434 U.S. 834 (1977).

³⁶ See Mathews, *SEC Civil Injunctive Actions*, 5 REV. SEC. REG. 969, 969 (1972) [hereinafter cited as Mathews, *SEC Civil Injunctive Actions*]; Mathews, *Liabilities of Lawyers*, *supra* note 15, at 106.

³⁷ Mathews, *SEC Civil Injunctive Actions*, *supra* note 36, at 969; see also *SEC v. Coven*, 581 F.2d 1020, 1027-28 (2d Cir. 1978), *cert. denied* 440 U.S. 950 (1979); *SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044, 1047 (2d Cir. 1976).

³⁸ Section 10(b) is codified at 15 U.S.C. § 78j(b) (1982).

³⁹ Rule 10b-5, 17 C.F.R. § 240.10b-5 (1984), 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,

(b) to make any untrue statement of a material fact or to omit to state material fact necessary in order to make the statements made, in the light of 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.

Id.

⁴⁰ 15 U.S.C. § 77q(a) (1982). For the text and a discussion of section 17, see *infra* note 65 and accompanying text.

⁴¹ See, e.g., *SEC v. Haswell*, 658 F.2d 698, 699 (10th Cir. 1981); *SEC v. Coven*, 581 F.2d 1020, 1021 (2d Cir. 1978), *cert. denied*, 440 U.S. 950 (1979); *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 536 (2d

10(b) is a "catchall anti-fraud provision"⁴² proscribing fraud or any material misstatement or omission by any person in connection with the sale or purchase of any security. For violating the provisions of Section 10(b) and Rule 10b-5, a person can be subject to primary or secondary liability.⁴³

In order to be subject to primary liability, a person must have actively participated in a scheme to defraud investors or must have violated a duty he or she owed directly to a plaintiff.⁴⁴ A plaintiff must prove three factors to establish a primary violation of Section 10(b): (1) a misrepresentation or omission of a material fact⁴⁵ by the defendant in connection with the purchase or sale of a security; (2) reliance⁴⁶ by the plaintiff in buying or selling the security upon the misrepresentation or omission; and (3) "scienter" by the defendant in connection with that misrepresentation or omission.⁴⁷ This scienter requirement was defined by the Supreme Court in the 1976 case of *Ernst & Ernst v. Hochfelder*⁴⁸ as a "mental state embracing intent to deceive, manipulate, or defraud."⁴⁹ As a result of this definition, the *Hochfelder* Court held that mere negligence by an individual in misstating or omitting a material fact was insufficient to establish a violation of section 10(b) in an action brought by a private plaintiff.⁵⁰ Four years later in *Aaron v. SEC*,⁵¹ the Court extended the scienter requirement under section 10(b) to injunctive actions brought by the SEC.⁵² The Supreme Court has expressly left open the issue of

Cir. 1973); *SEC v. National Student Marketing Corp.*, 457 F. Supp. 682, 699-700 (D.D.C. 1978); *SEC v. Century Inv. Transfer Corp.*, [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,232, at 91,438 (S.D.N.Y. Oct. 5, 1971).

⁴² *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983).

⁴³ See, e.g., *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 93-95 (5th Cir. 1975); *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1199 (W.D. Mo. 1983); *In re North Am. Acceptance Corp. Securities Cases*, 513 F. Supp. 608, 624-25 (N.D. Ga. 1981). See generally *Ruder, Secondary Liability in Securities Fraud Cases*, 8 INST. ON SEC. REG. 407 (1976) [hereinafter cited as *Ruder, Secondary Liability*]; *Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delecto and Contribution*, 120 U. PA. L. REV. 597 (1972) [hereinafter cited as *Ruder, Multiple Defendants*].

⁴⁴ See, e.g., *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 93-95 (5th Cir. 1975); *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1199 & n.32 (W.D. Mo. 1983); see also *Ruder, Multiple Defendants*, *supra* note 43, at 612-20.

⁴⁵ A fact is deemed material if there is substantial likelihood that a reasonable investor would consider it important in determining whether to purchase or sell. *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153-54 (1972).

⁴⁶ The reliance requirement is traditionally satisfied upon proof that "the misrepresentation is a substantial factor in determining the course of conduct which results in . . . loss." *T.J. Raney & Sons v. Fort Cobb, Oklahoma Irrigation Fuel Auth.*, 717 F.2d 1330, 1332 (10th Cir. 1983) (quoting *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90, 102 (10th Cir. 1971) (quoting *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir. 1965))), *cert. denied*, 465 U.S. 1026 (1984). In cases where the primary issue is an omission of information, there is a rebuttable presumption of reliance if the plaintiff can show the omission was material. *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153-54 (1971).

⁴⁷ See, e.g., *Croy v. Cambell*, 624 F.2d 709, 715 (5th Cir. 1980); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 93 (5th Cir. 1975); *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1199 (W.D. Mo. 1983); *Savino v. E.F. Hutton & Co.*, 507 F. Supp. 1225, 1231 (S.D.N.Y. 1981). See also *R. JENNINGS & H. MARSH, SECURITIES REGULATION*, 808-12 (5th ed. 1982).

⁴⁸ 425 U.S. 185 (1976).

⁴⁹ *Id.* at 193 n.12.

⁵⁰ *Id.* at 193.

⁵¹ 446 U.S. 680 (1980).

⁵² *Id.* at 691.

whether recklessness⁵³ satisfies this scienter requirement in both private claims and SEC injunctive actions.⁵⁴ All courts of appeals which have considered the issue have held that recklessness is sufficient to satisfy the scienter requirement under section 10(b) for primary or principal wrongdoers.⁵⁵

An opining attorney may also be subject to secondary liability under section 10(b) for "aiding and abetting" a federal securities law violation by a primary wrongdoer.⁵⁶ While the elements have not yet crystalized into a set pattern,⁵⁷ the three general requirements for establishing an aiding and abetting violation of section 10(b) are: (1) the existence of a securities law violation by a "primary" party; (2) the aider and abettor knowingly and substantially assisted the conduct that constitutes the violation; and (3) awareness or knowledge by the aider and abettor that his role was part of an activity that was improper or illegal.⁵⁸ To satisfy this third element of aiding and abetting which is often referred to as the knowledge or "intent" portion of the offense, the plaintiff must show that the defendant acted with scienter.⁵⁹ The Supreme Court has also left unresolved the sufficiency of recklessness to satisfy this scienter requirement for aiders and abettors.⁶⁰ Accordingly, federal courts have taken different approaches to this issue. Some courts, for example, have stated that recklessness satisfies the scienter requirement for both primary and secondary violations of section 10(b).⁶¹ Others have held that recklessness will not establish scienter in an aiding and abetting action unless the defen-

⁵³ In *Franke v. Midwestern Oklahoma Dev. Auth.*, 428 F. Supp. 719, 725 (W.D. Okla. 1976), a district court put forth one of the most frequently quoted definitions of the recklessness which is sufficient to establish scienter. According to the *Franke* court:

In the context of an omissions case, reckless 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 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.

Id. at 725. See also W. CARY & M. EISENBURG, CORPORATIONS 820 (5th ed. 1980).

⁵⁴ *Herman & MacLean v. Huddleston*, 459 U.S. 375, 378 n.4 (1983); *Aaron*, 446 U.S. at 85 n.5; *Hochfelder*, 425 U.S. at 194 n.12.

⁵⁵ See, e.g., *ITT v. Cornfield*, 619 F.2d 909, 923 (2d Cir. 1980); *McLean v. Alexander*, 599 F.2d 1190, 1197-98 (3d Cir. 1980); *Hoffman v. Eastbrook*, 587 F.2d 509, 516-17 (1st Cir. 1978), *cert. denied*, 439 U.S. 970 (1978); *Sunstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1044 (7th Cir. 1977).

⁵⁶ For examples of SEC injunctive actions brought against opining attorneys, see, e.g., *SEC v. Coven*, 581 F.2d 1020, 1025-28 (2d Cir. 1978), *cert. denied*, 440 U.S. 950 (1979); *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 541-42 (2d Cir. 1973); *SEC v. National Student Marketing Corp.*, 457 F. Supp. 682, 700-01 (D.D.C. 1978); *SEC v. National Student Marketing Corp.*, 402 F. Supp. 641, 646-50 (D.D.C. 1975); see also R. JENNINGS & H. MARSH, *supra* note 47, at 1133-37; Leiman, *supra* note 11, at 283-85. This concept of aiding and abetting originated in the field of criminal law, which has traditionally held that whoever aids and abets the commission of a crime is punishable as a primary violator. *Ruder, Multiple Defendants*, *supra* note 43, at 627.

⁵⁷ *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 94 (5th Cir. 1975).

⁵⁸ See, e.g., *Stokes v. Lokken*, 644 F.2d 779, 782-83 (8th Cir. 1981); *ITT v. Cornfield*, 619 F.2d 909, 922 (2d Cir. 1980); *Monsen v. Consolidated Beef Co.*, 579 F.2d 793, 799 (3d Cir.), *cert. denied* 434 U.S. 930 (1978). See generally Brunelle, *A Contemporary Legal Context Analysis of Aiding and Abetting*, 11 SEC. REG. L.J. 182, 182-83 (1983).

⁵⁹ *Hochfelder*, 425 U.S. at 193; see also cases cited *supra* note 58.

⁶⁰ *Herman & MacLean v. Huddleston*, 459 U.S. 375, 379 n.4 (1983); *Aaron*, 446 U.S. at 687 n.5; *Hochfelder*, 425 U.S. at 194 n.12.

⁶¹ See, e.g., *Stokes v. Lokken*, 644 F.2d 779, 783 (8th Cir. 1981); *Boyles v. Dodge*, [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,467, at 92,734 (N.D. Ill. Feb. 8, 1982).

dant owes a particularized duty to the plaintiff.⁶² Still other courts have found recklessness sufficient to meet the scienter requirement of aiding and abetting where it was foreseeable by the defendant that a class of persons such as the plaintiff would rely on his statement.⁶³

SEC civil injunctive actions are also frequently brought against attorneys for violations of section 17(a) of the Securities Act.⁶⁴ Section 17(a) is similar to Section 10(b) of the Exchange Act, except that it applies only to sales, not purchases, of securities.⁶⁵ Thus, the requirements of establishing the existence of primary or secondary liability under section 17(a) are very similar to the standards for proving liability under section 10(b).⁶⁶ In *Aaron v. SEC*, however, the Supreme Court held that the SEC was required to establish scienter as an element of a civil enforcement action brought for violations of section 10(b) and section 17(a)(1), but that the Commission did not have to prove that a defendant acted with scienter to establish violations of sections 17(a)(2) and 17(a)(3) of the Securities Act.⁶⁷ In civil injunctive actions based on the violation of these later two

⁶² See, e.g., *Edwards and Hanley v. Wells Fargo Securities Corp.*, 602 F.2d 478, 484-85 (2d Cir. 1979), *cert. denied*, 444 U.S. 1045 (1980); *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 44, 47 (2d Cir.), *cert. denied*, 434 U.S. 1039 (1978).

⁶³ See, e.g., *Morgan v. Prudential Group, Inc.*, 527 F. Supp. 957, 960-62 (S.D.N.Y. 1981); *In re North Am. Securities*, 513 F. Supp. 606, 626 (N.D. Ga. 1981); *Oleck v. Fischer*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,898, at 95,698-700 (S.D.N.Y. June 8, 1979), *aff'd on other grounds*, 623 F.2d 791, 795 (2d Cir. 1980); *Sharp v. Coopers & Lybrand*, 457 F. Supp. 879, 888 (E.D. Pa. 1978).

⁶⁴ See, e.g., *SEC v. Haswell*, 654 F.2d 698, 698 (10th Cir. 1981); *SEC v. Coven*, 581 F.2d 1020, 1021 (2d Cir. 1978); *SEC v. National Student Marketing Corp.*, 402 F. Supp. 641, 642 (D.D.C. 1975).

⁶⁵ Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (1982) provides:

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —

- (1) to employ any device, scheme, or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement or a material fact or any omission 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

- (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Id. Because of the similarity between section 17 of the Securities Act and section 10(b) of the Exchange Act, claims under section 17(a) are usually put forth in conjunction under section 10(b) claims and courts often neglect to discuss section 17(a). See *Hazen, A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act*, 65 VA. L. REV. 641, 647-59 (1978); see also R. JENNINGS & H. MARSH, *supra* note 47, at 817-18.

⁶⁶ See, e.g., *Savino v. E.F. Hutton & Co.*, 507 F. Supp. 1225, 1231 (S.D.N.Y. 1981); *Felts v. National Account Sys. Ass'n, Inc.*, 479 F. Supp. 54, 64, 68 (N.D. Miss. 1978).

⁶⁷ *Aaron*, 446 U.S. at 695-700. In *Hochfelder*, the Court had held that the language of section 10, specifically the terms "manipulative," "device," and "contrivance," manifested congressional intent that the section was concerned only with knowing and intentional misconduct and, thus, scienter was required. 425 U.S. at 197-99. In *Aaron*, the Court held that section 17(a)(1)'s language "to employ any device, scheme, or artifice to defraud" showed a similar intent by Congress to proscribe only knowing or intentional misconduct. 446 U.S. at 696. Thus, the Court held that the SEC was required to establish scienter when bringing a civil injunctive action under this section. *Id.* The Court stated, however, that no language in either § 17(a)(2) or § 17(a)(3) evinced congressional intent that these sections should apply only to cases involving fraudulent misconduct. 446 U.S. at

provisions of the Securities Act, the Court stated that the SEC need only show negligence by the defendant.⁶⁸

Several direct and indirect consequences arise from entry of a permanent injunction against an attorney.⁶⁹ If a defendant fails to comply with the terms of an injunctive decree, he may be prosecuted for either civil or criminal contempt of court.⁷⁰ Also, under the SEC's disciplinary rules of practice, the entry of a permanent injunction against an individual automatically allows the Commission to temporarily deny that person the privilege of practicing or appearing before the SEC and could lead to the attorney's permanent disqualification from practicing securities law.⁷¹ Entry of a permanent injunction against an attorney is also likely to increase the probability of civil actions being brought against the attorney by private litigants.⁷² In addition, under the Supreme Court's decision in *Parklane Hosiery Company, Inc., v. Shore*,⁷³ a private plaintiff can employ offensive collateral estoppel to preclude an attorney from relitigating issues of fact decided against him in an SEC civil injunctive action.⁷⁴ Given these potentially adverse effects of a SEC injunctive action, the imposition of a permanent injunction against an attorney may well do more damage to his business and securities law practice than would an adverse money judgment in a private damage action.⁷⁵

B. Rule 2(e) Proceedings

In addition to potential liability in SEC injunctive actions, an opining securities attorney may be subject to disciplinary proceedings brought by the SEC under Rule 2(e) of the Commission's rules of practice.⁷⁶ The Commission has stated that Rule 2(e) is not

696-97. Therefore, for injunctive actions brought under these sections, scienter is not a requirement. *Id.* at 697.

⁶⁸ 446 U.S. at 700-01. The *Aaron* Court did state, however, that the degree of scienter in an attorney's past conduct could be very important in a court's consideration of the "likelihood of future violations by the defendant" which the SEC is required to prove in order to obtain an injunction. *Id.* at 701. See also *id.* at 703 (Burger, C.J., concurring); SEC v. Haswell, 654 F.2d 698, 699-700 (10th Cir. 1981).

⁶⁹ See Block, *An Overview: Responsibilities of Attorneys Under the Federal Securities Laws*, 36 Bus. Law. 1781, 1782 (1981); Mathews, *Liabilities of Lawyers*, *supra* note 15, at 105-106; Mathews, *SEC Civil Injunctive Actions*, *supra* note 36, at 969-71.

⁷⁰ See Mathews, *Liabilities of Lawyers*, *supra* note 15, at 105; Mathews, *SEC Civil Injunctive Actions*, *supra* note 36, at 969-71.

⁷¹ Under Rule 2(e), 17 C.F.R. § 201.2(e) (1984), after the entry of the injunction, the attorney is temporarily suspended from appearing before the Commission. After being notified of the suspension, the lawyer has thirty days to apply to the Commission to request that the suspension be lifted. If such a request is not made, the suspension becomes permanent. *Id.* § 201.2(e)(3)(ii). At the hearing, the burden of proof is on the attorney to present evidence of mitigating circumstances showing why permanent suspension is inappropriate. In presenting evidence, the attorney is precluded from contesting "any finding made against him or facts admitted by him in the [prior] judicial or administrative hearing . . ." *Id.* § 201.2(e)(3)(iv); see also Johnson, *supra* note 14, at 648-49; Marsh, *Rule 2(e) Proceedings*, 35 Bus. Law. 987, 999-1000 (1980).

⁷² See Sommer, *supra* note 2, at 83,692.

⁷³ 439 U.S. 322 (1979).

⁷⁴ *Id.* at 331-33.

⁷⁵ See Mathews, *Liabilities of Lawyers*, *supra* note 15, at 106.

⁷⁶ For text of Rule 2(e), see *supra* note 31. While the federal securities laws do not provide the SEC with express authority to discipline attorneys who practice before it, courts have recognized that there is no need for a federal administrative agency to have specific authority to regulate the

intended to provide an alternative remedy to its powers to seek injunctive relief for violations of the federal securities laws. Rather, it is a method of protecting the investing public from professionals who have abused the privilege of practicing before the Commission.⁷⁷

As originally promulgated in 1935, Rule 2(e) provided the SEC with the power to temporarily or permanently deny professionals, such as attorneys, the privilege of appearing before it.⁷⁸ Such disciplinary action could be taken upon a finding, after notice and opportunity for a hearing, that the attorney lacked the requisite qualifications to represent others or was lacking in character or integrity or had engaged in unethical or unprofessional conduct.⁷⁹ In 1970, Rule 2(e) was amended to add willful violations and willful aiding and abetting violations of the federal securities laws as other grounds for temporarily or permanently suspending an attorney from practicing before the Commission.⁸⁰ Because the Commission has characterized the opportunity of an attorney to practice before it as a "privilege," the standard of proof applicable in a Rule 2(e) proceeding is the "preponderance of the evidence" rather than the "clear and convincing evidence" standard applicable in actions involving deprivation of rights.⁸¹

conduct of professionals who practice before it. See, e.g., *Touche Ross & Co. v. SEC*, 609 F.2d 570, 579 (2d Cir. 1979); *SEC v. Csapo*, 533 F.2d 7, 12 (D.C. Cir. 1976); see also *Goldsmith v. United States Bd. of Tax Appeal*, 270 U.S. 117, 121-22 (1926) (Supreme Court rejected the need for specific statutory provisions for a federal administrative agency to regulate the conduct of professionals). Such power is inherent in such a quasi-judicial body's rule-making authority. *Touche, Ross & Co.*, 609 F.2d at 579. Pursuant to this recognition, the SEC promulgated Rule 2(e), which is the Commission's disciplinary rule governing the conduct of lawyers and other professionals who practice before it. See 17 C.F.R. § 201.2(e) (1984).

If a Rule 2(e) action is brought against an individual, a hearing for the purpose of taking evidence will be brought before an administrative law judge (ALJ). *Id.* § 201.11. After the presentation of evidence, the ALJ hands down a decision which sets forth: findings and conclusions upon all material issues of fact and law; an appropriate order; a statement of the time within which a petition for review by the Commission may be filed. *Id.* § 201.16. If no petition is filed within the appropriate time period, the decision of the ALJ is final. *Id.* If a petition is made within the requisite time period, the SEC will review the ALJ's order and decide whether to uphold it or reverse it. *Id.* § 201.17.

⁷⁷ *In re Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,149 (Feb. 28, 1981).

⁷⁸ See Kemp, *Disciplinary Proceedings by the SEC Against Attorneys*, 14 CLEV.-MAR. L. REV. 23, 23 (1965). The Commission broadly interprets which activities constitute the privilege of appearing before it. For example, in a consent decree under which an attorney's privilege of appearing before the Commission was suspended for twelve months, the SEC stated that during this time period the lawyer:

shall not prepare or disseminate any oral or written opinions involving matters arising under the federal securities laws; shall not directly advise, either orally or in writing any issuer with regard to any security being offered to the public; and shall not provide any consulting services to any other attorney unless such other attorney states that he alone is responsible for the preparation of any oral or written opinion to be disseminated regarding the public offering.

In re Hodgin, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,334, at 82,427 (Sept. 27, 1979).

⁷⁹ Kemp, *supra* note 78, at 23.

⁸⁰ 17 C.F.R. § 201.2(e)(iii) (1984). See Securities Act Release No. 5147 (May 10, 1971), reported in [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,064.

⁸¹ Rule 2(e) expressly states that the opportunity to practice before the SEC is a privilege. 17 C.F.R. § 201.2(e) (1984). In *Steadman v. SEC*, 450 U.S. 91, 100-02, *reh'g denied*, 451 U.S. 933 (1981), the Supreme Court upheld the SEC's view that the preponderance of evidence standard was applicable in a Rule 2(e) proceeding.

Although the SEC has stated that a successful Rule 2(e) proceeding affects only "our narrow type of practice" and does not affect an attorney's ability to practice other areas of the law,⁸² the consequences of a successful Rule 2(e) proceeding can be devastating for a corporate attorney.⁸³ The SEC has stated that a revocation of the privilege of appearing before it will not only prevent a disqualified attorney from engaging personally in activities related to the Commission's work,⁸⁴ but also will bar the attorney from indirectly benefiting from his firm's securities law practice.⁸⁵ Thus, the disqualified lawyer may not even receive profits from his firm's securities law practice.⁸⁶ The rule further provides that an entire law firm could be sanctioned for a securities law violation.⁸⁷ Under such a penalty, "partners and associates of a disqualified firm may not practice before the Commission so long as they remain members or are associated with the sanctioned firm."⁸⁸

C. Civil Actions Brought by Private Plaintiffs Under the Federal Securities Laws

In addition to SEC injunctive and Rule 2(e) actions, an opining securities attorney is also susceptible to civil actions brought by private plaintiffs to recover damages suffered because of alleged violations of the provisions of the federal securities laws.⁸⁹ While the federal securities laws do not explicitly impose civil liability on attorneys, opining lawyers are clearly not exempt from the civil liability and antifraud provisions of these statutes.⁹⁰ Civil liability may be imposed on an opining securities attorney under four sections of the federal securities laws.⁹¹

Section 11⁹² of the Securities Act expressly provides a right of recovery to persons who purchase securities in conjunction with a materially misleading registration state-

⁸² *In re Emmanuel Fields*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,407, at 83,174 n.20 (June 18, 1973).

⁸³ See Barber, *Lawyers Duties in Securities Transactions Under Rule 2(e): The Carter Opinion*, 1982 B.Y.U. L. REV. 513, 522-24; Johnson, *supra* note 14, at 647-50; Marsh, *supra* note 71, at 993-95. In addition, see the discussion of the sanctions issued attorney Hodgins, *supra* note 78.

⁸⁴ 17 C.F.R. § 201.2(e) (1984); see generally articles cited *supra* note 83.

⁸⁵ SEC Securities Act Release No. 5147 (May 10, 1971), reported in [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,064, at 80,313.

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ Usually, an opining attorney is subject to liability in private actions as in injunctive and 2(e) suits for "aiding and abetting" (secondary) violations of the federal securities laws. See Leiman, *supra* note 11, at 284 n.18. When a third party brings a civil action for damages against an opining lawyer, the plaintiff will also most likely join the party who is allegedly guilty of primary violations of securities laws. The resulting damage award would then reflect the liability of both parties. In these types of cases, however, the primary wrongdoer is usually insolvent or bankrupt. See R. JENNINGS & H. MARSH, *supra* note 47, at 1134; Leiman, *supra* note 11, at 278; Note, *Attorneys' Liability*, *supra* note 4, at 435 n.131.

⁹⁰ See *infra* notes 98, 104, 107, 109, 112, and accompanying text. See also Cheek, *Professional Responsibility and Self-Regulation of the Securities Lawyer*, 32 WASH. & LEE L. REV. 597, 605-17 (1975); Note, *Duties and Obligations of the Securities Lawyer: The Beginning of a New Standard for the Legal Profession*, 1975 DUKE L.J. 121, 127-36 [hereinafter cited as Note, *Duties and Obligations*].

⁹¹ The four sections are: (1) section 11 of the Securities Act, 15 U.S.C. § 77k(a)(4) (1982); (2) section 12(2) of the Securities Act, 15 U.S.C. § 77l(2) (1982); (3) section 17 of the Securities Act, 15 U.S.C. § 77q(a) (1982); and (4) section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) (1982).

⁹² The relevant language of section 11, 15 U.S.C. § 77k(a) (1982), under which opining attorneys could be subject to liability, is:

ment filed pursuant to section 5 of the Securities Act.⁹⁵ Section 11 imposes liability on certain designated individuals — accountants, engineers, appraisers, or any person whose profession lends authority to their statements — for material⁹⁴ statements or omissions contained in a registration statement which are false or misleading. These individuals may avoid liability only if they establish that, after reasonable investigation, they had reasonable grounds to believe that the statements included in the registration were accurate and correct.⁹⁵ Attorneys are, however, not expressly identified as persons on whom civil liability can be imposed under section 11.⁹⁶ Moreover, lawyers who assist in the preparation of registration statements or who opine upon certain legal issues for underwriters have been held not to be "experts"⁹⁷ for purposes of section 11.⁹⁸ Numerous commentators have, however, stated that attorneys who consent to the inclusion of or reference to their opinions in registration statements are "experts" under section 11(a)(4) of the Securities Act and thus subject to liability for their opinions under this section.⁹⁹

Opining attorneys may also be subject to civil liability under section 12 of the Securities Act.¹⁰⁰ Section 12 expressly provides a private right of action to a purchaser of a security against any person who offers or sells a security (1) in violation of section 5 of the Securities Act or (2) by means of a prospectus or oral communication which misrepresents or omits material facts.¹⁰¹ Under section 12, however, plaintiffs may bring

In case any part of the registration statement, when such part became effective, contained an untrue statement of material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue . . . every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him

Id.

⁹⁵ 15 U.S.C. § 77k(a) (1982); see also R. JENNINGS & H. MARSH, *supra* note 47, at 749–50.

⁹⁴ For definition of material, see *supra* note 45.

⁹⁵ See 15 U.S.C. § 77k(a) (1982); see also R. JENNINGS & H. MARSH, *supra* note 47, at 750.

⁹⁶ See 15 U.S.C. § 77k(a)(4) (1982).

⁹⁷ Experts are defined in section 11(a)(4) as "persons whose profession gives authority to statements made by him" 15 U.S.C. § 77k(a)(4) (1982).

⁹⁸ See *Tirone v. Calderone-Curran Ranches, Inc.*, [1978 Transfer Binder] FED. SEC. L. REP. ¶ 96,480, at 93,775 (W.D.N.Y. June 14, 1978); *Escott v. Barchris Constr. Corp.*, 283 F. Supp. 643, 683 (S.D.N.Y. 1968).

⁹⁹ See R. JENNINGS & H. MARSH, *supra* note 47, at 756; Cheek, *supra* note 90, at 605 n.26; Rowe, *supra* note 11, at 369–70; Shipman, *supra* note 5, at 236–37.

¹⁰⁰ Section 12, 15 U.S.C. § 77(l) (1982), provides in part:

Any person who — (1) offers or sells a security in violation of section 5, or (2) offers or sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact . . . (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security

Id.

¹⁰¹ 15 U.S.C. § 77(l) (1982).

actions only against "a person who offers or sells a security."¹⁰² As interpreted by the courts, a person who offers or sells a security is one who is in privity with the purchaser or whose participation in the sale is a substantial factor in causing the transaction to take place.¹⁰³ Where significant participation by opining attorneys in sales of securities has been established, courts have held these lawyers to be sellers within the meaning of section 12 and subject to damages under this provision of the securities laws.¹⁰⁴

In addition, while neither section 10(b) nor Rule 10b-5 of the Exchange Act explicitly provide a private right of action for violation of their provisions,¹⁰⁵ the courts have acknowledged the existence of an implied private right of action for primary violations of this section for more than thirty-five years.¹⁰⁶ Courts have been willing to hold opining attorneys liable for damages to third parties for primary violations of Rule 10b-5.¹⁰⁷ Also, while the Supreme Court has expressly reserved the issue of whether a person may be liable in a private damage action as an aider and abettor under Rule 10b-5,¹⁰⁸ several courts of appeals have recognized the existence of an implied private right of action for damages against aiders and abettors.¹⁰⁹ The expansion in the potential liability of opining securities attorneys has occurred largely through the development of the concept of aiding and abetting liability under Rule 10b-5.¹¹⁰

¹⁰² *Id.*

¹⁰³ See *Junker v. Crory*, 650 F.2d 1349, 1360 (5th Cir. 1981); *Stokes v. Lokken*, 644 F.2d 779, 785 (8th Cir. 1981); *Croy v. Cambell*, 624 F.2d 709, 714 (5th Cir. 1980); *Pharo v. Smith*, 621 F.2d 656, 667 (5th Cir. 1980); see also *Rowe*, *supra* note 11, at 373-82.

¹⁰⁴ See *Junker*, 650 F.2d at 1349, 1360; *Katz v. Amos Treat*, 411 F.2d 1046, 1053 (2d Cir. 1969). The attorney's liability under section 12 may also be based on an aiding and abetting theory. See *Rowe*, *supra* note 11, at 373.

¹⁰⁵ See R. JENNINGS & H. MARSH, *supra* note 47, at 808.

¹⁰⁶ An implied private right of action under section 10 was first recognized in *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 513-14 (E.D. Pa. 1946). In the recent decision of *Herman & MacLean v. Huddleston*, the Supreme Court stated, "a private right of action under Section 10(b) of the 1934 Act and Rule 10b-5 has been consistently recognized for more than 35 years. The existence of this implied remedy is simply beyond peradventure." 459 U.S. 375, 381 (1983). For discussion of the elements of establishing a primary violation of section 10(b) and Rule 10b-5, see *supra* notes 44-55 and accompanying text.

¹⁰⁷ See, e.g., *Admiralty Fund v. Jones*, 677 F.2d 1289, 1296 (9th Cir. 1982); *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1199-1200, 1206-10 (W.D. Mo. 1983); *Felts v. National Account Sys. Ass'n, Inc.*, 469 F. Supp. 54, 64-68 (W.D. Miss. 1978).

¹⁰⁸ *Herman & MacLean*, 459 U.S. at 380 n.5; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 191-92 n.7 (1976). For a discussion of the elements of an aiding and abetting action see notes 56-63 and accompanying text.

¹⁰⁹ See, e.g., *Stokes v. Lokken*, 644 F.2d 779, 783-84 (8th Cir. 1981); *ITT v. Cornfield*, 619 F.2d 909, 922 (2d Cir. 1980); *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 44, 48-50 (2d Cir. 1978); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 86-88 (5th Cir. 1975). Given the Supreme Court's recent strict interpretations of the provisions of the federal securities laws, however, one commentator and a court of appeals have questioned the continued validity of civil aiding and abetting actions. See *Admiralty Funding v. Hugh Johnson*, 677 F.2d 1301, 1311 n.12 (9th Cir. 1982) and *Fischel*, *Secondary Liability under Section 10(b) of the Securities Act of 1934*, 69 CALIF. L. REV. 80, 82 (1981). No court has held, however, that civil aiding and abetting liability may not be imposed. Also, commentators and a court have stated that the Supreme Court's analysis of the existence of an implied action for civil liability in *Herman & MacLean v. Huddleston*, 459 U.S. 375, 387-88 (1983) supports the continued existence of a civil aiding and abetting action. See *Hokama v. E.F. Hutton & Co., Inc.*, 566 F. Supp. 636, 640-41 (D. Cal. 1983); *Brunelle*, *supra* note 58, at 182.

¹¹⁰ See *Leiman*, *supra* note 11, at 279, 284 n.18; *Parker, Attorneys' Liability Under the Securities Laws*, 10 LOY. L.A.L. REV. 521, 524 (1977); see also *Admiralty Fund v. Jones*, 677 F.2d 1289, 1296

In addition to these conventional theories of liability under Rule 10b-5, opining attorneys may be subject to Rule 10b-5 civil liability under the newly developed "fraud on the market" theory.¹¹¹ One of the categories of fraud on the market liability provides for the imposition of liability on individuals actively involved in a fraudulent scheme which results in an entirely unmarketable security being placed on the market.¹¹² This approach to fraud on the market liability was first enunciated in the 1981 case of *Shores v. Sklar*¹¹³ to relieve a plaintiff of showing actual reliance on any defendant's specific representations or omissions.¹¹⁴ To establish liability under this approach to the fraud on the market theory, a plaintiff must first demonstrate that the security involved in the case was unmarketable — a security which would never have been issued but for the

(9th Cir. 1982); *Stokes v. Lokken*, 644 F.2d 779, 784 (8th Cir. 1981); *In re North Am. Acceptance Co. Securities Cases*, 513 F. Supp. 608, 628-29 (N.D. Ga. 1981).

¹¹¹ See, e.g., *T.J. Raney & Sons, Inc. v. Fort Cobb, Oklahoma Irrigation Fuel Auth.*, 717 F.2d 1330, 1331-33 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Shores v. Sklar*, 647 F.2d 462, 471 (5th Cir. 1981), *cert. denied*, 459 U.S. 1102 (1983); *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1204-06 (W.D. Mo. 1983). The fraud on the market theory is based on the language of Rule 10b-5(1) and (3), rather than Rule 10b-5(2) unlike most conventional Rule 10b-5 actions. See *Lipton v. Documentation, Inc.*, 734 F.2d 740, 744 (11th Cir. 1984), *cert. denied*, 105 S. Ct. 814 (1985); *Shores*, 647 F.2d at 468-70. This theory was formulated to relieve a plaintiff asserting a Rule 10b-5 claim from demonstrating reliance on the defendant's fraudulent activities. *Shores*, 647 F.2d at 468-72. Thus, this theory has been used frequently by members of a class action to demonstrate that there is no need to show individual reliance by each member of a class upon the allegedly misleading statements or omissions. *T.J. Raney*, 717 F.2d at 1333-34.

The fraud on the market theory was first adopted by the Ninth Circuit in *Blackie v. Barrack*, 524 F.2d 891, 906-07 (9th Cir. 1975). Since the *Blackie* decision this theory has been adopted to varying degrees for Rule 10b-5 actions by five circuits. See, e.g., *Lipton v. Documentation, Inc.*, 734 F.2d 740, 747 (11th Cir. 1984), *cert. denied*, 105 S. Ct. 814 (1985); *T.J. Raney*, 717 F.2d at 1333; *Panzier v. Wolf*, 663 F.2d 365, 368 (2d Cir. 1981), *vacated as moot sub nom.*, *Price Waterhouse v. Panzier*, 459 U.S. 1027 (1982); *Shores*, 647 F.2d at 469-70. For discussion of the development and appropriateness of the fraud on the market theory see generally Black, *Fraud on the Market: A Criticism of Dispensing with the Reliance Requirement in Certain Open Market Transactions*, 62 N.C.L. REV. 435 (1984); Rapp, *Rule 10b-5 and "Fraud-on-the-Market" — Heavy Seas Meet Tranquil Shores*, 39 WASH. & LEE L. REV. 861 (1982); Note, *The Fraud on the Market Theory*, 92 HARV. L. REV. 1143 (1982).

¹¹² Three general categories of cases are found under the fraud on the market theory. See *Frankel v. Wyllie & Thornhill, Inc.*, 537 F. Supp. 730, 735-40 (W.D. Va. 1982). The first category involves cases where a common scheme, of which defendant's misrepresentations and omissions were a part, exists to manipulate and increase the market value of stock which results in injuring the plaintiff who purchased stock at an artificially high price. See *Blackie v. Barrack*, 524 F.2d 891, 905-08 (9th Cir. 1975). The second category concerns instances where fraudulent misrepresentations and omissions in a proxy statement are employed as part of a scheme to manipulate prices to create an unfair exchange ratio in a forced merger situation. See *Shlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380-81 (2d Cir. 1974). The last category of fraud on the market cases, which is discussed *infra* at notes 114-19 and accompanying text, involves cases where the defendants' fraudulent schemes result in entirely unmarketable securities being placed on the market. See, e.g., *T.J. Raney*, 717 F.2d at 1333; *Rose*, 562 F. Supp. at 1201. This approach to fraud on the market liability was first articulated by the Fifth Circuit in *Shores*, 647 F.2d at 470-71. This note will refer to this third category of fraud on the market cases as the "*Shores* approach" to the fraud on the market theory. It is under this *Shores* approach to the fraud on the market theory that opining attorneys may be held liable to private plaintiffs. See, e.g., *T.J. Raney*, 717 F.2d at 1331-33; *Shores*, 647 F.2d at 471; *Rose*, 562 F. Supp. at 1204-06.

¹¹³ 647 F.2d 462 (5th Cir. 1981) (en banc), *cert. denied*, 459 U.S. 1102 (1983).

¹¹⁴ *Id.* at 468-72.

defendant's fraud.¹¹⁵ Secondly, the defendant must have actively and knowingly¹¹⁶ participated in a scheme to bring the unmarketable security on the market.¹¹⁷ Finally, the plaintiff must show reliance on the availability of the security on the market as an indication of its apparent genuineness and demonstrate that as a consequence of this reliance he suffered a loss.¹¹⁸ Under this approach, courts have been willing to impose liability on opining attorneys usually as a result of their rendering of opinions concerning the legality of the issuance of municipal bonds.¹¹⁹

Finally, the Supreme Court has expressly withheld consideration of whether section 17(a)¹²⁰ of the Securities Act implies a private cause of action.¹²¹ A majority of the courts

¹¹⁵ See *id.* at 468, 470; *Rose*, 562 F. Supp. at 1201-02.

¹¹⁶ The courts have stated that plaintiff must show that the defendant acted with scienter, that is, an intent to deceive or defraud. *Shores*, 647 F.2d at 471; *Rose*, 562 F. Supp. at 1202. The court of appeals in *Shores* indicated that reckless behavior would suffice to fulfill the scienter requirement. 647 F.2d at 469.

¹¹⁷ See *Shores*, 647 F.2d 469; *Rose*, 562 F. Supp. at 1202.

¹¹⁸ See *Shores*, 647 F.2d at 467-70; *Rose*, 562 F. Supp. at 1202.

¹¹⁹ The impact which the *Shores* approach to the fraud on the market theory will have on the liability of opining attorneys in the future remains uncertain. In recent years, the Supreme Court has demonstrated a marked reluctance to extend the limits of private causes of action under the federal securities laws and instead has prescribed a strict statutory construction approach to determining liability under these statutes. See generally *Chiarella v. United States*, 445 U.S. 222 (1980); *Touche, Ross & Co. v. Reddington*, 442 U.S. 560 (1979); *Sante Fe Indus. Inc. v. Green*, 430 U.S. 462 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). But see *Herman & MacLean v. Huddleston*, 459 U.S. 375, 387-88 (1983) (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963)) ("securities laws should be construed not technically and restrictively, but flexibly to effectuate their remedial purposes"). The recent development of the fraud on the market theory appears to run contrary to this trend. See *Shores*, 647 F.2d at 484-85 (Randall, J., dissenting). Furthermore, the classic fraud on the market theory put forth in *Blackie* arose in transactions in the open market where it is reasonable to assume that misinformation disseminated into the marketplace will affect the price of a security. See *Blackie*, 524 F.2d at 907. In this context, it seems reasonable to allow a plaintiff to allege that he relied on the integrity of the market in buying the security and, thus, to shift the burden of proof to the defendant to disprove reliance. *Id.* In *Shores*, however, the Fifth Circuit applied the fraud on the market theory to the "not entirely analogous setting of newly issued securities on an undeveloped market." *Lipton v. Documentation, Inc.*, 734 F.2d 740, 746 (11th Cir. 1984), *cert. denied*, 105 S. Ct. 814 (1985). In this setting, it is not necessarily reasonable to assume that misinformation will affect market price because in the case of newly issued securities, the offeror and underwriters, not the market, set the price for which the securities will be sold. *Id.*; see also *Black*, *supra* note 111, at 1156-58. Moreover, the causal nexus between the misleading information and the plaintiff's purchase is more direct in a *Blackie* type of situation when the information affects the securities price than a *Shores* type of case where the information goes to the legitimacy of the issuance of the securities. See *Lipton*, 734 F.2d at 746; see also *Rapp*, *supra* note 111, at 886-87. Thus, as the Eleventh Circuit noted in *Lipton*, the adoption of the *Shores* approach to the fraud on the market theory represents "a context where its application is most questionable." 734 F.2d at 746. Still, this view of the fraud on the market theory has been adopted by every court which has considered it. See, e.g., *Lipton*, 734 F.2d at 748; *T.J. Raney*, 717 F.2d at 1333; *Rose*, 562 F. Supp. at 1201-03; *Dekio v. Stern Bros. & Co.*, 540 F. Supp. 406, 410-11 (W.D. Mo. 1982); *Frankel v. Wyllie & Thornhill, Inc.*, 537 F. Supp. 730, 735-40 (W.D. Va. 1982).

¹²⁰ For a discussion of elements of section 17(a) actions, see *supra* notes 64-68 and accompanying text.

¹²¹ See, e.g., *Herman & MacLean v. Huddleston*, 459 U.S. 375, 379 n.2 (1983); *Aaron v. SEC*, 446 U.S. 680, 698 (1980); *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 557 n.9 (1979).

of appeals, however, have recognized the existence of an implied private right of action under this section.¹²² Several federal courts¹²³ and most commentators¹²⁴ have asserted, however, that recognition of an implied right of action under section 17 is inconsistent with congressional intent and the statutory provisions of the Securities Act.¹²⁵

II. TRADITIONAL VIEW OF THE LIABILITY OF OPINING SECURITIES ATTORNEYS IN SEC INJUNCTIVE ACTIONS, RULE 2(e) PROCEEDINGS, AND CIVIL ACTIONS BROUGHT BY PRIVATE PLAINTIFFS UNDER THE SECURITIES LAWS

Historically, the courts and the Commission subjected an opining securities attorney to liability under the securities laws only when the lawyer actively participated in plans to defraud investors.¹²⁶ Under this traditional view of an opining securities lawyer's liability, an attorney could avoid legal sanctions in cases where he functioned solely in a professional capacity advising clients and was not a principal in schemes to defraud the public.¹²⁷

At common law, in rendering opinions, an attorney was required to use the care, skill, and diligence ordinarily possessed and generally exercised by members of the legal profession.¹²⁸ Thus, an opining attorney was not an insurer of results or a guarantor of the soundness of his opinions, but had only to exercise ordinary skill and diligence in rendering them.¹²⁹ Moreover, under tort principles, an attorney may be held liable for breaching this standard of care only if he has a duty to protect the plaintiff from the risk of harm which was suffered.¹³⁰ Traditionally, in the absence of fraud, an opining attorney was held to owe such a duty only to those persons with whom he was in privity of contract.¹³¹ The privity requirement was based on the premise that because the

¹²² See, e.g., *Stephenson v. Calpine Conifers, Ltd.*, 652 F.2d 808, 815-16 (9th Cir. 1982); *Kusher v. United States*, 603 F.2d 234, 241 (2d Cir. 1978), *cert. denied*, 442 U.S. 909 (1979); *Newman v. Prior*, 518 F.2d 97, 99 (4th Cir. 1975); *Shaefer v. First Nat'l Bank*, 509 F.2d 1287, 1293 (7th Cir. 1975), *cert. denied*, 425 U.S. 943 (1976); *Savino v. E.F. Hutton & Co.*, 507 F. Supp. 1225, 1231 (S.D.N.Y. 1981); *Baron v. Commercial & Indus. Bank of Memphis*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,826, at 95,308 (S.D.N.Y. April 11, 1979); *Felts v. National Account Sys. Ass'n, Inc.*, 469 F. Supp. 54, 64, 68 (N.D. Miss. 1978).

¹²³ See, e.g., *Landry v. All American Assurance Co.*, 688 F.2d 381, 388-91 (5th Cir. 1982); *In re North Am. Acceptance Corp. Securities Cases*, 513 F. Supp. 608, 618 (N.D. Ga. 1981); *Mendelson v. Capital Underwriter's Inc.*, 490 F. Supp. 1069, 1079-80 (N.D. Cal. 1980).

¹²⁴ See, e.g., *R. JENNINGS & H. MARSH*, *supra* note 47, at 817-18; L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 1148-50 (1st ed. 1983).

¹²⁵ These courts and commentators have emphasized that the Securities Act is a much narrower statute than the Exchange Act and that Congress intended civil actions to be brought only under sections 11 and 12 of the 1933 Act. They believe violators of section 17 should appropriately be subjected only to a civil injunctive or criminal action. L. Loss, *supra* note 124, at 1148-50.

¹²⁶ See *supra* notes 8-10.

¹²⁷ See *supra* notes 8-10.

¹²⁸ See, e.g., *Smith v. Lewis*, 13 Cal. 3d 349, 358, 530 P.2d 589, 593, 118 Cal. Rptr. 621, 627 (1975); *Lucas v. Hamm*, 56 Cal. 2d 583, 591, 364 P.2d 685, 689, 15 Cal. Rptr. 831, 832 (1961), *cert. denied*, 368 U.S. 987 (1962); *Hodges v. Carter*, 239 N.C. 517, 519, 80 S.E.2d 144, 145-46 (1954); see also *Freeman*, *supra* note 12, at 377-87; *Wade*, *supra* note 30, at 762-65.

¹²⁹ See cases cited *supra* note 128.

¹³⁰ See cases cited *supra* note 128; see also *Freeman*, *supra* note 12, at 377-79; W. PROSSER, *supra* note 9, at 667.

¹³¹ See, e.g., *National Savings Bank v. Ward*, 100 U.S. 195, 206 (1879); *Ultramares Corp. v. Touche, Ross & Co.*, 225 N.Y. 170, 189, 174 N.E. 444, 448 (N.Y. 1931); see also W. PROSSER, *supra* note 9, at 667-68.

attorney's obligation to perform competently arose entirely out of the contractual relationship between attorney and client, any liability for breach of this obligation should run only to the contracting parties.¹³²

This legal requirement of privity was established by the United States Supreme Court in the 1879 case of *National Savings Bank v. Ward*.¹³³ In this case, an attorney, at the request of his client, conducted a title search and provided the client with a written opinion that the land in question was held by the client in fee simple.¹³⁴ Relying on the attorney's opinion, a bank loaned money to the attorney's client for which the land in question was collateral.¹³⁵ After the client defaulted on the loan payments, the bank discovered that the title to the land was worthless.¹³⁶ In considering a malpractice action which the bank had brought against the lawyer, the Court stated that "[t]he only safe rule is to confine the right to recover to those who enter into the contract; if we go one step beyond that, there is no reason why we should not go fifty."¹³⁷ Therefore, the Court held that, in the absence of fraud or collusion, lawyers could be held liable for negligent performance of their duties only to those with whom they were in privity of contract.¹³⁸ The vast majority of courts treating this issue of opining attorneys' liability to third parties under common law followed the *Ward* holding.¹³⁹ Thus, apart from malpractice actions brought by clients, opining attorneys were historically exposed to liability under common law only for legal opinions containing intentional misrepresentations or representations made for which there was no reasonable basis for their accuracy.

The liability of attorneys under the federal securities laws was similarly limited. Under these statutes, the SEC and the courts traditionally imposed sanctions and civil liability on opining attorneys only where the lawyers were active participants in fraudulent investment schemes.¹⁴⁰ Thus, SEC injunctive actions were historically only instituted

¹³² See, e.g., *National Savings Bank v. Ward*, 100 U.S. 195, 206 (1879); *Ultramares Corp. v. Touche, Ross & Co.*, 225 N.Y. 170, 189, 174 N.E. 444, 448 (N.Y. 1931); see also, W. PROSSER, *supra* note 9, at 667-68.

¹³³ 100 U.S. 195 (1879).

¹³⁴ *Id.* at 196.

¹³⁵ *Id.* at 198.

¹³⁶ *Id.* at 198.

¹³⁷ *Id.* at 203 (citations omitted). In the landmark case of *Ultramares Corp. v. Touche, Ross & Co.*, 225 N.Y. 170, 174 N.E. 444 (N.Y. 1931), Judge Cardozo similarly stated:

Liability for negligence if adjudged in this case will extend to many callings other than an audit. Lawyers who certify their opinion as to the validity of municipal bonds with the knowledge that the opinion will be brought to the notice of the public, will become liable to investors if they have overlooked a statute or a decision to the same extent as if the controversy were one between client and adviser.

Id. at 188, 174 N.E. at 448.

¹³⁸ *Ward*, 100 U.S. at 204.

¹³⁹ For modern cases following *Ward*, see *Amey, Inc. v. Henderson, Franklin, Starnes & Holt*, P.A., 367 So. 2d 633, 634 (Fla. App. 1979); *Levine v. Graphic Scanning Corp.*, 87 A.D.2d 755, 755, 448 N.Y.S.2d 693, 693 (1982); *First Mun. Leasing v. Blankenship*, 648 S.W.2d 410, 413 (Tex. App. 1983). See also Landau, *supra* note 1, at 27; W. PROSSER, *supra* note 9, at 667.

¹⁴⁰ See, e.g., *Katz v. Amos Treat & Co.*, 411 F.2d 1046, 1053 (2d Cir. 1969); *United States v. Benjamin*, 328 F.2d 854, 863-64 (2d Cir.), *cert. denied*, 377 U.S. 953 (1964); *United States v. Crosby*, 294 F.2d 928, 938 (2d Cir. 1961), *cert. denied sub nom. Mittleman v. United States*, 368 U.S. 984 (1962); *SEC v. A.G. Bellin Securities Corp.*, 171 F. Supp. 233, 235-36 (S.D.N.Y. 1959); *In re Morris MacSchwebel*, 40 S.E.C. 347, 370-71 (1960), *modified*, 40 S.E.C. 459 (1961); *In re James DeWitt*, 38 S.E.C. 879, 881 (1959). See also Jenkins, *supra* note 11, at 510; Leiman, *supra* note 11, at 278-79; Lowenfils, *supra* note 11, at 413-16.

against repeat or notorious violators of the federal securities laws.¹⁴¹ The 1959 case of *SEC v. A.G. Bellin Securities Corp.*¹⁴² is typical of the cases in which the issuance of an injunction was predicated on a finding of direct participation by an attorney in a fraudulent scheme. In that case, an attorney had purchased the stock certificates and records of a shell corporation¹⁴³ and participated in making the arrangements by which unregistered shares of the corporation were illegally distributed to the public.¹⁴⁴ The defendant argued that his actions were taken on behalf of and pursuant to instructions from his clients and that he was therefore exempt from liability.¹⁴⁵ The federal district court found, however, that the evidence did not support the attorney's contention and held that he was a principal in the fraudulent transaction.¹⁴⁶ Therefore, the court permanently enjoined the lawyer from further violations of the Securities Act.¹⁴⁷

Administrative proceedings under Rule 2(e) were also instituted by the SEC against opining securities attorneys only in cases involving intentional and flagrant violations of the federal securities laws.¹⁴⁸ For instance, in the 1959 case of *In re James DeWitt*,¹⁴⁹ a lawyer, acting pursuant to a power of attorney, knowingly filed a notification under Regulation A of the Securities Act which contained false financial statements.¹⁵⁰ DeWitt also rendered an opinion to his client authorizing him to sell the shares covered by the notification even though the lawyer was aware that the required waiting period for such a sale had not passed.¹⁵¹ Furthermore, the lawyer requested and received money from his client under the false pretense that the money would be used illegally to induce SEC employees to act in a manner favorable to the client's interests.¹⁵² On the basis of these findings of egregious fraudulent conduct by the attorney, DeWitt was permanently disqualified from practicing securities law.¹⁵³

¹⁴¹ See also Jenkins, *supra* note 11, at 510-11; Karmel, *Attorneys' Securities Laws Liabilities*, 27 BUS. LAW. 1153, 1156 (1972); Leiman, *supra* note 11, at 278-79; Lowenfils, *supra* note 11, at 413-16.

¹⁴² 171 F. Supp. 233 (S.D.N.Y. 1959).

¹⁴³ A shell corporation "is a non-operating company with stock owned by the general public. Shells come into business when an operating company ceases doing business or when it spins off into a subsidiary." Orlanski, *Going Public Through the Backdoor and the Shell Game*, 58 VA. L. REV. 1451, 1451 (1972).

¹⁴⁴ *A.G. Bellin*, 171 F. Supp. at 235.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 237.

¹⁴⁸ See, e.g., Johnson, *supra* note 14, at 642-44; Kemp, *supra* note 78, at 40-44; Klein, *The SEC and the Legal Profession*, 11 INST. ON SEC. REG. 597, 608-12 (1979); Marsh, *supra* note 71, at 990. In fact, Rule 2(e) was not used to suspend an attorney from appearing before the Commission until 1950. *Id.* The first Rule 2(e) proceeding of record instituted against an attorney was *In re Albert J. Fleishman*, 37 S.E.C. 832 (1950). Up to 1960, only four Rule 2(e) actions were brought against lawyers. Marsh, *supra* note 71, at 990. Commentators have attributed this infrequent early use of the Rule 2(e) proceeding to the Commission's early philosophy of self regulation with respect to the legal profession. See Johnson, *supra* note 14, at 639 n.7.

¹⁴⁹ 38 S.E.C. 879 (1959).

¹⁵⁰ *Id.* at 880.

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ *Id.* For examples of other Rule 2(e) actions prior to 1970 which resulted in suspensions for egregiously fraudulent conduct see *In re Marshall Stewart*, Securities Act Release No. 4829 (April 29, 1966) (attorney who made intentionally false filings with the Commission permanently disqualified from practicing before the SEC); *In re Morris MacSchwebel*, 40 S.E.C. 347 (1960), *modified*, 40

Finally, as in injunctive and Rule 2(e) actions, courts traditionally held opining securities attorneys liable to private plaintiffs under the federal securities laws only when the lawyers actively participated in fraudulent investment plans.¹⁵⁴ In *Katz v. Amos Treat & Co.*,¹⁵⁵ for example, an attorney for an underwriter misrepresented to a potential investor that the SEC registration of securities to be underwritten by his client was substantially completed and that the stock was a safe investment.¹⁵⁶ On the basis of these findings, the Second Circuit held the attorney had placed his client "in a position to tackle Katz [the investor] for his money" and, thus, could be held liable as a principal for violations of the registration and antifraud provisions of the federal securities laws.¹⁵⁷

In contrast, in cases where lawyers had issued incorrect opinions but had not been found to be principals in fraudulent schemes, courts imposed no liability on the opining attorneys.¹⁵⁸ In the 1965 case of *Wonneman v. Stratford Securities Co.*,¹⁵⁹ an attorney had participated in the revival of a dormant corporation and the alteration of its capital structure, and had been responsible for the preparation of the corporate minutes.¹⁶⁰ In connection with these activities, the attorney had given an erroneous opinion to the corporate officers that its securities were exempt from the registration provisions of section 5 of the Securities Act and could be legally sold to the public without registration.¹⁶¹ When the securities proved worthless, purchasers of the stock brought an action against several persons, including the attorney.¹⁶² Despite the attorney's extensive involvement in the corporation and its sale of the stock, the court held that the attorney was a "stranger to the illegal sales" and, thus, could not be held liable to the shareholders.¹⁶³

Likewise, in *Nicewarner v. Bleavins*,¹⁶⁴ shareholders brought an action alleging violations of the federal securities laws against an attorney whose client had illegally sold them unregistered securities.¹⁶⁵ The court found that the lawyer had reason to anticipate the public offering, knew no registration was in effect, should have known that the instruments sold were securities and was in a position to see that the plaintiffs needed the protection of the Securities Act.¹⁶⁶ Yet, the court held that since the defendant had acted only in an advisory capacity as an attorney, he could not be held liable to the purchasers.¹⁶⁷

S.E.C. 459 (1961) (attorney who rendered legal opinions with no factual or legal basis permanently disqualified from practicing before the SEC).

¹⁵⁴ See Jenkins, *supra* note 11, at 510-11; Johnson, *supra* note 14, at 431-44; Klein, *supra* note 148, at 608-12; Leiman, *supra* note 11, at 278-79; Lowenfils, *supra* note 11, at 411-16; see also Marsh, *supra* note 71, at 987-93.

¹⁵⁵ 411 F.2d 1046 (2d Cir. 1969).

¹⁵⁶ *Id.* at 1052.

¹⁵⁷ *Id.* at 1053, 1055.

¹⁵⁸ See, e.g., *Nicewarner v. Bleavins*, 244 F. Supp. 261, 266 (D. Colo. 1965); *Wonneman v. Stratford Securities Co.*, [1957-1961 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,460 (S.D.N.Y. 1961). See generally authorities cited *supra* note 154.

¹⁵⁹ [1957-1961 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,034 (S.D.N.Y. 1961).

¹⁶⁰ *Id.* at 93,461.

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ 244 F. Supp. 261 (D. Colo. 1965).

¹⁶⁵ *Id.* at 263.

¹⁶⁶ *Id.* at 266.

¹⁶⁷ *Id.*

The traditional limitation on the liability of opining attorneys under common law and the federal securities statutes was inexorably linked to the historic view that a lawyer owed "unremitting loyalty" to the interests of his client.¹⁶⁸ As one commentator noted in 1969, "[t]he law, so far, is very clear. The lawyers' responsibility is exclusively to their own client."¹⁶⁹ As recently as 1962 in the case of *American Finance Co.*,¹⁷⁰ the SEC set forth this traditional view of the role and responsibilities of an attorney in the securities area by contrasting the attorney's role with the role of an accountant. The Commission stated:

Though owing a public responsibility, an attorney in acting as the client's advisor, defender, advocate, and confidant enters into a personal relationship in which his principal concern is with the interests and rights of his client. The requirement of the Act of certification by an independent accountant, on the other hand, is intended to secure for the benefit of public investors the detached objectivity of a disinterested person.¹⁷¹

Thus, under this historic view of the role and responsibilities of a securities lawyer, an opining attorney had a duty not to participate directly in a securities fraud.¹⁷² At all other times, however, the lawyer's performance of his duties was to be controlled by his "unremitting loyalty" to the interests of his clients.¹⁷³ The role of the opining securities attorney was akin to that of a scrivener whose function was to put the thoughts of a client in the proper legal form.¹⁷⁴ Therefore, the courts and the SEC would not impose sanctions or civil liability on attorneys who acted solely in an advisory capacity and were not principals in a scheme to defraud investors.¹⁷⁵

III. MODERN DEVELOPMENT OF THE LIABILITY OF OPINING SECURITIES ATTORNEYS UNDER THE FEDERAL SECURITIES LAWS

In the late 1960's and early 1970's, the SEC, the ABA, and the courts began to take a more expansive view of the role and responsibilities of opining securities attorneys.¹⁷⁶ One indication of this change occurred in the area of professional ethics with the Model Code of Professional Responsibility's (Code) differentiation between the role and responsibilities of an attorney as an advocate and as an advisor.¹⁷⁷ The Code noted that as an advocate, an attorney deals with past conduct and must take the facts as he finds them.¹⁷⁸ Thus, as an advocate, an attorney should resolve all doubts in favor of his client and "urge any permissible construction of the law favorable to his client, without regard to his professional opinion as to the likelihood that the construction will prevail."¹⁷⁹ As

¹⁶⁸ See, e.g., Frank, *supra* note 12, at 337-338; Jenkins, *supra* note 11, at 510-11; Leiman, *supra* note 11, at 277-79; Lowenfils, *supra* note 11, at 415-16; Sommer, *supra* note 2, at 83,689-90.

¹⁶⁹ Freeman, *supra* note 12, at 639.

¹⁷⁰ 40 S.E.C. 1043 (1962).

¹⁷¹ *Id.* at 1049.

¹⁷² See authorities cited *supra* note 168.

¹⁷³ See authorities cited *supra* note 168.

¹⁷⁴ See *supra* note 13 and accompanying text.

¹⁷⁵ See *supra* notes 8-10 and accompanying text.

¹⁷⁶ See *supra* note 14 and accompanying text.

¹⁷⁷ MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-3, 7-4, and 7-5 (1985).

¹⁷⁸ *Id.* EC 7-3.

¹⁷⁹ *Id.* EC 7-4.

an advisor, on the other hand, an attorney is involved in determining future conduct and relationships.¹⁸⁰ According to the Code, the attorney's role as advisor is to give his professional opinion as to what the ultimate decision of a court might be regarding the applicable law and the practical consequences of such a decision on his client.¹⁸¹ This differentiation between the role of an attorney as advocate and as advisor in the Code indicates that, at least in the view of the ABA, an opining securities attorney should not blindly follow the dictates of his clients, but instead should take a more objective and independent role in rendering opinions.¹⁸²

This changing view of the role and responsibilities of opining securities attorneys during the early 1970's is further manifested by the issuance of Formal Opinion No. 335 on February 1, 1974, by the ABA Committee on Ethics and Professional Responsibility (Committee).¹⁸³ This opinion focused on the standard of factual inquiry and investigation that should be followed by attorneys in rendering opinions relating to the sale of unregistered securities.¹⁸⁴ In the opinion, the Committee stated that an opining securities attorney is not justified in assuming facts as represented to him by a client or in basing an opinion on the assumption that such facts are correct.¹⁸⁵ The Committee emphasized that before issuing an opinion based on facts furnished by a client, an attorney should take steps to ensure that the client understands exactly what facts the attorney has requested and that the attorney understands precisely what the client has told him.¹⁸⁶ According to the Committee, if any of the alleged facts supplied by a client or the alleged facts taken as a whole are incomplete, suspect, inconsistent, or open to question, either on their face or on the basis of other facts known to the attorney, then the lawyer has a responsibility to make further inquiry into the validity of the facts.¹⁸⁷ The extent of the inquiry, the Committee continued, depends on the circumstances of the particular case.¹⁸⁸ In instances where the lawyer determines that further inquiry would still not satisfy him or that any material deficiency in the facts provided him remains, the Committee stated that the lawyer must refuse to give the opinion.¹⁸⁹ In the conclusion of Opinion No. 335, the Committee explicitly recognized that the role of the opining securities attorney was to give his considered *independent* opinion of the law and that "while the responsibility of the lawyer is to his client, he must not be oblivious of the extent to which others may be affected if he is derelict in fulfilling that responsibility."¹⁹⁰

¹⁸⁰ *Id.* EC 7-3.

¹⁸¹ *Id.*

¹⁸² *Id.* EC 7-3, 7-4, 7-5; see also, Greenbaum, *supra* note 2, at 800-02; Jennings, *The Corporate Lawyer's Responsibilities and Liabilities in Rendering Legal Opinions*, 30 BUS. LAW. 73, 74-75 (1975). In *Westlake v. Abrams*, a district court relying on EC 7-3 differentiated between the roles and potential liability of an attorney serving as an advocate and as an advisor. 656 F. Supp. 1330, 1350 (N.D. Ga. 1983).

¹⁸³ See also ABA Comm. on Ethics and Professional Responsibility, Formal Op. 346 (Revised) (1982) (tax law opinions in tax shelter investment offerings).

¹⁸⁴ ABA Comm. on Ethics and Professional Responsibility, Formal Op. 335, at 1 (1974).

¹⁸⁵ *Id.* at 3.

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.* at 6.

This transformation in the role and responsibilities of opining securities attorneys was also demonstrated in a speech given by SEC Commissioner Sommer entitled "The Emerging Responsibilities of the Securities Lawyer."¹⁹¹ In contrast to the views put forth by the SEC in *American Finance Co.*¹⁹² twelve years earlier, Sommer stated:

I would suggest in securities matters (other than those where advocacy is clearly proper) the attorney will have to function in a manner more akin to that of the auditor than that of the advocate. This means several things. It means he will have to exercise a measure of independence that is perhaps uncomfortable if he is also the close counselor of management in other matters, often including business decisions. It means he will have to be acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about were it not for his professional presence. It means he will have to adopt the healthy skepticism towards the representations of management which a good auditor must adopt.¹⁹³

Moreover, during the 1970's, the SEC also suggested that securities attorneys not only had a duty to advise clients not to engage in fraudulent activities, but also if a client refused to follow this advice and intended to violate the securities statutes, the attorney was required to resign and to notify the Commission about the client's conduct.¹⁹⁴ Under this view of a securities lawyer's responsibilities under the securities laws, the lawyer had an obligation to "blow the whistle" on a client.¹⁹⁵ Thus, attorneys were required to police and to ensure compliance by their clients with the federal securities laws.¹⁹⁶

Consistent with the ABA's and the SEC's more expansive view of the role and responsibilities of opining securities attorneys, the courts during this time period also broadened the scope of liability of opining lawyers under the federal securities laws.¹⁹⁷

¹⁹¹ Sommer, *supra* note 2, at 83,688.

¹⁹² 40 S.E.C. 1043 (1962). For discussion of this case, see *supra* notes 163-64 and accompanying text.

¹⁹³ Sommer, *supra* note 2, at 83,689-90. For a collection of various statements by other SEC officials expressing views similar to those of Commissioner Sommer, see Mathews, *Liabilities of Lawyers*, *supra* note 15, at 115-16. For articles written by commissioners during this period reflecting the Sommer's view of the changing role of securities attorneys, see Sommer, *Professional Responsibility: How Did We Get Here*, 30 BUS. LAW. 95 (1975); Sonde, *Professional Responsibility: A New Religion or the Old Gospel*, 24 EMORY L.J. 829 (1975); Sonde, *The Responsibility of Professionals Under the Federal Securities Laws*, 68 NW. U.L. REV. 1 (1973).

¹⁹⁴ The SEC's changing view of securities attorneys' duties was put forth in its filing of the *National Student Marketing* complaint. SEC v. National Student Marketing Corp., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,360 (D.D.C. Feb. 3, 1972). For a discussion of the SEC's filing of the complaint and the litigation which followed it, see *infra* notes 218-59 and accompanying text.

¹⁹⁵ See *National Student Marketing* (complaint), at 91,913-15 -17; see, e.g., Gruenbaum, *supra* note 2, at 796-98; Lipman, *supra* note 23, at 462-68.

¹⁹⁶ *National Student Marketing* (complaint), at 91,913-15 -17; see, e.g., Gruenbaum, *supra* note 2, at 796-98; Lipman, *supra* note 23, at 462-68.

¹⁹⁷ SEC civil injunctive actions include, for example, SEC v. Coven, 581 F.2d 1020, 1029 (2d Cir. 1978); SEC v. Universal Major Indus. Corp., 546 F.2d 1044, 1047 (2d Cir. 1976); SEC v. Spectrum, Ltd., 489 F.2d 535, 541-42 (2d Cir. 1973); SEC v. National Student Marketing Corp., 402 F. Supp. 641, 648-50 (D.D.C. 1975). For a collection of all SEC injunctive actions brought against opining attorneys during this time, see Rowe, *supra* note 11, at 384-407. Rule 2(e) actions instituted against opining lawyers include: *In re Gibson*, [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,334, at 82,426 (Dec. 7, 1981); Attorneys' Opinion Letters, [1980 Transfer Binder]

For the first time, the courts as well as the Commission were willing to impose judicial and administrative sanctions and civil liability against attorneys who had acted solely in a professional capacity as advisors if the courts or the SEC determined that the attorneys' had not fulfilled their responsibilities to the investing public.¹⁹⁸ The following subsection will examine the expansion during the 1970's in the number and scope of injunctive actions the SEC brought against opining securities attorneys. It will also look at more recent court decisions in injunction cases which appear to limit the scope of activities for which an opining attorney may have an injunction entered against him.

A. SEC Injunctive Actions

Beginning in the late 1960's, the SEC brought injunctive actions against opining attorneys with increasing frequency.¹⁹⁹ Along with the increase in the number of injunctive actions filed by the Commission, there was also a shift in the activities for which the SEC brought these suits.²⁰⁰ Where as injunctive actions had traditionally been instituted only against attorneys who were principals willfully engaged in schemes to defraud investors,²⁰¹ the SEC began bringing injunctive actions against attorneys who had acted solely in professional capacities as advisors to their clients without any direct interest in the activities complained of other than the ordinary fee.²⁰² In these cases, the Commission usually charged that the attorney had "aided and abetted"²⁰³ the federal securities laws violations of a client by rendering incorrect legal opinions which had resulted in injuring investors.²⁰⁴

FED. SEC. L. REP. (CCH) ¶ 82,876 at 84,325-27 (June 1, 1981); *In re Hodgin* [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,334, at 82,426-27 (Sept. 27, 1979); *In re O'Neil*, Securities Release No. 33-5938 (Aug. 3, 1978). Private damage actions instituted against opining attorneys under the federal securities laws include: *T.J. Raney & Sons v. Fort Cobb, Oklahoma Irrigation Auth.*, 717 F.2d 1330, 1333 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Stokes v. Lokken*, 644 F.2d 779, 783-85 (8th Cir. 1981); *Cronin v. Midwestern Oklahoma Dev. Auth.*, 619 F.2d 856, 862 (10th Cir. 1980); *Felts v. National Account Sys. Ass'n, Inc.*, 469 F. Supp. 54, 67-68 (N.D. Miss. 1978). For authorities discussing this transformation, see *Jenkins*, *supra* note 11, at 511; *Leiman*, *supra* note 11, at 279; *Lowenfils*, *supra* note 11, at 418-19; *Sommer*, *supra* note 2, at 83,687-89.

¹⁹⁸ See *supra* note 197.

¹⁹⁹ See, *Karmel*, *supra* note 141, at 156 (1972); *Mathews*, *SEC Civil Injunctive Actions*, *supra* note 36, at 969.

²⁰⁰ See *Jenkins*, *supra* note 11, at 511-13; *Karmel*, *supra* note 141, at 1156; *Lowenfils*, *supra* note 11, 419-23.

²⁰¹ See *supra* notes 141-47 and accompanying text.

²⁰² See, e.g., *SEC v. Haswell*, 654 F.2d 698, 698-99 (10th Cir. 1981); *SEC v. Coven*, 581 F.2d 1020, 1028-29 (2d Cir. 1978); *SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044, 1045-46 (2d Cir. 1976); *SEC v. Management Dynamics*, 515 F.2d 801, 809-10 (2d Cir. 1975); *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 541-42 (2d Cir. 1973); *SEC v. Frank*, 388 F.2d 486, 487-89 (2d Cir. 1968); *SEC v. Adler*, [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,674, at 98,555-56 (D.D.C. Nov. 5, 1980); *SEC v. Cohen*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,335, at 97,221-22 (D.D.C. 1980); *SEC v. Century Mortgage Co.*, 470 F. Supp. 300, 309-10 (D. Utah 1978); *SEC v. National Student Marketing Corp.*, 402 F. Supp. 641, 648-50 (D.D.C. 1975); *SEC v. Century Inv. Transfer Corp.*, [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,232, at 91,443 (S.D.N.Y. Nov. 17, 1971).

²⁰³ See *supra* notes 56-63 and accompanying text for discussion of aiding and abetting.

²⁰⁴ See cases cited *supra* note 202; see also *Leiman*, *supra* note 11, at 279, 284 n.18; *Parker*, *supra* note 110, at 524.

1. The Emergence of Opining Attorneys' Liability for Solely Advisory Activities: The Development of Disclosure Obligations and a Negligence Standard

In the 1968 case of *SEC v. Frank*,²⁰⁵ the Commission for the first time brought an injunctive action against an attorney based solely on his actions in preparing documents for his client.²⁰⁶ While the *Frank* case concerned the liability of an attorney for false statements contained in a prospectus rather than in a legal opinion, the decision demonstrated the Second Circuit's willingness to enter a permanent injunction against an attorney for aiding and abetting violations of the federal securities laws when the lawyer had acted solely in a professional capacity as an advisor to his client.²⁰⁷ In *Frank*, the Second Circuit rejected the defendant's contention that the role of a securities attorney was to be a "scrivener" of the thoughts of his clients.²⁰⁸ Noting the important function of documents such as legal opinions in the securities area,²⁰⁹ Judge Friendly, writing for the Second Circuit, stated, "a lawyer, no more than others can escape liability for fraud by closing his eyes to what he saw and could reasonably understand."²¹⁰ Thus, the court held that if the attorney had been provided with information that even a nonexpert would have realized was a false representation and still included it in his client's prospectus, a permanent injunction could be granted.²¹¹

The principles enunciated by the Second Circuit in *Frank* were explicitly applied to opining attorneys in *SEC v. Century Investment Transfer Corp.*²¹² In that case, decided in November, 1971, a New York federal district court granted a preliminary injunction against an attorney who had prepared a misleading legal opinion on the grounds that he had aided and abetted a fraudulent scheme to distribute unregistered securities.²¹³ The attorney, Caldwell, had prepared opinion letters stating that the issuance of securities by four shell corporations was exempt from registration under section 393 of the Bankruptcy Act and section 3(a)(10) of the Securities Act, which provide exemptions for shares issued partly for cash and partly for claims against a debtor in Chapter XI bankruptcy proceedings.²¹⁴ Because the shares had been issued solely for cash, however, the court found that Caldwell's opinion letters went "enough beyond being mere mistakes in legal judgment to constitute probable violations of the anti-fraud provisions of the securities laws."²¹⁵ Because Caldwell's issuance of these knowingly misleading opinion letters had been crucial to the distribution of the unregistered securities,²¹⁶ the court

²⁰⁵ 388 F.2d 486 (2d. Cir. 1968).

²⁰⁶ *Id.* at 488. The SEC alleged that the attorney, Frank, had violated the antifraud provisions of section 17(a) of the Securities Act and section 10(b) of the Exchange Act because of his actions in preparing an offering circular which allegedly contained material misrepresentations. *Id.* at 487. For explanation of sections 10(b) and 17(a), see notes 39-70 and accompanying text.

²⁰⁷ See Johnson, *supra* note 14, at 651-52.

²⁰⁸ *Frank*, 388 F.2d at 488.

²⁰⁹ *Id.* at 489.

²¹⁰ *Id.*

²¹¹ *Id.* The *Frank* court, however, refused to sustain the lower court's issuance of a temporary injunction which was based solely on SEC affidavits. *Id.* at 492-93.

²¹² [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,232 (S.D.N.Y. Nov. 7, 1971).

²¹³ *Id.* at 91,443.

²¹⁴ *Id.* at 91,439.

²¹⁵ *Id.* at 91,443.

²¹⁶ *Id.*

found the evidence sufficient to find Caldwell to be an "aider and abettor" of the fraudulent scheme and to grant the SEC's motion for a temporary injunction.²¹⁷

While the courts in *Frank* and *Century Investment Corp.* had stated that opining securities attorneys could be found guilty of aiding and abetting violations of the federal securities laws based solely on their activities in advising their clients, it was the SEC's filing of the *National Student Marketing* complaint²¹⁸ on February 2, 1972, which focused the attention of the securities bar on the dramatic changes occurring in the liability of opining attorneys under the federal securities laws.²¹⁹ The *National Student Marketing* complaint represented the first time that the SEC had instituted injunctive actions against members of large, prominent law firms with significant corporate practices for actions taken solely while representing a client.²²⁰

In its *National Student Marketing* complaint, the SEC alleged that the law firms of White & Case and Lord, Bissell & Brook, various partners at these firms, and a private practitioner had violated various antifraud provisions of the federal securities laws by issuing improper opinions.²²¹ Moreover, the SEC also alleged that these attorneys should not only have refused to give these opinions and advised their clients that their proposed conduct would violate the securities laws, but also if their clients refused to follow this advice, the lawyers had a duty to resign and to inform the SEC about their clients' actions.²²² To members of the securities bar, the complaint represented an attack on the traditional standard of care and priorities of duties owed by opining securities lawyers.²²³

The SEC's charges against the firms and their partners were based largely upon actions they had taken in connection with the merger of Interstate National Corporation (Interstate) with the National Student Marketing Corporation (NSMC).²²⁴ According to the terms of the merger agreement between the two companies, as a condition precedent to the consummation of the merger, Lord, Bissell & Brook, as Interstate's counsel, was to render a legal opinion stating that all actions performed by Interstate in connection with the merger had been validly taken and that no violations of federal or state laws or regulations had occurred to the knowledge of counsel.²²⁵ White & Case was also required to issue a similar opinion to Interstate.²²⁶ Another condition precedent to the completion

²¹⁷ *Id.*

²¹⁸ [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,360 (D.D.C. Feb. 2, 1972).

²¹⁹ Two weeks after the filing of the *National Student Marketing* complaint, the Wall Street Journal described the complaint as "the best read document since *Gone With The Wind*." Wall St. J., Feb. 15, 1972, at 1, col. 1.

²²⁰ Note, *Duties and Obligations*, *supra* note 90, at 137.

²²¹ *Id.* White & Case and one of its partners, Jay Epley III, were charged with violating section 17(a) of the Securities Act and sections 10, 13(a) and 14(a) of the Exchange Act. *Id.* at 91,913-15-17. Lord, Bissell & Brook and two of its partners, Max E. Mayer and Louis F. Shayer, were accused of violating section 17(a) of the Securities Act and section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. *Id.* at 91,913-16-18. Private attorney Robert Katz was charged with violating section 17(a) of the Securities Act and section 10(b) and Rule 10b-5 of the Exchange Act. *Id.* at 91,913-18.

²²² SEC v. National Student Marketing Corp., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,360, at 91,913-15-18 (D.D.C. Feb. 2, 1972).

²²³ See, e.g., Lowenfils, *supra* note 11, at 421; Patterson, *supra* note 12, at 1251-55; Sommers, *supra* note 2, at 83,687.

²²⁴ *National Student Marketing (complaint)*, at 91,931-15-20.

²²⁵ SEC v. National Student Marketing Corp., 457 F. Supp. 682, 690 (D.D.C. 1978).

²²⁶ *Id.*

of the merger was receipt by each company of a "comfort letter" from the other's independent public accountants stating that the accountants had no reason to believe that the unaudited financial statements for the company in question were not prepared in accordance with generally accepted accounting principles or required any adjustment in order that the results be fairly presented.²²⁷ The merger agreement terms, along with the unaudited interim financial statements of both companies over the preceding twenty-one months, were included in the proxy materials sent to the shareholders of both companies to secure their approval of the merger.²²⁸

During the closing meeting of the merger, however, the executives and attorneys for both companies were informed by Peat, Marwick & Mitchell (PMM), the accountants for NSMC, that PMM would disclose in its comfort letter that the \$702,000 profit figure for the nine month period ending on May 31, 1969, which had been reported by NSMC in its unaudited financial statements, had not been arrived at in accordance with generally accepted accounting procedures.²²⁹ Instead of these reported profits, PMM stated that NSMC had actually incurred net operating losses of approximately \$80,000 during this period.²³⁰

After PMM's disclosure that it would issue a comfort letter which would not conform to the requirements of the merger agreement,²³¹ the executives and attorneys for both companies conferred separately and finally decided to proceed with the merger.²³² The lawyers for White & Case and Lord, Bissell & Brook then issued their respective opinion letters and the merger was completed.²³³ After the completion of the merger and PMM's disclosure of the inaccurate nature of NSMC's interim financials, Lord, Bissell, & Brook issued an opinion that the offering qualified for Rule 133's broker exemption to section 5's registration requirements.²³⁴ This opinion did not mention the need for adjusting

²²⁷ *Id.*

²²⁸ *Id.* at 690-91.

²²⁹ *Id.* at 691-93. In its comfort letter, PMM stated that three problems existed with respect to the interim financial statement for the nine month period ending May 31, 1969. First, a change of \$500,000 was required for adjusting the amortization of deferred costs in the May statement to eliminate all costs for programs substantially completed or which started 12 months or more prior to May 31, 1969. Secondly, in August, 1969, NSMC's management wrote off receivables in the amount of \$300,000. The uncollectibility of this amount could have been determined at May 31, 1969, and should have been reflected in that date's financial statements. Finally, \$84,000 in acquisition costs for projects which NSMC decided not to pursue were transferred from additional paid-in capital to general and administrative costs. These changes should have been so transferred as of May 31, 1969. *Id.* at 692 n.18.

²³⁰ *Id.* at 691-93. Also, during the closing, but before the completion of the merger, PMM informed Jay Epley III, the White & Case partner in charge of the merger, that it would add another paragraph to its comfort letter urging disclosure of NSMC's corrected nine month financial statement and resolicitation of the shareholders of both companies. *Id.* at 695-96.

²³¹ *Id.* at 693-94.

²³² *Id.*

²³³ *Id.* at 694.

²³⁴ *Id.* at 697-98. Rule 133(d), 17 C.F.R. § 230.133 (1969), was promulgated by the Commission under the Securities Act, 15 U.S.C. § 77a-77kk (1982). Under Rule 133(d), exemptions for certain stock transactions from the registration requirements of the Securities Act were available if the stock was sold in a broker's transaction and if the seller did not engage in certain prohibited conduct in selling and trading the securities. 17 C.F.R. § 230.33 (1969). While Rule 133 was rescinded effective January 1, 1973, it was in effect during the period in which the National Student Marketing merger occurred.

NSMC's interim financials or for publicly disclosing PMM's comfort letter before the stock could be sold so that persons purchasing the stock would be aware of NSMC's true financial position.²³⁵

The final charges in the SEC's complaint concerned an opinion of counsel issued by attorney Robert Katz, counsel to individuals who had purchased Compujob, Inc., then a wholly owned subsidiary of NSMC, from NSMC.²³⁶ In the opinion letter, Katz stated that it was legal under New York law for NSMC to backdate the Compujob transaction from November 29, 1969, when it was completed, to August 31, 1969.²³⁷ This legal opinion, which was submitted to White & Case, was written to satisfy PMM that the sale of Compujob — and NSMC's gain therefrom — could be included in NSMC financial statements for the fiscal year ending August 31, 1969.²³⁸

In considering motions for summary judgment in the action against Robert Katz, the United States District Court for the District of Columbia focused on the issue of whether Katz had aided and abetted violations of the federal securities laws by issuing his opinion regarding the legality of backdating the Compujob transaction.²³⁹ For the purpose of considering whether the three requirements for an aiding and abetting violation had been established, the district court assumed that a primary violation of the federal securities laws had occurred and focused on whether Katz had acted with scienter and had provided substantial assistance to the achievement of the primary violation.²⁴⁰ In arguing that his conduct did not constitute a secondary violation of the federal securities laws, Katz emphasized that his participation in the transaction had been limited to issuing a legal opinion on a narrow issue of law.²⁴¹ He further stated that his opinion was technically accurate and that "economic reality is a matter for the accountants, and that as a lawyer, he was only obligated to look at the formal aspects of the transaction."²⁴² In rejecting this argument, the court stated that because Katz was involved in drafting the document for the sale of Compujob, the court would not allow him to close his eyes to the "commercial substance" of the transaction.²⁴³ Therefore, the court found Katz either actually knew that NSMC was involved in a fraudulent scheme or "recklessly ignored what should have been readily apparent."²⁴⁴ Finally, since PMM relied on Katz's opinion in including the Compujob transaction in the 1969 fiscal year figures, the court found that the "substantial assistance" element of aiding and abetting had been satisfied

²³⁵ SEC v. National Student Marketing Corp., 457 F. Supp. 682, 697-98 (D.D.C. 1978).

²³⁶ SEC v. National Student Marketing Corp., 402 F. Supp. 641, 642-43 (D.D.C. 1975).

²³⁷ *Id.* at 645.

²³⁸ *Id.* White & Case submitted a similar opinion to NSMC stating that it agreed with Katz's opinion and that NSMC was entitled to rely upon it. *Id.*

²³⁹ *Id.* at 643. For a discussion of the elements of an aiding and abetting action, see *supra* notes 56-63 and accompanying text.

²⁴⁰ 402 F. Supp. at 648.

²⁴¹ *Id.* at 646.

²⁴² *Id.* at 647.

²⁴³ *Id.* at 648. The judge stated:

This court rejects the proposition that a member of the bar can seek refuge behind a legal technicality elevating form over substance when he is a party to and fully familiar with the circumstances which indicate that an illusory transaction is being undertaken which could be utilized to mislead third parties.

Id.

²⁴⁴ *Id.* at 650.

and, thus, Katz's motion for summary judgment was dismissed.²⁴⁵ On April 28, 1977, Katz consented to an entry against him of a judgment permanently enjoining him from further violations of the federal securities laws.²⁴⁶

On May 16, 1977, Marion Jay Epley III, the White & Case partner in charge of the National Student Marketing merger with Interstate, consented to the entry of a permanent injunction against him without admitting or denying the SEC's allegations against him.²⁴⁷ Epley also agreed not to practice before the Commission for 180 days and agreed to limitations on his issuance of opinions.²⁴⁸ Also, on this date, White & Case and the SEC agreed to a settlement order.²⁴⁹ Under this order, White & Case agreed to "adopt, effectuate, and maintain" certain procedures in connection with their representation of securities clients.²⁵⁰ Many of these procedures concerned steps which White & Case would be required to follow when issuing opinions of counsel in the future.²⁵¹

The final proceeding of the *National Student Marketing* action concerned whether Lord, Bissel & Brook had aided and abetted violations of the federal securities laws through their actions as Interstate's general counsel. The district court first found that the closing of the NSMC and Interstate merger and the sale of NSMC stock by former Interstate shareholders after the receipt of the PMM comfort letter constituted primary violations of the federal securities laws.²⁵² The court also held that the attorneys knew that Interstate shareholders and the investing public were unaware of the inaccuracies in the NSMC financial statement, yet did not object to the closing of the merger.²⁵³ According to the court, this level of knowledge satisfied the scienter requirement of aiding and abetting.²⁵⁴ In deciding whether the attorneys' conduct had provided substantial assistance to the primary violations, however, the court found that the attorneys' issuance of legal opinions did not play a major part in the closing of the merger, but was only one of many conditions needed to consummate the merger.²⁵⁵ Ruling that this situation was not a case where the opinion of counsel concerned a specific issue and was undeniably relied on in completing the transaction, the court stated that the legal opinion issued by Lord, Bissel & Brook concerning the merger did not provide substantial assistance to the primary violation.²⁵⁶ Thus, the court held that Lord, Bissel & Brook

²⁴⁵ *Id.* at 649-50.

²⁴⁶ SEC v. National Student Marketing Corp., 457 F. Supp. 682, 687 n.2 (D.D.C. 1978). Katz also agreed to restrain from rendering legal opinions in the securities area which he knew or reasonably should have known were false. SEC v. National Student Marketing Corp., Civ. Act. No. 72-225 (D.D.C. Apr. 28, 1977).

²⁴⁷ SEC v. National Student Marketing Corp. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,027, at 91,601 (D.D.C. May 2, 1977).

²⁴⁸ *Id.* at 91,601-02.

²⁴⁹ *Id.* at 91,601.

²⁵⁰ *Id.*

²⁵¹ *Id.* For example, White & Case agreed not to issue a legal opinion in connection with securities until the partner who rendered it had consulted with two other partners of the firm. *Id.* at 91,600. White & Case also agreed not to deliver a legal opinion if it was aware that any material representation made by client was not true or correct in the light of the circumstances under which it is made. *Id.*

²⁵² SEC v. National Student Marketing Corp., 457 F. Supp. 682, 712 (D.D.C. 1978).

²⁵³ *Id.* at 712-13.

²⁵⁴ *Id.* at 710-12.

²⁵⁵ *Id.* at 714.

²⁵⁶ *Id.* at 714-15.

and its partners had not aided and abetted the violations of the federal securities laws through their issuance of legal opinions concerning the merger and sale of stock.²⁵⁷

While Lord, Bissel & Brook's issuance of opinions was found not to have substantially assisted violations of the securities laws, the district court did hold that the failure of the law firm and its attorneys to provide notice of PMM's disclosures to Interstate's shareholders before the closing did satisfy this element of aiding and abetting.²⁵⁸ Refusing to determine the precise contours of a securities attorney's disclosure obligations,²⁵⁹ the court found that the lawyers' failure to take any steps whatsoever to delay the closing of the merger and to ensure that this information was disclosed to Interstate's shareholders provided substantial assistance to their client's violations of the securities laws.²⁶⁰ While Lord, Bissel & Brook and its lawyers were found guilty of aiding and abetting violations, the court did not issue an injunction against these parties on the grounds that the SEC had not established the reasonable likelihood of future illegal conduct by the defendants.²⁶¹

Although the *National Student Marketing* litigation failed to resolve the issue of an opining lawyer's duty to report a client's violation of the securities laws to the SEC, the case demonstrated to the legal community the changes in opining attorneys' responsibilities and liabilities which had occurred during the 1970's.²⁶² After the *National Student Marketing* decision, a securities attorney's issuance of an erroneous legal opinion or "silence" at the closing of a merger clearly could constitute a violation of the securities laws.²⁶³ Thus, the case firmly established that opining attorneys may be held liable as aiders and abettors solely for actions taken in a professional capacity as a client's advisor.

While the *National Student Marketing* action received most of the public attention, it was the 1973 decision of the Second Circuit in *SEC v. Spectrum, Ltd.*,²⁶⁴ with its establishment of a negligence standard, which had the greatest potential for expanding the scope of activities for which a permanent injunction could be issued against an opining securities attorney. In *Spectrum*, an attorney, Shiffman, acting as counsel to a corporation, rendered an opinion incorrectly stating that certain individuals who had received Spectrum stock in a merger could sell these securities in a transaction exempt from the registration requirements of section 5 of the Securities Act.²⁶⁵ As a result of this opinion, the SEC instituted an injunctive action against Shiffman alleging that he had aided and abetted violations of the federal securities laws.²⁶⁶ In reversing the lower court's dismissal

²⁵⁷ *Id.*

²⁵⁸ *Id.* at 714-15.

²⁵⁹ *Id.* at 713-14. Thus, the court failed to resolve the issue of whether an opining lawyer has a duty under the securities laws to blow the whistle on a client.

²⁶⁰ *Id.*

²⁶¹ *Id.* at 716-17.

²⁶² *Id.* at 714. In this context, the court stated:

The filing of the complaint in this proceeding generated significant interest and an almost overwhelming amount of comment within the legal profession on the scope of a securities lawyer's obligations to his client and to the investing public. The very initiation of this action, therefore, has provided a necessary and worthwhile impetus for the profession's recognition and assessment of its responsibilities in this area.

Id.

²⁶³ *Id.* at 713.

²⁶⁴ 489 F.2d 535 (2d Cir. 1973).

²⁶⁵ *Id.* at 539.

²⁶⁶ *Id.* at 536.

of this action, the Second Circuit emphasized the "unique and pivotal role" opining attorneys play in the securities area and the need for the public to be able to rely on attorneys' securities opinions.²⁶⁷ In light of the important functions fulfilled by these lawyers, the court of appeals held that, in an SEC injunctive action, an opining securities attorney could be found guilty of aiding and abetting violations of the federal securities laws for simple negligence in issuing an opinion concerning an exemption from registration.²⁶⁸ Thus, the *Spectrum* decision greatly expanded the potential liability of opining attorneys in SEC injunctive actions. After this decision, not only could these lawyers have injunctions entered against them solely for actions taken in advising a client, but also the SEC only had to establish that the lawyer should have known that his opinion would be used by a client to further violations of the securities laws.²⁶⁹

Three years later, in *SEC v. Universal Major Industries Corp.*,²⁷⁰ the Second Circuit, despite the Supreme Court's intervening decision in *Hochfelder*,²⁷¹ again held that in a SEC injunctive proceeding an opining securities lawyer could be found guilty of aiding and abetting upon a showing of negligence.²⁷² In *Universal Major Industries*, an attorney issued opinions of counsel erroneously stating that no registration under Section 5 of the Securities Act was required for the transfer of common stock to debenture holders who had exercised their conversion privilege.²⁷³ In bringing an injunctive action against the opining attorney, the Commission stated that the lawyer "knew or in the exercise of reasonable care should have known that the securities were not exempt from registration" and, thus, was guilty of aiding and abetting violations of the securities laws.²⁷⁴ In affirming the lower court's entry of an injunction against the attorney, the Second Circuit held that the scienter requirement for civil liability under Rule 10b-5 announced in *Hochfelder* was not applicable in an SEC civil injunctive action.²⁷⁵ In this type of prophylactic proceeding for injunctive relief, the court of appeals stated, a cause of action could be based solely upon a showing of negligence.²⁷⁶

Finally, in its 1978 decision in *SEC v. Coven*,²⁷⁷ the Second Circuit extended the holdings of *Spectrum* and *Universal Major Industries* to hold that a permanent injunction could be issued against an opining attorney for aiding and abetting violations of Section 17(a) of the Securities Act without a showing of scienter.²⁷⁸ In *Coven*, an attorney who had responsibility for effectuating a public offering of a corporation's securities drafted an "all or nothing" escrow agreement which provided that all funds obtained from buyers be kept in an escrow account until the first three million shares of the stock had

²⁶⁷ *Id.* at 542.

²⁶⁸ *Id.* at 541.

²⁶⁹ *Id.*

²⁷⁰ 546 F.2d 1044 (2d Cir. 1976).

²⁷¹ For a discussion of *Hochfelder*, see *supra* notes 48-50 and accompanying text.

²⁷² *Universal Major Indus.*, 546 F.2d at 1047.

²⁷³ *Id.* at 1045-46.

²⁷⁴ *SEC v. Universal Major Indus. Corp.*, Civil Action No. 73-3626, at 5 (S.D.N.Y. Aug. 21, 1973).

²⁷⁵ *Universal Major Indus.*, 546 F.2d at 1047.

²⁷⁶ *Id.* Furthermore, even if scienter was required, the court declared that there was evidence to support the district court's finding that the opining attorney had acted with "knowledge or reckless disregard to the truth." *Id.*

²⁷⁷ 581 F.2d 1020 (2d Cir. 1978).

²⁷⁸ *Id.* at 1026-28. For a discussion of the elements of an action brought for alleged violations of section 17(a), see *supra* notes 64-68 and accompanying text.

been sold.²⁷⁹ During the closing of this "all or nothing" portion of the offering, the bank refused to release the funds in the escrow account until it had assurance that three million shares had been sold.²⁸⁰ Although a meeting of the underwriters on the previous day had made the attorney aware that no one was sure how many shares had been sold,²⁸¹ the lawyer, Coven, issued an opinion letter representing that 3,075,000 shares of the securities had been sold.²⁸² As a result, the all or nothing portion of the account was improperly closed and the proceeds from the sale of the stock were released.²⁸³ When it later became apparent that the underwriters were attempting to manipulate the price of the stock, the SEC brought injunctive actions against eleven persons, including the attorney.²⁸⁴

In affirming the lower court's entry of a permanent injunction against Coven, the Second Circuit held that the Supreme Court's decision in *Hochfelder* did not preclude the district court from issuing an injunction based on an aiding and abetting violation of section 17(a) of the Securities Act without a showing of scienter.²⁸⁵ The court stated that unlike section 10(b) of the Exchange Act, congressional intent was to allow an injunction to be issued for a violation of section 17(a) on the basis of negligent conduct.²⁸⁶ Therefore, the Second Circuit stated, "the test is whether an alleged aider and abettor should have been able to conclude that his act was likely to be used in furtherance of illegal activity in light of all the circumstances."²⁸⁷

As this discussion has demonstrated, in a series of decisions handed down during the 1970's, the Second Circuit greatly expanded opining lawyers' potential liability in SEC injunctive actions. After these decisions, the SEC no longer had to establish that an attorney issued an incorrect opinion with intent to defraud or even with reckless disregard for the truth.²⁸⁸ Simple negligence by a securities lawyer in rendering an opinion now sufficed to subject the attorney to an SEC injunctive action.²⁸⁹

2. Retreat by the Courts From the Negligence Standard

While the decisions of the Second Circuit during the 1970's indicated that an injunctive action could be brought against an attorney solely for negligence in rendering opinions,²⁹⁰ during the 1980's the courts seemingly have retreated from this negligence

²⁷⁹ 581 F.2d at 1022.

²⁸⁰ *Id.* at 1023.

²⁸¹ *Id.*

²⁸² *Id.*

²⁸³ *Id.*

²⁸⁴ *Id.* at 1021.

²⁸⁵ *Id.* at 1025-28.

²⁸⁶ *Id.* at 1026-27.

²⁸⁷ *Id.* at 1028. Moreover, because Coven had rendered the opinion of counsel to the bank even though he had been put on notice that no one was sure exactly how many shares had been sold, the court held that his actions were not only negligent for purposes of satisfying the intent requirement of Section 17(a), but also amounted to the kind of reckless disregard for the truth sufficient to support a finding of scienter under Section 10(b). *Id.* at 1028.

²⁸⁸ See *supra* notes 264-87 and accompanying text for a discussion of these cases.

²⁸⁹ See *supra* notes 264-87 and accompanying text for a discussion of cases adopting a negligence standard for determining the liability of opining lawyers.

²⁹⁰ See *supra* notes 264-87 and accompanying text for a discussion of these Second Circuit opinions.

standard.²⁹¹ In the 1980 case of *SEC v. Aaron*, for example, the Supreme Court held that in injunctive actions brought for alleged violations of section 10(b) of the Exchange Act or section 17(a)(1) of the Securities Act, the SEC must show that the defendant acted with scienter to obtain injunctive relief.²⁹² While the *Aaron* Court did hold that negligence by a defendant could suffice for an injunction to be entered against him under section 17(a)(2) or (a)(3) of the Securities Act,²⁹³ the Court expressly recognized that the presence or absence of scienter would likely be an "important factor" in deciding whether an injunction should be issued in a particular case.²⁹⁴ Moreover, subsequent decisions by federal courts indicate that these courts have retreated from the negligence standard.²⁹⁵ Therefore, to obtain injunctive relief against an opining attorney today, it appears that the SEC must show that a defendant acted with an intent to defraud or with reckless disregard for the truth.²⁹⁶

For example, the Tenth Circuit in the 1981 case of *SEC v. Haswell*²⁹⁷ upheld a district court's ruling that the SEC must show that an attorney acted with an intent to defraud, or at least with reckless disregard for the truth, in issuing an erroneous legal opinion to obtain injunctive relief.²⁹⁸ In *Haswell*, the Commission brought an injunctive action against an opining attorney alleging that he had aided and abetted violations of section 17(a) of the Securities Act and section 10(b) and Rule 10b-5 of the Exchange Act by issuing a favorable bond opinion after he had been put on notice that the sellers of the bonds were likely to commit fraud.²⁹⁹

In considering these charges, an Oklahoma federal district court first asserted that to establish an aiding and abetting violation under sections 10(b) and 17(a), it was necessary to show that an opining attorney's conduct amounted to "fraud or conduct so reckless that it was an extreme departure from the standards of ordinary care."³⁰⁰ Based on the evidence before it, the court found that Haswell had rendered carefully considered opinions, which, whether correct or incorrect, had been made "in utmost good faith."³⁰¹ Therefore, the district court held that the attorney had not violated the securities laws and denied the SEC's application for an injunction against Haswell.³⁰² Sub-

²⁹¹ See *infra* notes 292-308 and accompanying text.

²⁹² 446 U.S. 680, 697 (1980).

²⁹³ *Id.* For a discussion of *Aaron* and the rationale for the Court's decision, see *supra* notes 67-68 and accompanying text.

²⁹⁴ 446 U.S. at 702; see also *id.* at 703 (Burger, C.J., concurring) ("because the Commission must show some likelihood of a future violation, defendants whose actions have been in good faith are not likely to be enjoined").

²⁹⁵ See *infra* notes 297-308 and accompanying text.

²⁹⁶ See *infra* notes 297-308 and accompanying text.

²⁹⁷ 645 F.2d 698 (10th Cir. 1981), *aff'g*, *SEC v. Haswell*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,156 (W.D. Okla. Oct. 19, 1977).

²⁹⁸ *Haswell*, 654 F.2d at 699-700.

²⁹⁹ *SEC v. Haswell*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,156, at 93,774 (W.D. Okla. Oct. 19, 1977).

³⁰⁰ *Id.* at 96,375. The district court further stated that to be subject to liability under these sections, the attorney must have engaged in "conduct which presented a danger of misleading buyers that was either known to Haswell or was so obvious that he must have been aware of it." *Id.*

³⁰¹ *Id.* at 96,376.

³⁰² *Id.* Moreover, the district judge stated that even if Haswell had violated the securities laws, no injunction should be entered against him. *Id.* at 96,376. According to the court, in light of his reputation as a "scholarly, ethical, and cautious attorney," there was not a reasonable likelihood that the wrong would be repeated. *Id.*

sequent to this decision, however, the Supreme Court handed down its decision in *Aaron v. SEC*.³⁰³

In hearing the appeal of the *Haswell* case, the Tenth Circuit affirmed the decision of the court below regarding the alleged violations of sections 10(b) and 17(a)(1), finding that the evidence supported the district court's holding that the opining attorney had not acted with the requisite scienter.³⁰⁴ The court of appeals further stated that although scienter was not a necessary element of section 17(a)(2) and (a)(3) violations, the Supreme Court had indicated in *Aaron* that the presence or absence of scienter still bears heavily on a court's decision on whether or not to grant an injunction under these sections.³⁰⁵ The Tenth Circuit stated that, according to the *Aaron* holding, the degree of scienter in an attorney's conduct was an important consideration in determining the likelihood of future securities laws violations by the defendant which the SEC had to establish to obtain an injunction.³⁰⁶ Thus according to the court of appeals the district court's finding that *Haswell* had acted in good faith in issuing the legal opinions supported its decision to deny the SEC's request for injunctive relief.³⁰⁷ Given this lack of scienter by the opining attorney in the present case, the Tenth Circuit upheld the lower court's decision.³⁰⁸

3. Opining Attorneys' Liability in SEC Injunctive Actions Today

This section has demonstrated that during the 1970's not only did the number of SEC injunctive actions brought against opining attorneys increase,³⁰⁹ but also the scope of activities for which the Commission instituted these suits expanded.³¹⁰ SEC injunctive actions were no longer limited to instances where the attorneys were principals in schemes to defraud investors.³¹¹ Beginning in the 1970's, the SEC instituted injunctive actions against attorneys who, acting solely in their professional capacity, issued legal opinions which, in the view of the Commission, had aided and abetted the transgressions of their clients.³¹² Also, during this time period, the SEC contended that an opining attorney had a duty to report a client's fraudulent activities to the Commission.³¹³

Today, in the area of SEC injunctive actions, the precise contours of a securities attorney's obligation to disclose a client's fraudulent actions have not been fully resolved.³¹⁴ While the lawyer must take steps to avoid assisting a client in perpetuating a

³⁰³ 446 U.S. 680 (1980). For a discussion of *Aaron* and the rationale for the Court's decision see *supra* notes 67-68 and 292-94 and accompanying text.

³⁰⁴ *Haswell*, 654 F.2d at 700.

³⁰⁵ *Id.* at 699.

³⁰⁶ *Id.* at 699-700 (quoting *Aaron*, 446 U.S. at 701).

³⁰⁷ *Id.* at 700.

³⁰⁸ *Id.*

³⁰⁹ See *supra* note 199.

³¹⁰ See *supra* notes 200 and 201.

³¹¹ See *supra* note 201.

³¹² See *supra* note 201.

³¹³ This view of securities attorneys' duties was put forth in the SEC's filing of the *National Student Marketing* complaint. SEC v. National Student Marketing Corp., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,360, at 91,913-15-17 (D.D.C. Feb. 3, 1972). For a discussion of the SEC's filing of this complaint and the litigation which followed it, see *supra* notes 218-263 and accompanying text.

³¹⁴ See *supra* notes 262-263 and accompanying text.

fraud, the *National Student Marketing* view of an attorney as a "whistle blower" seems to have been abandoned.³¹⁵

Similarly, while the Second Circuit during the 1970's held that in injunctive actions the intent element of an aiding and abetting offense could be satisfied by a showing of negligence by an opining lawyer,³¹⁶ today courts appear unwilling to adopt this standard. The Supreme Court in *Aaron* established that scienter must be shown in injunctive actions brought against attorneys for alleged violations of section 10(b) of the Exchange Act and section 17(a)(1) of the Securities Act. Moreover, as the *Haswell* decision demonstrates, even in injunctive suits instituted for alleged violations of section 17(a)(2) and (a)(3) of the Securities Act, the presence or absence of scienter in an opining attorney's conduct is likely to influence significantly a court's decision of whether to issue an injunction.³¹⁷ Thus, if an attorney can demonstrate good faith in rendering legal opinions, even if his advice is subsequently determined to be incorrect, courts are unlikely to enter an injunction against the lawyer.³¹⁸ A further limitation on the susceptibility of opining attorneys to injunctive actions as the *National Student Marketing* action against Lord, Bissel & Brook manifests, arises from the requirement that an attorney's issuance of a legal opinion play a major role in the completion of his client's fraudulent activities for the substantial assistance portion of the aiding and abetting action to be satisfied.³¹⁹ As the *Coven*, *Spectrum*, and *Century Investment Corp.* decisions illustrate, courts have granted injunctive relief only when an attorney's legal opinion deals with specific issues and is relied upon by other parties in the consummation of an illegal transaction.³²⁰

³¹⁵ See discussion of *In re Carter and Johnson* *infra* notes 394-97 and accompanying text.

³¹⁶ See, e.g., *SEC v. Coven*, 581 F.2d 1020, 1028-29 (2d Cir. 1978), *cert. denied*, 440 U.S. 590 (1979); *SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044, 1047 (2d Cir. 1976); *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 541-42 (2d Cir. 1973); see also *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980).

³¹⁷ *Haswell*, 654 F.2d at 699-700; see also *Leiman*, *supra* note 11, at 287-88.

³¹⁸ *Haswell*, 654 F.2d at 699-700; see also *Aaron v. SEC*, 446 U.S. 680, 701 (1980); *id.* at 703 (Burger, C.J., concurring). In his concurring opinion, Chief Justice Burger emphasized that "because the Commission must show some likelihood of a future violation, defendants whose actions have been in good faith are not likely to be enjoined." *Id.* Also, in the recent case of *In re Carter and Johnson*, the SEC itself asserted that:

[i]t is axiomatic that a lawyer will not be liable as an aider and abettor merely because his advice, followed by his client, is ultimately determined to be wrong. What is missing in that instance is wrongful intent on part of the lawyer. It is that element of intent that provides the basis for distinguishing between those professionals who may be appropriately considered as subjects for discipline and those who, acting in good faith, have merely made errors of judgment or have been careless.

[1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (Feb. 28, 1981). For a discussion of *In re Carter and Johnson* see *infra* notes 349-88 and accompanying text.

³¹⁹ *SEC v. National Student Marketing Corp.*, 457 F. Supp. 682, 714 (D.D.C. 1978). The district court in this case contrasted the merger opinion rendered by Lord, Bissell & Brook with the legal opinions rendered by counsel in the *Spectrum* and *Coven* cases. The court stated, "this is not a case where an opinion of counsel addresses a specific issue and is undeniably relied on in completing the transaction." *Id.*

³²⁰ See, e.g., *SEC v. Coven*, 581 F.2d 1020, 1028-29 (2d Cir. 1978); *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 537-40 (2d Cir. 1973); *SEC v. National Student Marketing Corp.*, 457 F. Supp. 682, 714 (D.D.C. 1978); *SEC v. Century Inv. Transfer Corp.*, [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,232, at 91,443 (S.D.N.Y. Nov. 7, 1971); see also Note, *Attorneys' Liability*, *supra* note 4, at 445.

B. Rule 2(e) Disciplinary Proceedings

While Rule 2(e) actions were historically instituted against attorneys in cases involving egregious fraudulent activities, in the last fifteen years, the SEC's use of this disciplinary proceeding has undergone significant changes.³²¹ Similar to the pattern which occurred with respect to SEC injunctive actions, the Commission during the 1970's, dramatically expanded the scope and use of its Rule 2(e) action.³²² In recent years, however, the Commission has sought to restrict the usage of its disciplinary proceeding.³²³ This subsection will begin with an examination of the expansion in Rule 2(e) actions which took place during the 1970's. The second part of this subsection will discuss the *In re Carter and Johnson* decision and recent statements by SEC chief counsels which demonstrate the SEC's changing position towards employment of this disciplinary action.

1. Expansion in the Scope and Use of the Rule 2(e) Actions During the 1970's

During the early 1970's, in a development parallel to that of SEC injunctive actions, the SEC sought to expand the use and scope of the Rule 2(e) disciplinary proceedings. One method by which this expansion was accomplished was the promulgation of amendments to the Commission's disciplinary rules which contained additional and more explicit grounds for suspending professionals such as attorneys from practicing before the SEC.³²⁴ During this period, the SEC also adopted the view that its invocation of Rule 2(e) proceedings would no longer be limited to cases where attorneys or other professionals filed false reports with the Commission or engaged in some other type of flagrantly unethical conduct which, in the Commission's view, threatened the integrity and process of the agency.³²⁵ Instead, the SEC took the position that it could suspend any professional who failed to perform any duties or obligations owed to the Commission.³²⁶

³²¹ Barber, *supra* note 83, at 521-22; Johnson, *supra* note 14, at 644-50; Klein, *supra* note 148, at 612; Marsh, *supra* note 71, at 990-93; Comment, *SEC Disciplinary Rules and the Federal Securities Laws: Regulation, Rules, and Responsibilities of the Attorney*, 1972 DUKE L.J. 969, 984-85 [hereinafter cited as Comment, *SEC Disciplinary Rules*].

³²² See *infra* notes 324-48 and accompanying text.

³²³ See *infra* notes 398-400 and accompanying text.

³²⁴ In 1970, Rule 2(e) was amended to add willful violations and willful aiding and abetting violations of the federal securities laws or the rules or regulations thereunder as additional grounds for suspending an attorney from appearing before the Commission. Securities Act Release No. 5088, [1970 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 77,913, at 80,333-34 (Sept. 24, 1970). In addition, the rule was further amended at this time to provide for the automatic suspension of an attorney if he has been suspended or disbarred by any state or convicted of a felony or misdemeanor involving moral turpitude. *Id.* at 80,333. A 1971 amendment to Rule 2(e) further allowed the Commission to suspend the privilege of appearing before the SEC of persons who have been permanently enjoined from violating the federal securities laws or aiding and abetting the violation of such laws. *Id.* An important feature of these amendments to Rule 2(e) is that the suspension of the attorney's privilege of appearing before the Commission is automatic and takes effect immediately. For discussion of the operation of Rule 2(e), see *supra* note 76. See also Johnson, *supra* note 14, at 648-49; Marsh, *supra* note 71, at 999-1000.

³²⁵ See *In re Keating*, Muething & Klekamp, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,124, at 81,989-97 (July 2, 1979) (opinions of Williams, Chairman concurring and Karmel, Comm'r, dissenting). See also Barber, *supra* note 83, at 521-22; Marsh, *supra* note 71, at 991.

³²⁶ See authorities cited *supra* note 325.

Consistent with this expansion in the scope of activities covered by Rule 2(e), the number of 2(e) proceedings instituted by the SEC against lawyers in general,³²⁷ and opining attorneys in particular, increased dramatically.³²⁸ Beginning in the 1970's the Commission held that opining securities attorneys could not avoid administrative sanctions under Rule 2(e) simply by not participating in fraudulent activities.³²⁹ Stressing the importance of attorneys' opinions in the securities area and the reliance of the investing public on these opinions, the Commission applied its administrative sanctions against opining attorneys who functioned solely in a professional capacity.³³⁰

The Commission's statements in *In re Emmanuel Fields*³³¹ manifest the SEC's changing philosophy about the circumstances in which Rule 2(e) actions should be instituted against opining securities attorneys.³³² In *Fields*, the Commission instituted a 2(e) proceeding against an attorney who had issued false and misleading opinions and had previously consented to the entry of permanent injunctions against him.³³³ While *Fields* did not dispute the SEC's factual allegations, he challenged the Commission's power to permanently disqualify him from practicing securities law.³³⁴ In rejecting *Fields*' argument and permanently disqualifying him from practicing before the Commission, the SEC stated:

Very little of a securities lawyer's work is adversary in character . . . [H]e works in his office where he prepares prospectuses, proxy statements, opinions of counsel, and other documents which we, our staff, and the financial community, and the investing public must take on faith. This is a field where unscrupulous lawyers can inflict irreparable harm on those who rely on the

³²⁷ While Rule 2(e) was promulgated in 1935, no disciplinary proceedings were instituted under the Rule against attorneys until 1950. Klein, *supra* note 148, at 608. Between 1950 and 1959 inclusive, four Rule 2(e) proceedings were brought against attorneys. *Id.* at 609. Between 1960 and 1969 inclusive, ten Rule 2(e) actions were brought against attorneys. *Id.* at 609-12. Between 1970 and 1979 inclusive, forty-three Rule 2(e) actions were instituted against lawyers. *Id.* at 612. As one commentator stated, "[g]eometric growth fails adequately to describe the increased use of 2(e) against lawyers" during the 1970's. *Id.*

³²⁸ No Rule 2(e) actions were brought against securities attorneys solely for issuing legal opinions prior to 1970. See *supra* notes 148-53 and accompanying text. During the last fifteen years, several 2(e) actions have been instituted against lawyers for rendering erroneous legal opinions. See, e.g., *In re Gibson*, [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,068, at 84,713 (Dec. 7, 1981); *Attorneys' Opinion Letters*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,874, at 84,325 (June 3, 1981); *In re Hodgins*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,334, at 82,426 (Sept. 27, 1979); *In re O'Neil*, Securities Act Release No. 5938 (Aug. 3, 1978) as reported in Klein, *supra* note 148, at 627; *In re Emmanuel Fields*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,407, at 83,175 n.25 (June 18, 1973).

³²⁹ See, e.g., Barber, *supra* note 83, at 521-22; Jenkins, *supra* note 11, at 516-18; Johnson, *supra* note 14, at 643; Marsh, *supra* note 71, at 991; Comment, *SEC Disciplinary Rules*, *supra* note 321, at 985. See also cases cited *supra* note 328. For an interesting discussion of this issue, see *In re Keating*, Muething & Klekamp, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,124, at 81,989-97 (July 2, 1979) (Williams, Chairman, concurring and Karmel, Comm'r, dissenting).

³³⁰ See cases cited *supra* note 328; see also Jenkins, *supra* note 11, at 517; Lowenfils, *supra* note 11, at 423-24.

³³¹ [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,407 (June 18, 1973).

³³² See generally Gruenbaum, *supra* note 2, at 802; Krane, *Attorney Unshackled: SEC Rule 2(e) Violates Client's Sixth Amendment Right to Counsel*, 57 NOTRE DAME LAW. 50, 55-56 (1981); Lowenfils, *supra* note 11, at 423-24; Sonde, *supra* note 193, at 861-62.

³³³ *In re Emmanuel Fields*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,407, at 83,172, 83,175 n.25 (June 18, 1973).

³³⁴ *Id.* at 83,173.

disclosure documents that they produce. Hence, we are under a duty to hold our bar to appropriately rigorous standards of professional honor. To expect this vital function to be performed entirely by overburdened state courts who have little or no contact with the matters with which we deal would be to shirk that duty.³³⁵

In accord with the philosophy expressed in *Fields*, the Commission during the 1970's frequently used the Rule 2(e) action to discipline opining lawyers who, according to the SEC, had failed to fulfill the responsibilities which these attorneys owed the investing public. As it had in injunctive actions instituted during this time period, the SEC usually alleged that the lawyer, solely by issuing an erroneous legal opinion, had aided and abetted the securities law violations of a client.³³⁶ *In re Richard Hodgkin*³³⁷ is typical of the administrative proceedings brought by the SEC against opining attorneys during the 1970's. In that case, the SEC sought to revoke an attorney's privilege of appearing before the Commission.³³⁸ The attorney, Hodgkin, who had been retained to represent certain limited partnership interests, issued an opinion letter stating that the sale of these interests was exempt from registration provisions of section 5 of the Securities Act. In fact, the sale was not exempt from the registration requirements.³³⁹ In instituting Rule 2(e) proceedings against Hodgkin, the SEC alleged that he had willfully violated and willfully aided and abetted violations of the registration and antifraud provisions of the federal securities laws by his issuance of this opinion letter.³⁴⁰ Hodgkin consented to the entry of an order under which he was suspended from appearing before the Commission for twelve months.³⁴¹ One member of the SEC, Commissioner Karmel, dissented from this judgment because, in her view, the attorney's conduct was not sufficiently egregious to justify the temporary suspension.³⁴² According to Commissioner Karmel, this decision exemplified the SEC's unwarranted expansion during the 1970's of the activities which could be punishable under Rule 2(e).³⁴³ She characterized the decision as "tantamount to the setting of ethical and competency standards for the practice of law — something this agency has neither the expertise nor the authority to do."³⁴⁴ Since there had not been "clear and convincing evidence of intentional misconduct" by Hodgkin in rendering

³³⁵ *Id.* at 83,174 n.20.

³³⁶ See cases cited *supra* note 328.

³³⁷ [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,334 (Sept. 27, 1979).

³³⁸ *Id.* at 82,426.

³³⁹ *Id.*

³⁴⁰ *Id.*

³⁴¹ *Id.* at 82,427.

³⁴² *Id.* at 84,427 (Karmel, Comm'r, dissenting). Commissioner Karmel stated that Rule 2(e) actions should only be brought in instances where a lawyer has improperly conducted himself while personally representing clients before the Commission and, thus, directly threatened the SEC's administrative process. *Id.* She asserted that the Rule 2(e) action should be employed only in cases in which the attorney's conduct affected the Commission's ability to function or obstructed administrative justice. *Id.* Commissioner Karmel was a vocal opponent on the expansion in the use and scope of activities covered by Rule 2(e) which occurred during the 1970's. See *In re Keating, Muething & Klekamp*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,124, at 81,992-97 (July 2, 1979) (Karmel, Comm'r, dissenting); Daley & Karmel, *Attorneys' Responsibilities: Adversaries at the Bar of the SEC*, 24 EMORY L.J. 747 (1975).

³⁴³ *Hodgin*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,334, at 82,427 (Karmel, Comm'r, dissenting).

³⁴⁴ *Id.*

the erroneous opinion, Commissioner Karmel asserted that Rule 2(e) proceedings should not have been instituted against him.³⁴⁵

As *Hodgin* indicates, during the 1970's, the SEC no longer limited its use of Rule 2(e) actions to instances of egregious fraud by opining lawyers. Instead, through the employment of the newly adopted aiding and abetting basis for Rule 2(e) proceedings, the Commission disqualified attorneys from practicing securities law based solely on actions taken in a professional capacity as a client's advisor.³⁴⁶ Moreover, during this time period, the Commission seemingly took the position that *Hochfelder's* scienter requirement was inapplicable in Rule 2(e) aiding and abetting actions.³⁴⁷ While the SEC did not explicitly state the standard of culpability required in these actions, it appeared that the Commission had instituted Rule 2(e) actions based solely on negligent mistakes by lawyers.³⁴⁸ Thus, prior to 1980, simple negligence by an attorney in rendering an opinion could have resulted in a lawyer forfeiting the privilege of practicing securities law.

2. A Higher Threshold In Rule 2(e) Proceedings: *In re Carter and Johnson*

In the 1981 case of *In re Carter and Johnson*,³⁴⁹ the SEC rejected the usage of a negligence standard in aiding and abetting actions brought under Rule 2(e).³⁵⁰ In this disciplinary proceeding, the SEC also finally retreated from the *National Student Marketing* view of a securities attorney's ethical responsibilities.³⁵¹ The Rule 2(e) proceedings against Carter and Johnson arose out of the attorneys' activities as general counsel for the National Telephone Company (National).³⁵² National was engaged in the business of installing and leasing telephone systems which interfaced with AT & T equipment.³⁵³ While National presented an outward picture of continued growth and profits, it was faced increasingly with liquidity problems.³⁵⁴ In an attempt to rectify this problem, in the spring of 1974, the company arranged for a fifteen million dollar loan from a consortium of banks.³⁵⁵ Before the loan could be finalized, however, National began taking short term advances on the loan and, by September 1974, had used up almost the entire line of credit.³⁵⁶ In an attempt to placate the banks, National agreed to enter

³⁴⁵ *Id.* at 82,848 (Karmel, Comm'r, dissenting).

³⁴⁶ See cases cited *supra* note 328 and authorities cited *supra* note 329.

³⁴⁷ See, e.g., Marsh, *supra* note 71, at 997-98; Miller, *The Distortion and Misuse of Rule 2(e)*, 7 SEC. REG. L.J. 54, 54-57 (1979). In the trial portion of *In re Carter and Johnson*, discussed *infra* note 372 and accompanying text, the administrative law judge (ALJ) found that *Hochfelder's* scienter requirement was inapplicable in Rule 2(e) actions. *In re Carter and Johnson*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,175, at 82,180 (Mar. 7, 1979) (trial). According to the ALJ, "willful in this context means intentionally committing the act which constitutes the violation." *Id.* (quoting *SEC v. Tager*, 344 F.2d 5, 8 (8th Cir. 1965)).

³⁴⁸ See, e.g., *In re Jo M. Ferguson*, Securities Act Release No. 5523 (Sept. 3, 1974) (attorney sanctioned under Rule 2(e) because he knew or should have known of violations).

³⁴⁹ *In re Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847 (Feb. 28, 1981) (appeal).

³⁵⁰ *Id.* at 84,167.

³⁵¹ *Id.* at 84,172-73. For a discussion of the SEC's view of an attorney's responsibility to blow the whistle on a client, see *supra* notes 22-23 and accompanying text.

³⁵² *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,150-51 (appeal).

³⁵³ *Id.* at 84,151.

³⁵⁴ *Id.*

³⁵⁵ *Id.*

³⁵⁶ *Id.*

into a "lease maintenance program" (LMP) if the company continued to experience financial difficulties.³⁵⁷ Under the terms of the LMP, National would wind down its business by restricting sales and only maintaining leases which it had already sold.³⁵⁸ Under the terms of the company's agreement with the banks, if National sought to borrow additional funds from the banks or if certain liquidity ratios were not satisfied, National would be required to institute the LMP.³⁵⁹

During this period of financial crisis, National's president, Sheldon Hart, refused to disclose the financial problems which the company was facing and continued to issue optimistic reports to National's shareholders and the financial community.³⁶⁰ Specifically, the particulars of the loan agreement, the existence of the LMP, and the potential consequences of both for National were not disclosed in a December 20th press notice released by National, a December 23rd letter to the company's shareholders, or in National's Form 8-K³⁶¹ for December 1974.³⁶² The press release and the Form 8-K were prepared by Hart with the assistance of attorneys Carter and Johnson.³⁶³

By March 1975, National's financial situation had deteriorated to such an extent that the company was required under the terms of the loan agreement to implement the LMP.³⁶⁴ In response to this situation, Hart, without knowledge of counsel, falsely certified to the banks that compliance with the LMP had been initiated.³⁶⁵ Later in March and again in April, Carter and Johnson advised Hart that National should publicly disclose its obligation to implement the LMP.³⁶⁶ Hart, however, refused to follow the attorneys' advice.³⁶⁷ In fact, the terms of the loan agreement, including National's obligation to implement the LMP were not disclosed until May 27, 1975, three days after Hart was forced to resign as National's president.³⁶⁸ On July 2, 1975 National initiated Chapter XI bankruptcy proceedings.³⁶⁹

As a consequence of the attorneys' actions in connection with their representation of National, the SEC instituted Rule 2(e) proceedings against Carter and Johnson.³⁷⁰ Specifically, the Commission charged that the attorneys had engaged in unethical and unprofessional conduct during National's financial crisis. The SEC also alleged that the lawyers had aided and abetted violations of the securities laws by assisting Hart in the preparation of the misleading press release and Form 8-K and by failing to disclose material facts concerning National's financial condition between May 1974 and May 1975.³⁷¹ After conducting a hearing, an administrative law judge found that the evidence

³⁵⁷ *Id.* at 84,158.

³⁵⁸ *Id.* at 84,156-58.

³⁵⁹ *Id.* at 84,158-59.

³⁶⁰ *Id.* at 84,159-62.

³⁶¹ A form 8-K is a financial report which companies with registered securities must file with the SEC.

³⁶² *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,158-61 (appeal).

³⁶³ *Id.* at 84,160.

³⁶⁴ *Id.* at 84,161.

³⁶⁵ *Id.*

³⁶⁶ *Id.* at 84,162.

³⁶⁷ *Id.*

³⁶⁸ *Id.* at 84,163-64.

³⁶⁹ *Id.* at 84,152.

³⁷⁰ *Id.* at 84,150-51.

³⁷¹ *Id.*

supported all of the SEC's charges and suspended Johnson from appearing before the Commission for nine months and Carter for one year.³⁷²

On appeal, the SEC initially focused on whether the attorneys had aided and abetted violations of the federal securities laws.³⁷³ The Commission first found that National's failure to disclose the true nature of the LMP in the December 20th press release and in the December 8-K form constituted primary violations of the securities laws.³⁷⁴ The Commission then determined that the actions of the attorneys in the preparation of these documents satisfied the "substantial assistance" element of an aiding and abetting offense.³⁷⁵ The SEC rejected, however, the notion that negligence by a securities lawyer was sufficient to satisfy the "intent" element of aiding and abetting.³⁷⁶ Instead, the SEC held that, in order to be found guilty of aiding and abetting, securities attorneys must be "aware or know that their role was part of an activity that was improper or illegal."³⁷⁷ The Commission emphasized that this intent element differentiated between an attorney who should be subject to professional discipline and one who had made merely a good faith error in judgment.³⁷⁸ Stressing the need for securities attorneys to be able to give advice without fear of legal liability or the loss of the ability to practice before the SEC, the Commission concluded that the evidence was insufficient to establish that "either attorney had acted with sufficient knowledge and awareness or recklessness to satisfy the test for willful aiding and abetting."³⁷⁹ Therefore, the SEC overturned the ALJ's decision regarding the attorneys' violation of the federal securities laws.³⁸⁰

In addressing the issue of whether Carter and Johnson had engaged in unethical or improper professional conduct, the Commission first asserted that an attorney with significant responsibilities in the effectuation of a company's fulfillment of disclosure requirements under the federal securities laws must take all reasonable steps to prevent a client from engaging in illegal conduct.³⁸¹ According to the SEC, advising a client to make accurate disclosure is initially sufficient to satisfy the attorney's professional responsibilities, even if the advice is not followed.³⁸² If the lawyer determines, however, that his advice is not being sought in good faith, the attorney is required to take further prompt action to avoid being co-opted into the fraud.³⁸³ The specific steps to be taken, the SEC stated, depend on the facts of the individual case.³⁸⁴ Generally, in this type of situation, the SEC recommended that the lawyer directly approach the board of directors or other officers in the company about the senior executive's failure to make disclosures required by the federal securities statutes.³⁸⁵ Emphasizing that resignation should only

³⁷² *In re Carter and Johnson*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,175, at 82,180 (Mar. 7, 1979) (trial).

³⁷³ *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,165 (appeal).

³⁷⁴ *Id.* at 84,166.

³⁷⁵ *Id.*

³⁷⁶ *Id.* at 84,167.

³⁷⁷ *Id.*

³⁷⁸ *Id.*

³⁷⁹ *Id.*

³⁸⁰ *Id.*

³⁸¹ *Id.* at 84,172.

³⁸² *Id.*

³⁸³ *Id.*

³⁸⁴ *Id.*

³⁸⁵ *Id.* at 84,173.

be considered by the lawyer as a last resort, the SEC stated "[s]o long as a lawyer is acting in good faith and exerting reasonable efforts to prevent violations of the law by his client, his professional obligations have been met. In general, the best result is that which promotes the continued, strong minded participation of the lawyer."³⁸⁶

Employing this standard to the case before it, the SEC found that both lawyers' conduct was ethically improper because neither of the attorneys had advised National's board of directors or any other National officer about Hart's refusal to disclose information concerning the company's perilous financial situation.³⁸⁷ Yet, because the contours of a securities lawyer's ethical responsibilities were not clear at the time of the lawyers' actions, the Commission determined that its ruling would have only prospective effect. Therefore, the SEC reversed the ALJ's ruling that the attorneys had violated the ethical standards of Rule 2(e).³⁸⁸

3. Opining Attorneys' Potential Liability in Rule 2(e) Actions Today

While *In re Carter and Johnson* dealt with the issue of securities attorneys' susceptibility to discipline under Rule 2(e) for the preparation of disclosure documents rather than legal opinions, the Commission's holding in this case represents a transformation in the views of the SEC towards the potential liability and ethical responsibilities of all securities attorneys.³⁸⁹ In the *Carter and Johnson* opinion, the SEC continued to hold that attorneys who act solely in a professional capacity as advisors to their clients could be liable for aiding and abetting violations of the securities laws.³⁹⁰ Recognizing, however, that attorneys who are preoccupied with their own potential liability may be unable to adequately perform their duties, the Commission rejected the position it had taken during the 1970's that mere negligence by an attorney in rendering an opinion or in advising a client was sufficient to establish the requisite intent in an aiding and abetting action.³⁹¹ After the Commission's decision, it would appear that an opining lawyer who acts independently and in good faith cannot be sanctioned under the SEC's disciplinary rules for alleged willful aiding and abetting violations of the federal securities laws.³⁹² To impose sanctions in a Rule 2(e) proceeding today, the Commission must prove that an attorney acted with specific intent to defraud or at least with reckless disregard for the truth in rendering an incorrect legal opinion.³⁹³

³⁸⁶ *Id.* at 84,172-73.

³⁸⁷ *Id.* at 84,171-72.

³⁸⁸ *Id.* at 84,173.

³⁸⁹ In *Carter and Johnson*, the SEC stated that, "we do not distinguish between the professional advice of a lawyer given orally or in writing and similar advice which is embodied in drafting documents to be filed with the Commission. Liability in these circumstances should not turn on such artificial distinctions, particularly in light of the almost limitless range of forms which legal advice can take." *Id.* at 84,166. For law review articles discussing the significance of the decision, see Barber, *supra* note 83, at 538; Friedman, *supra* note 29, at 297-98; Kronstein, *supra* note 29, at 293-96.

³⁹⁰ *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,165-67 (appeal).

³⁹¹ See *id.* at 84,167.

³⁹² See *id.*

³⁹³ *Id.*; see also Kronstein, *supra* note 29, at 293-96; *In re Gibson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,068, at 84,713 (Dec. 7, 1981) (attorney was suspended from practicing before the SEC for nine months for aiding and abetting a scheme to distribute unregistered and

Moreover, in the *Carter and Johnson* decision, the SEC appears to have rejected the view, which it espoused in *National Student Marketing* and advocated during the 1970's, that a securities lawyer has a responsibility under the securities laws to blow the whistle on a client.³⁹⁴ At least in situations like the one in *Carter and Johnson*, the SEC now asserts that a securities attorney does *not* have a duty to inform the Commission about a client's intention to commit a fraud.³⁹⁵ In this type of situation, the Commission now suggests that the lawyer inform the board of directors or other officials in a company about a chief executive's intention to violate the securities laws.³⁹⁶ If the company still refuses to take appropriate action, then the attorney must resign to avoid being co-opted into the fraud.³⁹⁷

Subsequent to its decision in *In re Carter and Johnson*, the SEC has also indicated that it will decrease the frequency with which it brings Rule 2(e) actions against attorneys.³⁹⁸ In a recent speech, the then General Counsel for the SEC, Edward Greene, asserted that the Commission should institute disciplinary proceedings against lawyers only if they engage in misconduct which is a violation of established state ethical or professional misconduct rules and has a direct impact on the Commission's processes.³⁹⁹ Where attorneys have willfully aided and abetted violations of the federal securities laws, Greene asserted that the Commission should institute injunctive actions against the lawyers, not Rule 2(e) proceedings.⁴⁰⁰ Thus, at least for the time being, the SEC has retreated from its expansive use of Rule 2(e) actions and will institute these proceedings only in cases of egregious conduct.

C. Civil Actions Brought By Private Plaintiffs Against Opining Attorneys Under The Federal Securities Laws

The expansive view of the duties of opining securities attorneys which was demonstrated in SEC injunctive actions and disciplinary proceedings during the 1970's has also been in evidence to a certain extent over the last fifteen years in the area of civil liability.⁴⁰¹ Traditionally, courts held that attorneys owed duties only to their clients and

unrestricted securities by recklessly opining that pledges of securities were exempt from registration without setting forth Rule 144 resale restrictions).

³⁹⁴ *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,172-73 (appeal); see also Greene, *supra* note 27, at 84,800. For a discussion of this *National Student Marketing* view of securities lawyers' duties, see *supra* notes 22-23 and accompanying text.

³⁹⁵ *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,172-73 (appeal).

³⁹⁶ *Id.* at 84,172.

³⁹⁷ *Id.*

³⁹⁸ See Brown & Mahoney, *Corporate Counsel*, 15 INST. ON SEC. REG. 95, 99 (1984) (comments of present SEC General Counsel Dan Goelzer); see also Greene, *supra* note 27, at 84,799-800.

³⁹⁹ Greene, *supra* note 27, at 84,799-800.

⁴⁰⁰ *Id.* at 84,800. Present SEC General Counsel Dan Goelzer has indicated that his position is the same as Ed Greene's. See Brown & Mahoney, *supra* note 398, at 99.

⁴⁰¹ See, e.g., *T.J. Raney & Sons v. Fort Cobb, Oklahoma Irrigation Fuel Auth.*, 717 F.2d 1330, 1333 (10th Cir. 1983), cert. denied, 465 U.S. 1026 (1984); *Stokes v. Lokken*, 644 F.2d 779, 783-85 (8th Cir. 1981); *Cronin v. Midwestern Oklahoma Dev. Auth.*, 619 F.2d 856, 862 (10th Cir. 1980); *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1204-10 (W.D. Mo. 1983); *Morgan v. Prudential Group, Inc.*, 527 F. Supp. 957, 960-61 (S.D.N.Y. 1981); *In re North Am. Acceptance Corp. Securities Cases*, 513 F. Supp. 608, 626-29 (N.D. Ga. 1981); *Felts v. National Account Sys. Ass'n, Inc.*, 479 F. Supp. 54, 67-68 (N.D. Miss. 1978); *Escott v. Barchris Constr. Co.*, 283 F. Supp.

were subject to civil liability to the investing public only when actively participating in fraudulent schemes.⁴⁰² Since approximately 1970, however, courts have held that attorneys who render legal opinions or prepare disclosure documents owe duties to the investing public and may be held civilly liable to members of the investing public for actions undertaken solely in a professional capacity as advisors to their clients.⁴⁰³ Unlike the pattern evidenced in SEC injunctive actions and Rule 2(e) proceedings, however, courts have never held these attorneys liable to third parties under the securities laws for mere negligence in rendering opinions. Instead, courts have found opining lawyers civilly liable to private plaintiffs only when these lawyers knowingly or recklessly render incorrect opinions which substantially assist the securities law violations of a client.⁴⁰⁴

The first portion of this subsection examines the emergence of securities attorneys' duty to protect the interests of the investing public and the imposition of liability on these lawyers when they knowingly or recklessly fail to perform this duty. Secondly, the most likely source of opining attorneys' liability to private plaintiffs, an action alleging primary or aiding and abetting violations of section 10(b) of the Exchange Act,⁴⁰⁵ will be discussed. The final portion of this subsection focuses on the recent trend of private plaintiffs bringing suits against opining attorneys under the developing "fraud on the market" theory.

1. Emergence of Securities Attorneys' Duties and Potential Liability to Investors under the Federal Securities Laws

The trend towards holding securities attorneys to a higher standard of conduct relative to the investing public first surfaced in the 1968 case of *Escott v. Barchris Construction Co.*⁴⁰⁶ In *Barchris*, an attorney-director, Grant, was held civilly liable under section 11 of the Securities Act to debenture holders of a bankrupt corporation because of false and misleading statements contained in the company's prospectus.⁴⁰⁷ While Grant's liability was based on his position as a director, the court emphasized that, because he was also an attorney, Grant was not entitled to rely upon his client's representations and had a duty to verify his client's statements through a careful examination of the com-

643, 646 (S.D.N.Y. 1968); see also Jenkins, *supra* note 11, at 511; Leiman, *supra* note 11, at 278-80; Sommer, *supra* note 2, at 83,687-91.

⁴⁰² See *supra* notes 158-67 and accompanying text.

⁴⁰³ See cases cited *supra* note 401. While in the civil liability area during the 1970's the courts began to move away from the traditional limits on opining attorneys' liability and began to impose liability on lawyers who acted solely in a professional capacity as a client's advisor, no court attempted to impose liability on attorneys under section 10 for simple negligence in issuing opinions.

⁴⁰⁴ See, e.g., T.J. Raney & Sons v. Fort Cobb, Oklahoma Irrigation Fuel Auth., 717 F.2d 1330, 1333 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); Stokes v. Lokken, 644 F.2d 779, 783-85 (8th Cir. 1981); Cronin v. Midwestern Oklahoma Dev. Auth., 619 F.2d 856, 862 (10th Cir. 1980); Rose v. Arkansas Valley Envtl. & Util. Auth., 562 F. Supp. 1180, 1204-10 (W.D. Mo. 1983); Morgan v. Prudential Group, Inc., 527 F. Supp. 957, 960-61 (S.D.N.Y. 1981); *In re North Am. Acceptance Corp. Securities Cases*, 513 F. Supp. 608, 626-29 (N.D. Ga. 1981); Felts v. National Account Sys. Ass'n, Inc., 479 F. Supp. 54, 67-68 (N.D. Miss. 1978); *Escott v. Barchris Constr. Co.*, 283 F. Supp. 643, 646 (S.D.N.Y. 1968); see also Jenkins, *supra* note 11, at 511; Leiman, *supra* note 11, at 278-80; Sommer, *supra* note 2, at 83,687-91.

⁴⁰⁵ See Leiman, *supra* note 11, at 284 & n.18.

⁴⁰⁶ 283 F. Supp. 643 (S.D.N.Y. 1968).

⁴⁰⁷ *Id.* at 690-92.

pany's records.⁴⁰⁸ Commentators and at least one court have noted that implicit in the language of the *Barchris* decision is the view that securities lawyers rendering legal opinions or preparing disclosure documents may not assume the truthfulness of their clients' assertions and, thus, have a duty to investigate the validity of their clients' statements.⁴⁰⁹

Similarly, in *Felts v. National Account Systems Association*,⁴¹⁰ citing the *Barchris* case as well as the *Frank* and *National Student Marketing* decisions,⁴¹¹ a federal district court held an attorney liable to purchasers of a company's promissory notes because of the lawyer's activities in connection with his representation of the issuer.⁴¹² As was the case in *Barchris*, the attorney, Peters, was also an officer in the issuing company.⁴¹³ In his capacity as counsel for the issuer, Peters erroneously advised the company's officials that its promissory notes either were not securities or were within the intrastate exemption from registration provided by the federal securities laws.⁴¹⁴ Similar representations were made to Mississippi state securities officials.⁴¹⁵ When the company defaulted on payments to the holders of its promissory notes, these investors brought an action against several persons, including Peters, to recover for alleged violations of federal and state securities laws.⁴¹⁶

In considering whether Peters had aided and abetted violations of the federal securities laws through his activities for the issuer, the court emphasized that Peters' legal services "were undertaken not only for the benefit of the issuer but also, under the securities laws, for the benefit of the purchasers of securities."⁴¹⁷ After finding that several primary violations of the federal securities laws had occurred and that Peters' erroneous legal advice regarding exemption from registration had substantially assisted these violations,⁴¹⁸ the court examined whether the intent element of the aiding and abetting offense had been satisfied.⁴¹⁹ According to the court, the failure of Peters as counsel for the issuer to make a reasonable inquiry to ascertain the truthfulness of statements made by his client and to conduct an independent investigation of whether the notes were actually exempt from registration, constituted gross negligence and recklessness.⁴²⁰ Thus, finding that the scienter requirement of *Hochfelder* had been sat-

⁴⁰⁸ *Id.* at 690.

⁴⁰⁹ See *Felts v. National Account Sys. Ass'n*, 469 F. Supp. 54, 67 (W.D. Miss. 1978); see *Frank*, *supra* note 12, at 346-47; *Johnson*, *supra* note 14, at 650-51; *Lowenfils*, *supra* note 11, at 428-29; *Sommer*, *supra* note 2, at 690-91.

⁴¹⁰ 469 F. Supp. 54 (N.D. Miss. 1978).

⁴¹¹ *Id.* at 65-66.

⁴¹² *Id.* at 66-68. Peters was found to have violated the provisions of sections 12 and 17 of the Securities Act and section 10(b) and Rule 10b-5 of the Exchange Act. *Id.* at 67-68. In considering the section 12 claim, the court stated that without the substantial assistance of Peters as attorney for the issuer, the sale of the securities would not have been accomplished and, therefore, he was liable under section 12. *Id.* at 68.

⁴¹³ *Id.* at 60. Peters was the "titular president" of the issuer while another defendant, Steen, actually controlled the activities of the enterprise.

⁴¹⁴ *Id.*

⁴¹⁵ *Id.* at 60-61.

⁴¹⁶ *Id.* at 58, 63.

⁴¹⁷ *Id.* at 68.

⁴¹⁸ *Id.*

⁴¹⁹ *Id.*

⁴²⁰ *Id.*

ified, the court held Peters liable to the purchasers of the promissory notes for aiding and abetting violations of the federal securities laws.⁴²¹

Thus, beginning in the late 1960's and continuing in the 1970's, as the courts and the SEC began to broaden the role and responsibilities of attorneys under the securities laws, the scope of the potential civil liability of lawyers under these laws also expanded. As the cases discussed in this subsection demonstrate, attorneys who provide securities advice to clients today are now viewed as having a duty to protect the interests of the investing public. If a lawyer ignores this duty and intentionally or recklessly provides incorrect advice to a client, injured investors are able to recover damages from the attorney under the securities laws. Most frequently, injured investors allege that an opining attorney aided and abetted the securities law violation of a client by the issuance of an incorrect legal opinion.⁴²² Also, the recent development of the *Shores* approach to the fraud on the market theory⁴²³ has provided private plaintiffs with an additional cause of action under which they may recover damages from opining attorneys.⁴²⁴ The next two subsections examine these private damage actions most frequently brought by private plaintiffs against opining lawyers under the federal securities statutes today.

2. Opining Attorneys' Liability to Private Plaintiffs under Conventional Theories of Rule 10b-5 Liability

The action which is most frequently instituted against opining attorneys by injured investors under the federal securities laws is one alleging aiding and abetting violations of section 10(b) of the Exchange Act. Two 1981 decisions, *Stokes v. Lokken*⁴²⁵ and *In re North American Acceptance Corp. Securities Cases*,⁴²⁶ illustrate the standards under which opining securities attorneys may be subject to civil liability to injured investors under this conventional theory of section 10(b) liability. In both of these cases, the courts considered motions for summary judgment made by opining attorneys who had allegedly violated the securities laws by their issuance of opinions of counsel.⁴²⁷

The *Stokes* case concerned the activities of an attorney, Lokken, who rendered an opinion that the sale of coins in bulk did not involve the sale of securities.⁴²⁸ While

⁴²¹ *Id.* Peters and his co-defendant were required to pay the plaintiffs \$163,409.47. *Id.* at 70.

⁴²² See, e.g., *Stokes v. Lokken*, 644 F.2d 779, 783-85 (8th Cir. 1981); *Cronin v. Midwestern Oklahoma Dev. Auth.*, 619 F.2d 856, 862 (10th Cir. 1980); *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1204-10 (W.D. Mo. 1983); *Morgan v. Prudential Group, Inc.*, 527 F. Supp. 957, 960-61 (S.D.N.Y. 1981); *In re North Am. Acceptance Corp. Securities Cases*, 513 F. Supp. 608, 626-29 (N.D. Ga. 1981); see also Leiman, *supra* note 11, at 284 & n.18.

⁴²³ See *supra* notes 111-119 and accompanying text.

⁴²⁴ *T.J. Raney*, 717 F.2d at 1331-33; *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1201-03, 1205-06 (W.D. Mo. 1983).

⁴²⁵ 644 F.2d 779 (8th Cir. 1981).

⁴²⁶ 513 F. Supp. 608 (N.D. Ga. 1981).

⁴²⁷ In *Stokes*, the attorney was charged with aiding and abetting violations of section 10 and Rule 10b-5 of the Exchange Act and of violating the provisions of section 12 of the Securities Act. 644 F.2d at 781, 785. The *Stokes* case was on appeal from the district court's granting of the lawyer's motion for summary judgment. *Id.* at 781. In *North American Securities*, the attorneys had allegedly violated the provisions of sections 12(2) and 17 of the Securities Act and section 10(b) and Rule 10b-5 of the Exchange Act. 513 F. Supp. at 614-15.

⁴²⁸ *Stokes*, 644 F.2d at 782. The *Stokes* case developed out of the activities of the Continental Finance Corporation (CFC) which was engaged in marketing precious metals. *Id.* While auditing CFC's books, the accounting firm of Touche, Ross, & Co. requested a legal opinion concerning

reaching this conclusion, Lokken noted in the opinion letter that these transactions could conceivably be characterized as sales of securities and hence would be in violation of federal and state securities laws.⁴²⁹ The conclusion that the sale did not constitute a sale of securities later proved to be incorrect and the company for which the opinion letter was issued went bankrupt.⁴³⁰ After the institution of bankruptcy proceedings by the issuer, purchasers of the company's securities instituted an action against several defendants, including the opining attorney and his law firm, seeking compensation for damages suffered because of alleged violations of the federal securities laws.⁴³¹

In considering an appeal of a district court's dismissal of the charges against the attorney and his firm, the United States Court of Appeals for the Eighth Circuit rejected the plaintiff's contention that the attorney's reliance on facts provided by the issuer's president constituted gross negligence and amounted to recklessness.⁴³² Stating that to require a standard of independent factual inquiry in these circumstances would prevent clients from obtaining expeditious legal advice and lawyers from maintaining a busy practice,⁴³³ the Eighth Circuit held that the opinion letter was the product of a good faith reliance on the facts given to the attorney by his client.⁴³⁴ Furthermore, the court of appeals emphasized that the opinion noted that other attorneys could reach different conclusions and that liability might result from reliance on the conclusions reached in the opinion.⁴³⁵ Therefore, the court found that Lokken had not acted recklessly or with an intent to defraud and, thus, held that the scienter element of aiding and abetting had not been satisfied.⁴³⁶

In connection with the substantial assistance element of aiding and abetting, the court further noted that Lokken's legal opinion had been given not to the issuer, but to independent auditors who had then given issuer a clean audit report.⁴³⁷ While the accounting firm may have relied on Lokken's opinion letter, the court held that, given the facts of this case, "such reliance is hardly proof of substantial assistance considering the hedging nature of the opinion."⁴³⁸ Thus, the court affirmed the lower court's entry of summary judgment in favor of the attorney.⁴³⁹

In the *North American Securities* case, the investors charged the law firm of Arnall, Golden & Gregory (Arnall) with violations of the registration and antifraud provisions of the federal securities laws in connection with its representation of the North American Acceptance Corporation (NAAC).⁴⁴⁰ NAAC was principally engaged in making first and

whether the sale of gold and silver on margin accounts constituted a sale of securities within the meaning of federal and state securities laws. *Id.*

⁴²⁹ *Id.*

⁴³⁰ *Id.* at 781, 784.

⁴³¹ *Id.* at 781.

⁴³² *Id.* at 783 n.3.

⁴³³ *Id.*

⁴³⁴ *Id.* at 784.

⁴³⁵ *Id.*

⁴³⁶ *Id.*

⁴³⁷ *Id.*

⁴³⁸ *Id.*

⁴³⁹ *Id.* The court dismissed the section 12 claim because Lokken had not been in privity of contract with the purchasers and his opinion letter had not been a substantial factor in causing the sales to take place. *Id.* at 785.

⁴⁴⁰ 503 F. Supp. at 614-15.

second mortgages on residential properties and in servicing the receivables this business generated.⁴⁴¹ To help finance its operation, NAAC sold three separate intrastate debt securities which were not registered with either the SEC or state officials.⁴⁴² NAAC also owned a forty-six percent interest in Securities Mortgage Investors (SMI), which was NAAC's principal customer for the sale of its receivables.⁴⁴³ In March, 1972, NAAC was purchased by Omega-Alpha, Inc., which proceeded to transfer most of the cash and assets out of NAAC.⁴⁴⁴ Furthermore, during this period, NAAC lost its favorable position with SMI because of that company's merger with another firm.⁴⁴⁵ By May, 1973, NAAC's principal source of income to repay holders of its debt notes was the sale of additional debt securities through television, newspapers, and direct solicitation.⁴⁴⁶ In February, 1974, NAAC filed Chapter XI bankruptcy proceedings.⁴⁴⁷

After NAAC's financial collapse, purchasers of the company's debt securities filed a class action against several defendants, including Arnall, alleging violations of the registration and antifraud provisions of the federal securities laws.⁴⁴⁸ Some of these allegations were based on legal opinions rendered by the firm which stated that NAAC's thrift and term notes were exempt from the registration provisions of the Securities Act because of the exemption provided to intrastate securities by section 3(a)(11) of the Securities Act.⁴⁴⁹

In deciding whether sufficient evidence existed to establish the three elements for an aiding and abetting violation, the *North American Securities* court focused on whether the requisite culpability on the part of the law firm existed to satisfy *Hochfelder's* scienter requirement.⁴⁵⁰ Noting that Arnall knew that, as a result of its advice, purchasers of the debt securities would receive no prospectus disclosing the risks relating to the purchase, the court stated that "extreme recklessness" would satisfy the scienter standard.⁴⁵¹ The court further asserted that in finding NAAC's thrift and term notes were within section 3(a)(11) of the Securities Act "intrastate exemption" from registration, the lawyers for Arnall had to determine that the section's "doing business" requirement was satisfied.⁴⁵²

⁴⁴¹ *Id.* at 615.

⁴⁴² *Id.* NAAC sold: (1) thrift notes, which were simply promissory notes bearing specified maturity dates nine months from the date of purchase but redeemable upon demand of the holder; (2) term notes, which were promissory notes payable one to five years after the date of sale; and (3) thrift certificates, which were identical to thrift notes but were not payable upon demand. *Id.*

⁴⁴³ *Id.*

⁴⁴⁴ *Id.* at 616.

⁴⁴⁵ *Id.*

⁴⁴⁶ *Id.*

⁴⁴⁷ *Id.*

⁴⁴⁸ *Id.* at 614-15.

⁴⁴⁹ *Id.* at 617.

⁴⁵⁰ *Id.* at 625-26.

⁴⁵¹ *Id.* at 626. In support of its position that recklessness satisfied *Hochfelder's* scienter requirement in an aiding and abetting action, the court cited *Oleck v. Fisher*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,898 (S.D.N.Y. 1978), and *Sharp v. Coopers & Lybrand*, 457 F. Supp. 879 (E.D. Pa. 1978).

⁴⁵² 503 F. Supp. at 626. Section 3(a)(11) of the Securities Act provides an exemption from registration to intrastate issues. To qualify for this exemption, the issuer must meet the "doing business in the state" requirement. This requirement is satisfied only by performance of substantial operational activities in the state by the issuer and is not met simply by performance in the state of such activities as bookkeeping or maintaining stock records. SEC Securities Act Release No. 4434

The court found that Arnall had decided on using an "operating income" test⁴⁵³ to satisfy the doing business requirement, although its attorneys possessed information which militated against the availability of the exemption.⁴⁵⁴ The court additionally found that the attorneys excluded the \$27,000,000 NAAC loaned to Omega-Alpha, and SMI's purchases of receivables held by NAAC, from their operating income calculations.⁴⁵⁵ In light of these facts, the court stated it was "unable to conclude as a matter of law that Arnall's opinions were not recklessly or intentionally erroneously rendered" or that Arnall did not construct its legal tests to accommodate unfavorable facts.⁴⁵⁶ Thus, the motion for summary judgment was denied.⁴⁵⁷

As these cases demonstrate, by the 1980's, courts had abandoned traditional limits on opining attorneys' civil liability under the securities laws and were now willing to hold lawyers liable for damages under these statutes for actions taken solely in their capacity as a client's advisor.⁴⁵⁸ This expansion in potential liability of opining lawyers under the federal securities laws occurred largely through the development of the concept of aiding and abetting.⁴⁵⁹ In aiding and abetting actions brought against opining attorneys, a central issue is usually the intent or awareness with which an opinion allegedly containing

(1961), *reprinted in* L. Loss, *supra* note 124, at 319-25. For a general discussion of the current "doing business" requirement see Securities Act Release No. 5450 (1974), *reprinted in* L. Loss, *supra* note 124, at 329-30.

⁴⁵³ According to Rule 147, which is set forth in Securities Act Release No. 5450, an operating income test is one method of determining whether an issuer is entitled to an intrastate exemption. In order to satisfy this test, at least 80% of issuer's gross revenues must be derived from the operation of business or property located in the state and, 80% of issuer's assets must be located in the state. Securities Act Release No. 5450, *reprinted in* L. Loss, *supra* note 124, at 329-30.

⁴⁵⁴ 503 F. Supp. at 627. The facts which indicated that the "doing business" requirement was not met included the following: (1) 74% of NAAC's assets were outside Georgia; (2) three out of four directors of NAAC were from out-of-state; (3) 51.6% of its direct loans were out-of-state; (4) 76.5% of its home improvement loans were out-of-state; (5) all land loans were out-of-state; (6) only 10.4% of all operating assets were in Georgia. *Id.*

⁴⁵⁵ *Id.*

⁴⁵⁶ *Id.* at 629.

⁴⁵⁷ *Id.* The section 12 charges brought against AGG were dismissed because there was no privity between the law firm and the sellers and AGG could not be found to have caused the sale of the securities "simply because it advised NAAC that the intrastate exemption was available and advised NAAC to continue selling notes in a time of financial instability." *Id.* at 620. Subsequent to the district court's denial of the motion for summary judgment, the defendants in the case, AGG, the First National Holding Corporation and Sol Blaine settled the case out of court. The defendants agreed to pay the plaintiffs \$2,100,000 in consideration for dropping their suit. *In re North Am. Acceptance Securities Co. Cases*, [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,831, at 94,260 (N.D. Ga. Aug. 16, 1982).

⁴⁵⁸ See, e.g., *Stokes v. Lokken*, 644 F.2d 779, 783-85 (8th Cir. 1981); *Cronin v. Midwestern Oklahoma Dev. Auth.*, 619 F.2d 856, 862 (10th Cir. 1980); *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1204-10 (W.D. Mo. 1983); *Morgan v. Prudential Group, Inc.*, 527 F. Supp. 957, 960-61 (S.D.N.Y. 1981); *In re North Am. Securities Co. Cases*, 513 F. Supp. 608, 626-29 (N.D. Ga. 1981).

⁴⁵⁹ See, e.g., *Stokes v. Lokken*, 644 F.2d 779, 783-85 (8th Cir. 1981); *Cronin v. Midwestern Oklahoma Dev. Auth.*, 619 F.2d 856, 862 (10th Cir. 1980); *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1204-10 (W.D. Mo. 1983); *Morgan v. Prudential Group, Inc.*, 527 F. Supp. 957, 960-61 (S.D.N.Y. 1981); *In re North Am. Securities Co. Cases*, 513 F. Supp. 608, 626-29 (N.D. Ga. 1981); see also *Leiman*, *supra* note 11, at 284 & n.18. For a discussion of the requirements of an aiding and abetting action see *supra* notes 56-63 and accompanying text.

misrepresentations and omissions was rendered.⁴⁶⁰ To be held liable for damages to a third party an intent to deceive, manipulate, or defraud, that is scienter, by the lawyer in rendering the opinion must be established — mere negligence will not suffice.⁴⁶¹

Courts also generally have held that recklessness in issuing an erroneous opinion is tantamount to scienter and is sufficient to establish the liability of an opining lawyer.⁴⁶² As the *Stokes* case illustrates, however, if an attorney can show good faith in relying on facts provided by the client or in interpreting the law, no liability will be imposed.⁴⁶³ As the *North American Securities* litigation demonstrates, only where an opining lawyer closes his eyes to what is readily apparent or twists the facts or law to reach the conclusion his client desires are courts willing to find that the scienter requirement has been satisfied and to impose liability on the opining lawyer.⁴⁶⁴

To satisfy the substantial assistance element of an aiding and abetting action, a private plaintiff must establish that an attorney's issuance of a legal opinion played an integral role in the completion of a client's fraudulent activity.⁴⁶⁵ Thus, if, as in *Stokes*, a lawyer renders a "reasoned opinion" which states that it is possible for others to reach a different conclusion, the substantial assistance element of the offense probably will not be satisfied.⁴⁶⁶ Only when an attorney gives a "clean opinion" which addresses a single issue and is relied upon by others in completing a transaction will the substantial assistance element of an aiding and abetting action be satisfied and the attorney be subject to liability for damages under the securities laws.⁴⁶⁷

⁴⁶⁰ See *In re Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,166-67 (Feb. 28, 1981); see also Block, *supra* note 69, at 1787; Leiman, *supra* note 11, at 283-85; Note, *Attorneys' Liability*, *supra* note 4, at 445; Note, *Stokes v. Lokken: Attorney Liability Under Rule 10b-5*, 15 CREIGHTON L. REV. 1027, 1030-36 (1981) [hereinafter cited as Note, *Attorney Liability Under Rule 10b-5*].

⁴⁶¹ See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193-94 (1976). For a discussion of *Hochfelder*, see *supra* notes 48-50 and accompanying text.

⁴⁶² See, e.g., T.J. Raney & Sons v. Fort Cobb, Oklahoma Irrigation Fuel Auth., 717 F.2d 1330, 1333 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Stokes v. Lokken*, 644 F.2d 779, 784 (8th Cir. 1981); *Cronin v. Midwestern Oklahoma Dev. Auth.*, 619 F.2d 856, 862 (10th Cir. 1980); *Morgan v. Prudential Group, Inc.*, 527 F. Supp. 957, 960-62 (S.D.N.Y. 1981); *In re North Am. Securities Co. Cases*, 513 F. Supp. 608, 626 (N.D. Ga. 1981).

⁴⁶³ *Stokes*, 644 F.2d at 783 n.3, 784.

⁴⁶⁴ *In re North Am. Securities Co. Cases*, 513 F. Supp. at 628-29.

⁴⁶⁵ See *Stokes*, 644 F.2d at 784; see also SEC v. Coven, 581 F.2d 1020, 1028-29 (2d Cir. 1978); SEC v. Spectrum, Ltd., 489 F.2d 535, 537-40 (2d Cir. 1973); SEC v. National Student Marketing Corp., 457 F. Supp. 682, 714 (D.D.C. 1978); SEC v. Century Inv. Transfer Corp., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,232, at 91,443 (S.D.N.Y. Nov. 7, 1971); Note, *Attorneys' Liability*, *supra* note 4, at 445; but see *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,166 (appeal) ("[t]he second element — substantial assistance — is generally satisfied in the context of a securities lawyer performing professional duties, for he is inevitably deeply involved in his client's disclosure activities and often participates in the drafting documents").

⁴⁶⁶ See *Stokes*, 644 F.2d at 784.

⁴⁶⁷ See *id.*; see also SEC v. Coven, 581 F.2d 1020, 1028-29 (2d Cir. 1978); SEC v. Spectrum, 489 F.2d 535, 537-40 (2d Cir. 1973); SEC v. National Student Marketing Corp., 457 F. Supp. 682, 714 (D.D.C. 1978); SEC v. Century Inv. Transfer Corp., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,232, at 91,443 (S.D.N.Y. Nov. 7, 1971); Note, *Attorneys' Liability*, *supra* note 4, at 445; but see *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,166 (appeal) ("[t]he second element — substantial assistance — is generally satisfied in the context of a securities lawyer performing professional duties, for he is inevitably deeply involved in his client's disclosure activities and often participates in the drafting documents").

3. Development of Opining Securities Attorneys' Potential Liability Under the Fraud on the Market Theory

In recent years, the development of the fraud on the market theory under Rule 10b-5⁴⁶⁸ has provided private plaintiffs with an additional cause of action under which they may recover damages from opining lawyers under the federal securities laws.⁴⁶⁹ Under the *Shores* approach to the fraud on the market theory,⁴⁷⁰ individuals who participate in schemes which result in an entirely unmarketable security being placed on the market may be held liable under Rules 10b-5(1) and 10b-5(3) to purchasers of this security.⁴⁷¹ In recent cases, courts have held that lawyers who render opinions of counsel may be held liable for damages to the entire class of purchasers of an "unmarketable security" under this new view of Rule 10b-5 liability.⁴⁷²

In the 1983 case of *Rose v. Arkansas Valley Environmental & Utility Authority*,⁴⁷³ for example, a federal district court refused to dismiss the fraud on the market liability charges instituted against an opining bond attorney by a class of purchasers of revenue bonds.⁴⁷⁴ The *Rose* case involved the issuance in 1974 of revenue bonds by the Arkansas Valley Environmental & Utility Authority (the Authority) to finance the construction of streets, curbs, and gutters in a private real estate development in Prue, Oklahoma.⁴⁷⁵ In connection with the issuance of these bonds, an attorney, Fred Rausch, issued favorable legal opinions regarding the legality of the issuance of these bonds.⁴⁷⁶ After the Authority defaulted on the payment of interest in June or July, 1975, purchasers of the bonds brought an action against several persons, including Rausch, alleging that the bonds were essentially worthless from the time they had been issued.⁴⁷⁷ The plaintiffs specifically alleged that, by omitting several material facts in his legal opinions, Rausch had misled buyers of the securities and caused them to suffer losses as a result.⁴⁷⁸

In considering Rausch's potential liability under the *Shores* approach to the fraud on the market theory, the district court first held that, for the purpose of considering the defendants' motion for summary judgment, the plaintiffs had adequately established that the Authority's bonds were so lacking in the basic essentials that, absent a fraudulent

⁴⁶⁸ For a discussion of the fraud on the market theory, see *supra* notes 111-19 and accompanying text.

⁴⁶⁹ See, e.g., *T.J. Raney*, 717 F.2d at 1331-33; *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1201-03, 1205-06 (W.D. Mo. 1983).

⁴⁷⁰ For a discussion of the *Shores* approach to fraud on the market liability, see notes 111-19 and accompanying text.

⁴⁷¹ Under this *Shores* approach to the fraud on the market theory, three elements must be established: (1) the security involved must be so lacking in the basic elements that, in the absence of a fraudulent scheme, it would never have been issued on the market at any price; (2) a defendant must knowingly and actively participate in the fraudulent scheme which resulted in the security being placed on the market; (3) the plaintiff must show that he relied on the "integrity of the market" to furnish securities which were not the product of a fraudulent scheme. *T.J. Raney*, 717 F.2d at 1332-33; *Shores*, 647 F.2d at 469-70; *Rose*, 562 F. Supp. at 1201-03.

⁴⁷² *T.J. Raney*, 717 F.2d at 1331-33; *Rose*, 562 F. Supp. at 1205-06.

⁴⁷³ 562 F. Supp. 1180 (W.D. Mo. 1983).

⁴⁷⁴ *Id.* at 1205-06.

⁴⁷⁵ *Id.* at 1186.

⁴⁷⁶ *Id.* at 1205.

⁴⁷⁷ *Id.* at 1187.

⁴⁷⁸ *Id.* at 1205-06.

scheme, the securities would never have been issued.⁴⁷⁹ The court further found that the plaintiffs had relied on the integrity of the market in purchasing these securities.⁴⁸⁰ Finally, in considering Rausch's involvement in the fraudulent scheme, the court focused on the attorney's issuance of favorable opinions of counsel regarding the legality of the bonds.⁴⁸¹ Asserting that the rendering of a favorable bond opinion was a necessary step in the issuance and marketing of the securities, the court concluded that Rausch's issuance of an allegedly misleading opinion made him a "substantial actor and integral participant" in the fraudulent scheme.⁴⁸² Therefore, the district court refused to dismiss the fraud on the market charges brought against the opining lawyer, Rausch.⁴⁸³

Similarly, in the 1983 case of *T.J. Raney & Sons v. Fort Cobb, Oklahoma Irrigation Fuel Authority*,⁴⁸⁴ the Tenth Circuit upheld a lower court's denial of a motion to decertify a class action suit instituted against several defendants including an opining attorney under the fraud on the market theory.⁴⁸⁵ The *Raney* case concerned the activities of the Fort Cobb, Oklahoma Irrigation Authority (Fuel Authority) which sought to provide natural gas service to several counties in Oklahoma.⁴⁸⁶ In connection with these activities, the Fuel Authority attempted to structure itself as a valid public trust with the beneficiary of the trust being the town of Eakly, Oklahoma.⁴⁸⁷ After the formation of this purported public trust, the Fuel Authority was allowed, under Oklahoma law, to issue tax-exempt industrial bonds.⁴⁸⁸ After securing the legal opinion of its bond counsel that it was a valid public trust which could legally sell bonds under Oklahoma law, the Fuel Authority issued bonds, the proceeds of which were to be used for the construction or acquisition of a gas distribution facility.⁴⁸⁹ When the Fuel Authority failed to make the required interest payments to its bondholders, T.J. Raney & Sons, a broker-dealer of securities, brought a class action on behalf of the purchasers of the bonds against several defendants, including the opining attorney, alleging various violations of the federal securities laws.⁴⁹⁰ The plaintiffs specifically alleged that the opining attorney had recklessly passed on the validity and legality of the bonds and thereafter concealed the wrongful divergence of the proceeds of the bonds.⁴⁹¹

The trial court, upon consideration of these charges, first found that the Fuel Authority was not a valid public trust and, therefore, was prohibited under Oklahoma law from issuing tax-exempt industrial bonds.⁴⁹² At a later hearing, the court further decided to deny the defendants' motion to decertify plaintiffs' class action which relied

⁴⁷⁹ *Id.* at 1201-03.

⁴⁸⁰ *Id.* at 1206.

⁴⁸¹ *Id.*

⁴⁸² *Id.*

⁴⁸³ *Id.* The court also refused to dismiss the "traditional Rule 10b-5 claims" brought by the plaintiffs against the opining attorney. *Id.* at 1207-10.

⁴⁸⁴ 717 F.2d 1330 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984).

⁴⁸⁵ *Id.* at 1333; *see also In re Fort Cobb, Oklahoma Irrigation Fuel Auth.*, 468 F. Supp. 338, 341 (W.D. Okla. 1979).

⁴⁸⁶ *In re Fort Cobb*, 468 F. Supp. at 340-41.

⁴⁸⁷ *Id.* at 340-43.

⁴⁸⁸ *T.J. Raney*, 717 F.2d at 1333.

⁴⁸⁹ *Id.* at 1331-32.

⁴⁹⁰ *Id.* at 1332.

⁴⁹¹ *Id.* at 1331-32.

⁴⁹² *In re Fort Cobb*, 468 F. Supp. at 343.

on the fraud on the market theory.⁴⁹³ In affirming the district court's decision, the Tenth Circuit first adopted the *Shores* approach to the fraud on the market theory.⁴⁹⁴ In determining the applicability of this theory to the case before it, the court of appeals emphasized that the Fuel Authority was not a public trust and, consequently, was prohibited under Oklahoma law from issuing any bonds.⁴⁹⁵ Given the clear illegality of the issuance of these securities, the Tenth Circuit held that, at least for purpose of considering the motion before it, the plaintiffs had established that the opining attorney had "knowingly brought . . . bonds to market with an intent to defraud."⁴⁹⁶ After further finding that the plaintiffs had relied on the availability of the securities as indicating their lawful issuance and that they had suffered damages as a result, the court of appeals upheld the decision of the district court and dismissed the defendants' motion.⁴⁹⁷

As the *Rose* and *T.J. Raney* cases demonstrate, in addition to the traditional theories of 10(b) liability, today attorneys may also be held liable to private parties under the newly developed fraud on the market theory. Under the *Shores* approach to this view of Rule 10b-5 liability, opining lawyers may be held liable to investors because of their assistance to issuers or underwriters in placing a new security on the market.⁴⁹⁸ As recent case law illustrates, if an attorney knowingly or recklessly issues an incorrect opinion which allows an "unmarketable security" to be placed on the market, that lawyer could be held civilly liable to the entire class of purchasers of the security regardless of whether these individuals read or relied on the attorney's opinions.⁴⁹⁹

The impact which the fraud on the market theory will have on the liability of opining lawyers in the future, however, remains uncertain. In recent years, the Supreme Court has demonstrated a marked reluctance to extend the limits of implied rights of action under the federal securities laws.⁵⁰⁰ The Court has instead prescribed a strict statutory construction approach to determining liability under the federal securities statutes.⁵⁰¹ The recent development of the fraud on the market theory, which arises from implying a private right of action from Rule 10b-5(1) and 10b-5(3), appears to run counter to this trend.⁵⁰² This is especially true of the *Shores* approach to fraud on the market liability which was described by the Eleventh Circuit as being "a context

⁴⁹³ *T.J. Raney*, 717 F.2d at 1331.

⁴⁹⁴ *Id.* at 1332-33.

⁴⁹⁵ *Id.* at 1333.

⁴⁹⁶ *Id.*

⁴⁹⁷ *Id.*

⁴⁹⁸ See, e.g., *id.*; *Rose*, 562 F. Supp. at 1204-06; see also *Shores*, 647 F.2d at 671.

⁴⁹⁹ *T.J. Raney*, 717 F.2d at 1333; *Rose*, 562 F. Supp. at 1204-06; see also *Shores*, 647 F.2d at 671.

⁵⁰⁰ See generally *Chiarella v. United States*, 445 U.S. 222 (1980); *Touche, Ross & Co. v. Reddington*, 442 U.S. 560 (1979); *Sante Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); but see *Herman & MacLean v. Huddleston*, 459 U.S. 375, 387-88 (1983) ("securities laws should be construed not technically and restrictively, but flexibly to effectuate their remedial purposes") (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963)).

⁵⁰¹ See generally *Chiarella v. United States*, 445 U.S. 222 (1980); *Touche, Ross & Co. v. Reddington*, 442 U.S. 560 (1979); *Sante Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); but see *Herman & MacLean v. Huddleston*, 459 U.S. 375, 387-88 (1983) ("securities laws should be construed not technically and restrictively, but flexibly to effectuate their remedial purposes") (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963)).

⁵⁰² *Shores*, 647 F.2d at 484-85 (Randall, J., dissenting).

where its [the fraud on the market theory's] application is most questionable."⁵⁰³ Thus, the validity of this new theory of opining attorneys' liability will likely be considered by the Supreme Court in the near future.

IV. THE CURRENT STATE OF OPINING ATTORNEYS' LIABILITY UNDER THE FEDERAL SECURITIES LAWS AND ITS EFFECT ON OPINING ATTORNEYS AND THE SECURITIES BAR

During the last fifteen years, the liability of opining attorneys under the federal securities laws has undergone significant changes.⁵⁰⁴ Traditionally, opining lawyers were held liable only when they actively participated in plans to defraud the public. During the 1970's, however, through the dramatic increase in the use and scope of Rule 2(e) and SEC injunctive actions, the Commission attempted to expand the ethical responsibilities and potential liability of opining lawyers under the securities laws.⁵⁰⁵ In addition to imposing liability and sanctions on these lawyers when they functioned solely in a professional capacity giving advice to a client, the Commission advocated adoption of a negligence standard in aiding and abetting cases and the imposition of a "whistle blowing" ethical responsibility on securities lawyers.⁵⁰⁶

Today, in SEC injunctive actions, Rule 2(e) proceedings and private damage actions brought under the securities laws, courts have continued to impose liability or sanctions on opining lawyers for actions taken solely in a professional capacity as a client's advisor.⁵⁰⁷ Today, in these actions, however, the SEC or a private party must establish: (1) the existence of an independent securities law violation by a primary violator; (2) substantial assistance by the opining lawyer in the conduct that constitutes the violation; and (3) awareness or knowledge by the opining attorney that his role was part of an activity that was improper or illegal.⁵⁰⁸ Thus, despite statements to the contrary by the SEC during the 1970's, an opining attorney may not be subjected to liability under the federal securities laws merely because he did not exercise reasonable care and negligently reached an incorrect legal conclusion.⁵⁰⁹ To be found guilty of an aiding and abetting violation, the SEC or a private party must not only show that the lawyer's opinion was erroneous, but also that the lawyer acted with an intent to defraud or at least with reckless disregard for the truth in rendering the incorrect legal opinion.⁵¹⁰ Moreover, to satisfy the substantial assistance portion of an aiding and abetting action, a plaintiff must also establish that an attorney's issuance of a legal opinion played an integral role in the completion of his client's fraudulent activity.⁵¹¹

⁵⁰³ *Lipton v. Documentation, Inc.*, 734 F.2d 740, 746 (11th Cir. 1984).

⁵⁰⁴ See *supra* notes 309-20, 389-400, 422-24 and accompanying text.

⁵⁰⁵ See *supra* notes 199-204, 321-48 and accompanying text.

⁵⁰⁶ See *supra* notes 22-23 and accompanying text.

⁵⁰⁷ See, e.g., *SEC v. Haswell*, 645 F.2d 698, 699-700 (10th Cir. 1981); *Stokes v. Lokken*, 644 F.2d 779, 783-84 (8th Cir. 1981); *In re Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (Feb. 28, 1981).

⁵⁰⁸ See, e.g., *Stokes*, 644 F.2d at 783-84; *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (appeal).

⁵⁰⁹ See, e.g., *Haswell*, 654 F.2d at 699-700; *Stokes*, 644 F.2d at 783-84; *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (appeal).

⁵¹⁰ See, e.g., *Haswell*, 654 F.2d at 699-700; *Stokes*, 644 F.2d at 783-84; *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (appeal).

⁵¹¹ Substantial assistance is one of the three requirements of aiding and abetting actions. See *supra* note 58. For a discussion of the substantial assistance factor in cases concerning opining

In a pattern similar to that evidenced in aiding and abetting actions, an opining attorney is no longer perceived by the Commission as having an ethical obligation to "blow the whistle" on a client.⁵¹² When faced with a client who intends to violate the securities laws, the opining lawyer's obligation is to take appropriate steps to avoid being co-opted into the fraudulent activity.⁵¹³ As in other areas of the law, if all other actions fail, the securities lawyer should resign as the client's counsel.⁵¹⁴

This evolution in the liability of opining attorneys during the last fifteen years has made the securities bar cognizant of the important contribution legal opinions make to the proper functioning of the federal securities laws. These recent developments have convinced securities attorneys to take steps to ensure that they fulfill their responsibilities to the investing public. During this time period, commentators have written numerous articles examining policies and procedures which should be followed in rendering legal opinions.⁵¹⁵ In addition, the SEC, ABA, and the state bar associations have provided practitioners with guidelines and forms to be used in drafting opinions of counsel.⁵¹⁶ Moreover, today, most law firms with significant securities practices have formulated quality control procedures to ensure that legal opinions issued by members of their firms meet the requirements of the securities laws.⁵¹⁷ This heightened awareness and care with which attorneys render legal opinions has undoubtedly made lawyers carefully circumscribe the opinions they render and has probably led to a reduction in the number of erroneous opinions issued.⁵¹⁸ Thus, this expansion in the potential liability of opining securities attorneys should be viewed as a beneficial development for the legal profession and the investing public.

Moreover, the current standard of opining attorneys' liability, which allows these attorneys to be subject to sanctions for actions taken solely in an advisory capacity, is mandated by the underlying policy of the federal securities laws — protection of the

attorney liability, see *Stokes*, 644 F.2d at 785; *SEC v. National Student Marketing Corp.*, 457 F. Supp. 682, 714-15 (D.D.C. 1978); *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,166 (appeal).

⁵¹² *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,172-73 (appeal); see also Greene, *supra* note 27, at 84,800.

⁵¹³ *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,172 (appeal).

⁵¹⁴ *Id.* at 84,173.

⁵¹⁵ For a good bibliography of these articles, see Rowe, *supra* note 11, at 446-50.

⁵¹⁶ See generally *Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions*, 14 PAC. L.J. 1001 (1983) (prepared by the Committee on Corporations of the Business Law Section of the State Bar of California); *Legal Opinions to Third Parties: An Easier Path, A Report of the Special Committee on Legal Opinions and Commercial Transactions for the New York County Lawyers Association*, 34 BUS. LAW. 1891 (1979); *Report By Special Committee on Lawyers' Role in Securities Transactions: The Association of the Bar of New York City*, 33 BUS. LAW. 1343 (1978); *Omnibus Opinion for Use by Seller's Counsel in the Sale of a Closely Held Business*, 61 MASS. L.Q. 108 (1976) (prepared by the Subcommittee on Opinion Writing, Committee on Corporate Banking and Business Law, Mass. Bar Association); ABA Comm. on Ethics and Professional Responsibility, ABA Formal Op. 346 (revised) (1982); ABA Comm. on Ethics and Professional Responsibility, ABA Formal Op. 335 (1974).

⁵¹⁷ Connell, *Legal Opinions in the Context of a Private Placement*, in *OPINION LETTERS OF COUNSEL* 209 (1984); see also *SEC v. National Student Marketing Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,027, at 91,600 (May 2, 1977); *In re McLaughlin and Stern, Ballen, & Miller*, Securities Act Release No. 11553 (1975).

⁵¹⁸ Conversation with Professor Scott Fitzgibbon, Professor of Securities Regulations at Boston College Law School (March 21, 1986).

interests of the investing public through disclosure of all material information.⁵¹⁹ The rendering of legal opinions by attorneys concerning compliance by their clients with the federal securities laws plays an integral role in the fulfillment of this policy.⁵²⁰ These legal opinions are often the "passkeys" to securities transactions which determine whether or not a particular sale of securities occurs.⁵²¹ Thus, by issuing correct legal opinions, securities attorneys assure that the public's faith in the securities markets is maintained.⁵²² As Judge Friendly observed more than twenty years ago:

In our complex society . . . the lawyer's opinion can be [an] instrument for inflicting pecuniary loss more potent than the chisel or the crowbar Congress could not have intended that men holding themselves out as members of these ancient professions [the legal and accounting professions] should be able to escape . . . liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess.⁵²³

Opining lawyers, therefore, must be subject to sanctions or civil liability when they knowingly or recklessly ignore this responsibility and issue erroneous legal opinions which substantially assist the securities law violations of their clients.⁵²⁴

While opining attorneys must be subject to liability for actions taken solely in an advisory capacity to ensure protection of the investing public, the adoption of a negligence standard as a measure of these lawyers' liability would likely have a "chilling effect" on the performance of their duties for their clients.⁵²⁵ Opining attorneys play an integral role in the functioning of the investment markets.⁵²⁶ The advice which opining lawyers provide to their clients ensures that the investment community receives the flow of material information which is necessary for the marketplace to operate effectively.⁵²⁷ In providing this advice, opining lawyers are often asked to make difficult judgments in areas where legal precedent provides only general and inconclusive guidance.⁵²⁸ If securities attorneys were subject to sanctions or liability for simple negligence in giving this advice, they would be inclined to issue broad, overly cautious opinions, instead of

⁵¹⁹ Johnson, *supra* note 14, at 669; Sonde, *supra* note 193, at 842; Note, *Attorney Liability Under Rule 10b-5*, *supra* note 460, at 1030.

⁵²⁰ See *supra* notes 5-10 and accompanying text; see also Frank, *supra* note 12, at 338-41; Gruenbaum, *supra* note 2, at 798-800; Johnson, *supra* note 14, at 667-69; Sommer, *supra* note 2, at 83,688-90.

⁵²¹ See *supra* notes 5-7 and accompanying text.

⁵²² See, e.g., SEC v. Spectrum, Ltd., 489 F.2d 535, 540 (2d Cir. 1973); Attorneys' Opinion Letters, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,874, at 84,326 (June 1, 1981).

⁵²³ United States v. Benjamin, 328 F.2d 854, 863 (2d Cir.), *cert. denied*, 377 U.S. 953 (1964).

⁵²⁴ See, e.g., Block, *supra* note 69, at 1787; Jenkins, *supra* note 11, at 553, 557; Johnson, *supra* note 14, at 660; Messer, *Role and Reasonable Expectations of the Underwriter, Lawyer and Independent Securities Auditor in the Efficient Provision of Verified Information: Truth in Securities Reinforced*, 52 NEB. L. REV. 429, 454 (1973).

⁵²⁵ See, e.g., *In re Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (Feb. 28, 1981); see also Lipman, *supra* note 23, at 469-71; Note, *Attorney Liability under Rule 10b-5*, *supra* note 460, at 1030.

⁵²⁶ See, e.g., *Carter and Johnson*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (appeal).

⁵²⁷ *Id.*

⁵²⁸ *Id.*

the hard, specific advice required by their clients.⁵²⁹ Moreover, lawyers who are viewed by clients as being motivated by concerns for their own personal liability will no longer be consulted on difficult issues.⁵³⁰ This disincentive effect of the heightened standard of liability upon the disclosure of material information to counsel, therefore, would provide less protection to the public and could actually result in an increased number of securities law violations.⁵³¹ It was in recognition of these potentially disastrous consequences that both the SEC and the courts refused to impose liability or sanctions on opining lawyers who, in good faith, were careless or made errors in judgment.⁵³²

Moreover, so delimited, the imposition of liability on opining attorneys under the securities statutes is consistent with the positions taken by courts concerning lawyers' liability in other areas of the law. In the majority of states, for example, opining lawyers may not be held liable to third parties for mere negligence in rendering opinions.⁵³³ Like the federal courts and the SEC, these state courts feared that the adoption of a negligence standard would adversely affect the quality of legal services provided by an attorney.⁵³⁴ Thus, in these jurisdictions, the privity requirement limits an opining lawyer's liability to persons other than a client in those instances where a lawyer knowingly or recklessly renders an incorrect legal opinion.⁵³⁵ Even, in those states which have adopted a negligence standard, courts, concerned with the effect which this heightened standard of liability would have on a lawyer's actions, have taken measures to severely restrict the scope of an attorney's liability under this standard.⁵³⁶

⁵²⁹ *Id.*; see also Lipman, *supra* note 23, at 469-71; Note, *Attorney Liability Under Rule 10b-5*, *supra* note 460, at 1030.

⁵³⁰ See Carter and Johnson, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (appeal); see also Lipman, *supra* note 23, at 471-72; Note, *Duties and Obligations*, *supra* note 90, at 142-43.

⁵³¹ See Carter and Johnson, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (appeal); see also Lipman, *supra* note 23, at 471-72; Note, *Duties and Obligations*, *supra* note 90, at 142-43.

⁵³² See, e.g., SEC v. Haswell, 654 F.2d 698, 699-700 (10th Cir. 1981); Stokes v. Lokken, 644 F.2d 779, 783-84 (8th Cir. 1981); Carter and Johnson, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,847, at 84,167 (appeal).

⁵³³ See, e.g., Amey, Inc. v. Henderson, Franklin, Staines, & Holt, 367 So.2d 633, 635 (Fla. App. 1979); Bloomer Amusement Co. v. Eskenazi, 75 Ill. App. 3d 117, 119, 394 N.E.2d 16, 18 (1979); Grassi v. Tavito Homes, Inc., 90 A.D.2d 479, 480, 454 N.Y.S.2d 471, 472 (App. Div. 1982); First Mun. Leasing Corp. v. Blankenship, Potts, Aiken, Hargin, & Stewart, 648 S.W.2d 410, 413 (Tex. Civ. App. 1983); Bell v. Manning, 613 S.W.2d 335, 339 (Tex. Civ. App. 1981); Goerke v. Vojvodich, 67 Wis. 2d 102, 105-06; 226 N.W.2d 211, 212-14 (1975); see also Note, *Attorneys' Negligence and Third Parties*, 57 N.Y.U. L. REV. 126, 126 (1982) (attorneys generally owe a duty of care only to their clients).

⁵³⁴ See, e.g., Bell v. Manning, 613 S.W.2d 335, 339 (Tex. Civ. App. 1981). In Bell, the court stated that "to hold defendant liable . . . would inject self-protective reservations into the attorney's counselling role. The attorney's preoccupation or concern with the possibility of claims based on mere negligence . . . would prevent him from devoting his entire energies to his client's interest." *Id.*

⁵³⁵ See, e.g., Amey, Inc. v. Henderson, Franklin, Staines, & Holt, 367 So. 2d 633, 635 (Fla. App. 1979); Bloomer Amusement Co. v. Eskenazi, 75 Ill. App. 3d 117, 119, 394 N.E.2d 16, 18 (1979); Grassi v. Tavito Homes, Inc., 90 A.D.2d 479, 480, 454 N.Y.S.2d 471, 472 (App. Div. 1982); First Mun. Leasing Corp. v. Blankenship, Potts, Aiken, Hargin, & Stewart, 648 S.W.2d 410, 413 (Tex. Civ. App. 1983); Bell v. Manning, 613 S.W.2d 335, 339 (Tex. Civ. App. 1981); Goerke v. Vojvodich, 67 Wis. 2d 102, 105-06; 226 N.W.2d 211, 212-14 (1975); see also Newburger, Loeb & Co. v. Gross, 563 F.2d 1057, 1077, 1080 (2d Cir. 1977).

⁵³⁶ See, e.g., Goodman v. Kennedy, 18 Cal. 3d 335, 344, 556 P.2d 737, 743, 134 Cal. Rptr. 375,

Similarly, lawyers acting solely in an advisory capacity who knowingly or recklessly assist their clients in making false statements may be subjected to criminal liability under other federal statutes.⁵³⁷ For example, in one case, an attorney was convicted of aiding and abetting the making of a false statement by his client in a visa petition.⁵³⁸ Finding that the attorney had acted with reckless disregard of whether the statements made by his client were true,⁵³⁹ the Second Circuit stated that a lawyer cannot escape liability "merely by closing his eyes to the obvious risk that he is engaging in unlawful conduct . . . [H]e cannot counsel others to make statements in the face of obvious indications of which he is aware that those assertions are not true."⁵⁴⁰ Thus, the standard of liability of opining attorneys under the federal securities statutes is consistent with the approach taken by the courts towards attorneys' liability in other areas of the law.

CONCLUSION

During the last fifteen years, the scope of potential liability of opining securities attorneys has undergone significant changes. While traditionally the courts and the SEC imposed sanctions and civil liability against opining attorneys only in instances where they were active participants in schemes to defraud investors, these lawyers may now be subjected to liability when acting merely in a professional capacity as advisors to their clients. While during the 1970's the SEC and some courts asserted that opining lawyers could be subjected to judicial or administrative sanctions for mere negligence in issuing an opinion or for failing to disclose a client's fraudulent actions to the SEC, today an opining attorney must knowingly or recklessly render an incorrect legal opinion which substantially aids the federal securities law violations of his client in order to be subject to sanctions or civil liability.

The major consequence of this evolution in opining attorneys' liability has been an increased awareness on the part of opining securities lawyers of the importance of their

381 (1977) (without evidence that the attorney knew that his legal opinion would be transmitted to and relied upon by this particular plaintiff, negligence standard should not be used); *Dawdy v. Sapp*, 365 So. 2d 461, 462 (Fla. Dist. Ct. App. 1978) (court created exception to privity rule in will drafting case). In *Goodman*, the Supreme Court of California stated:

To make an attorney liable for negligent confidential advice not only to the client who enters into a transaction in reliance upon the advice but also to the other parties to the transaction with whom the client deals at arm's length would inject undesirable self-protecting reservations into the attorney's counselling role. The attorney's preoccupation or concern with the possibility of claims based on mere negligence (as distinct from fraud or malice) by anyone with whom his client might deal "would prevent him from devoting his entire energies to his client's interests." (*Anderson v. Eaton*, (1930) 211 Cal. 113, 116, 293 P. 788, 790.) The result would be both "an undue burden on the profession" (*Lucas v. Hamm*, 56 Cal. 2d 583, 589, 15 Cal. Rptr. 821, 824, 364 P.2d 685, 688) and a diminution in the quality of the legal services received by the client.

18 Cal. 3d at 345, 556 P.2d at 743, 134 Cal. Rptr. at 381 (citations omitted).

⁵³⁷ See, e.g., *United States v. Schwartz*, 464 F.2d 499, 508-10 (2d Cir. 1972); *United States v. Sarantos*, 455 F.2d 877, 880-81 (2d Cir. 1972); *United States v. Abrams*, 427 F.2d 86, 91 (2d Cir.), cert. denied, 400 U.S. 832 (1970); *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir.), cert. denied, 377 U.S. 953 (1964).

⁵³⁸ *United States v. Sarantos*, 455 F.2d 877, 880 (2d Cir. 1972).

⁵³⁹ *Id.* at 881.

⁵⁴⁰ *Id.*

opinions and of their responsibilities to the investing public under the federal securities laws. This growth in potential liability has, therefore, led to an increase in the care with which these lawyers issue opinions and in the protection provided for the investing public. Thus, the evolution in the scope of liability of opining securities attorneys during the last fifteen years has been a beneficial development for all affected parties.

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