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Gatekeeper Liability of Inside Asset Management Attorneys "Appearing" Before the SEC

By Gary O. Cohen

This article addresses the liability of inside attorneys at asset management companies—mutual fund sponsors, investment advisers, broker-dealers, life insurance companies—as gatekeepers under rules of the US Securities and Exchange Commission (Commission or SEC)[1] regarding the conduct of attorneys "appearing" and "practicing" before the Commission within the meaning of those rules.[2]

I. SEC's Hands-Off Stance

The Commission reserves the right to discipline attorneys appearing and practicing before it, including attorneys acting in the role of gatekeepers.[3] However, the Commission's disciplining of attorneys appearing and practicing before it raises difficult policy considerations[4] that have long been debated.[5]

On the one hand, the Commission needs to protect its system of securities regulation from non-diligent or incompetent attorneys.[6] Congress has recognized this by mandating the Commission to adopt minimum standards of professional conduct for attorneys.[7] On the other hand, the Commission cannot have the authority to discipline attorneys to the extent that it would cause attorneys to temper their representation of companies.[8]

As a result, the Commission has had to adopt and implement rules intended to serve both of the foregoing objectives. For instance, the Commission has disciplined attorneys who violate federal securities laws with scienter or intent.[9] However, in typical practice areas such as prospectus disclosure, legal opinions, and compliance with the federal securities law, the Commission traditionally[10] has not disciplined attorneys who provide, in good faith, reasonable legal advice that in hindsight turns out to be wrong.[11]

The distinction can be difficult to apply in specific circumstances. Indeed, the record shows that the Commission has overruled the Staff on where the line should be drawn.[12]

A. SEC Concept of Attorney as Gatekeeper

A "gatekeeper" is generally defined as "one who controls access."[13]

The Commission regularly uses the term "gatekeeper" in the context of controlling access to the public securities markets.[14] As a prominent law school professor has explained, "[s]tructually, gatekeepers are independent professionals who are so positioned that, if they withhold their consent, approval or rating, the corporation may be unable to effect some transaction or to maintain some desired status."[15]

There has been a long-standing debate on whether an attorney can be a gatekeeper.

The traditional school of thought has been that an attorney cannot be a gatekeeper, because he or she is an advocate for a client with an obligation to keep the client's information confidential. Historically, bar associations have espoused this view.

In the federal securities law area, a contrary view has been that an attorney can be a gatekeeper, because he or she owes an obligation to investors to maintain independence from the client and even divulge the client's information to the Commission under certain circumstances.[16]

It is beyond the scope of this article to pursue the question of whether, and to what extent, attorneys can be a gatekeepers. Suffice to say, the Commission has traditionally treated attorneys as gatekeepers.[17]

B. Other Protections for Inside Attorneys

In addition to being free of responsibility for incorrect legal advice in hindsight, inside attorneys have certain protections against Commission disciplinary action arising out of appearing or practicing before the Commission.

Acting Other Than as an Attorney. The Commission has not sanctioned inside attorneys when they are not acting as attorneys providing legal advice. Under the Commission's rules, the definition of "appearing and practicing before the Commission" does *not* include conducting activities outside the context of providing legal services.[18]

No Obligation To Act in Best Interests of Company. An attorney appearing and practicing before the Commission must treat the entity, and not management, as the client.[19] However, an inside attorney, in representing the company, is not necessarily obligated to act in the *best interests* of the company.[20]

No Obligation To Act in Best Interests of Shareholders. An inside attorney, in representing the company, is not obligated to act in the best interests of the company's shareholders. The Commission bases its position on court decisions.[21]

Immunity from Private Rights of Action. Because an inside attorney has no obligation to act in the best interests of shareholders, shareholders do not have a private right of action against an inside attorney. Indeed, the Commission's rules expressly provide that its attorney conduct rules do not create a private right of action.[22]

Relying on Outside Legal Advice. The Commission, as a matter of administrative practice, has not sanctioned inside attorneys who rely on advice of outside attorneys. Commentators who have surveyed Commission actions against inside attorneys have concluded that those who relied on outside attorney advice are seldom Commission targets.[23]

The principal thrust of this article concerns inside attorneys[24] at asset management companies such as mutual fund sponsors, investment advisers, broker-dealers, and life insurance companies. However, there is little precedent and authority specifically related to the Commission's disciplining of inside attorneys in the absence of scienter,[25] much less in the context of mutual fund shares[26] and variable insurance products. Consequently, this article extrapolates from precedents and authorities involving outside, rather than inside, attorneys and in such contexts as Commission investigations and enforcement actions, rather than discharging typical responsibilities. The author recognizes that his extrapolation and other aspects of this article may be more in the nature of proposing a thesis than reporting and analyzing specific Commission precedent and authority.

II. Developments Creating Uncertainty for SEC's Traditional Approach

Despite the Commission's long-standing hands-off stance, the subject of inside attorney liability arises due to developments that have created uncertainties about the Commission's continuation of its traditional approach.

These developments include *changes* in the law, the Commission's view of negligence, and the

Commission's enforcement stance as articulated by Chair Mary Jo White.

A. Congressional Concern

In the wake of the corporate scandals involving Enron Corporation, Arthur Andersen LLP, WorldCom, and others in the early 2000s, Congress adopted the Sarbanes-Oxley Act.[27] The Act reflected the concern of Congress that some attorneys were not fulfilling their role as gatekeepers.

The Sarbanes-Oxley Act expanded the Commission's authority over attorneys appearing and practicing before it,[28] in two ways:

- confirmed the Commission's authority to discipline attorneys for professional misconduct,[29] and
- mandated the Commission to adopt minimum standards of professional conduct for attorneys.[30]

Pursuant to that Congressional mandate, the Commission adopted[31] "Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer."

Prior to that time, the Commission had relied principally on Rule 102(e) of its Rules of Practice to protect the Commission's regulatory processes from inappropriate conduct by attorneys. The attorney conduct rules included a definition of the term "appearing and practicing" before the Commission that was "based upon Rule 102(f)."[32] However, the attorney conduct rules, as authorized by Congress under the Sarbanes-Oxley Act, significantly enhanced the Commission's authority to address attorney misconduct.[33]

B. Negligence as Basis for Discipline

As noted above, the Commission has refrained from disciplining an attorney where there was a lack of "intent" to engage in wrongful conduct, that is, where the attorney acted in "good faith" and "merely made errors of judgment or have [sic] been *careless*."[34] As the Commission itself has said: "As far as we are aware, we have not sanctioned attorneys in litigated enforcement proceedings based on alleged *negligent* acts or omissions they may have committed in providing non-public legal advice to clients."[35]

However, there is reason to believe[36] that the Commission could discipline an attorney for negligent conduct.

To begin with, the Commission has adopted rules providing that *accountants*, in their role as gatekeepers, can be disciplined for "negligent conduct."[37] Although the Commission has distinguished between the gatekeeper roles of accountants and attorneys, the potential is there for the Commission to extend its codified negligence standard to attorneys.[38]

Indeed, the Commission *Staff* has recommended that the Commission discipline an inside attorney for negligent conduct.[39] And in response, the Commission said that "such a claim potentially warrants our consideration.[40] Indeed, Chair White has said, albeit not in the specific context of attorneys, that the Commission would pursue negligent conduct.[41]

C. Chair White's Enforcement Principles

Chair White[42] joined the Commission as Chair on April 10, 2013,[43] after serving as both a federal prosecutor[44] and private practitioner.[45] It is, therefore, not surprising that Chair White considers the Commission's "enforcement program" to be "a key priority"[46] for her.

She conceptualizes the Commission as a "strong" "cop,"[47] using the words, "robust," "strong," and "effective" to describe her enforcement approach.[48] She titled one of her speeches in terms of battle, *viz*, "Deploying the Full Enforcement Arsenal."[49]

She has articulated what she calls her "enforcement principles,"[50] which, as she has made clear, differ in certain ways from her predecessors. In some respects, the difference is a matter of emphasis, but in other respects, the difference is a matter of substance. She, herself, has referred to a "*subtle shift*"[51] of at least one enforcement priority.

Chair White has indicated that her enforcement principles constitute "important issues" for "inside"

attorneys[52] and apply to, among others, what she calls "delinquent gatekeepers."[53] Aiming her statements at least indirectly at "gatekeepers," she wants the SEC to be feared by wrongdoers;[54] be everywhere;[55] look at investment advisers and mutual funds;[56] pursue small as well as large violations;[57] pursue individuals as well as entities;[58] pursue negligent as well as willful violations;[59] require admissions;[60] send a deterrent message;[61] work with other regulators;[62] leverage technology;[63] and depend on whistleblowers.[64]

Chair White has gone further and made statements bearing directly on "gatekeeper" liability, stating that the SEC is focusing on gatekeepers[65] and expects gatekeepers to meet certain standards.[66] Recent statements by a Commissioner[67] and a former Director of the Commission's Division of Enforcement[68] confirm that the Commission continues to view attorneys as gatekeepers.

III. SEC Disciplinary Authority over Attorneys

The Commission exercises authority over attorneys who appear and practice before it. The Commission's rationale is that appearing or practicing before it is a *privilege*, rather than a right. Rule 102(e)(1) sets out this rationale in referring to "the privilege of appearing or practicing before it."

Commission rules provide for disciplining attorneys appearing or practicing before it, as discussed below.

Penalties that the Commission can impose on an attorney include:

- censure,
- temporary suspension from appearing or practicing before the Commission, or
- permanent suspension from appearing or practicing before the Commission,[69] which would amount to disbarment.

The consequences for an attorney suspended from appearing or practicing before the Commission is that he or she "may not perform many acts that non-lawyers, who have never been authorized to 'practice' before it can, and frequently do, perform."[70]

The Commission may impose any such penalty only after making a finding "after notice and opportunity for hearing in the matter."[71]

A. Federal Securities Laws

The Commission may impose penalties on an attorney who the Commission has found:

- "[n]ot to possess the requisite qualifications to represent others,"[72]
- "[t]o be lacking in character or integrity,"[73]
- "to have engaged in unethical or improper conduct,"[74]
- "[t]o have willfully violated … any provision of the Federal securities laws or the rules and regulations thereunder,"[75] or
- "[t]o have willfully … aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder."[76]

The Commission has brought cease-and-desist proceedings against inside attorneys.[77]

B. Attorney Conduct Rules

In addition to the foregoing, the Commission may impose penalties on an attorney for a "violation" of the professional conduct standards.[78]

The penalties that the Commission can impose on an attorney are "the civil penalties and remedies for a violation of the federal securities laws available to the Commission in an action brought by the Commission thereunder."[79]

The Commission may impose any penalty after "[a]n administrative disciplinary proceeding initiated by the Commission for violation" of the attorney conduct standards.[80]

The Commission's rules provide, regarding state professionalism laws, that an attorney:

- "is subject to the disciplinary authority of the Commission, regardless of whether the attorney may also be subject to discipline for the same conduct in a jurisdiction where the attorney is admitted or practices,"[81] or
- "who complies in good faith with the provisions of this part [*i.e.*, Rule 205] shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices."[82]

C. Attorneys Subject to SEC Attorney Conduct Rules

The Commission has said that the coverage of its attorney conduct rules is "broad"[83] and, consistent with the Congressional mandate in the Sarbanes-Oxley Act, covers attorneys appearing and practicing before the Commission "in any way"[84] in the representation of companies.

Subordinate Attorney. A subordinate attorney is "[a]n attorney who appears and practices before the Commission in the representation of an issuer on a matter under the supervision or direction of another attorney (other than under the direct supervision or direction of the issuer's chief legal officer (or the equivalent thereof))."[85]

The Commission's rules require a subordinate attorney to comply with the attorney conduct rules "notwithstanding that the subordinate attorney acted at the direction of or under the supervision of another person."[86]

Supervisory Attorney.[87] The Commission deems a "supervisory attorney" to be practicing and appearing before it, if the attorney supervises a subordinate attorney appearing or practicing before the Commission.

The Commission's rules define a "supervisory attorney" as "[a]n attorney supervising and directing another attorney who is appearing and practicing before the Commission in the representation of an issuer."[88] The Commission's rules further provide that "[t]o the extent a subordinate attorney appears and practices before the Commission in the representation of an issuer, that subordinate attorney's supervisory attorneys also appear and practice before the Commission."[89]

The Commission has explained as follows:

- "only a senior attorney who actually directs or supervises the actions of a subordinate attorney appearing and practicing before the Commission is a supervisory attorney under the rule";[90]
- "[a] senior attorney who supervises or directs a subordinate on other matters unrelated to the subordinate's appearing and practicing before the Commission would not be a supervisory attorney";[91] and
- "[c]onversely, an attorney who typically does not exercise authority over a subordinate attorney but who does direct the subordinate attorney in the specific matter involving the subordinate's appearance and practice before the Commission is a supervisory attorney."[92]

A supervisory attorney has an obligation to help ensure that the subordinate attorney complies with the Commission's attorney conduct rules. The Commission's rules require a supervisory attorney to "make reasonable efforts to ensure that a subordinate attorney … that he or she supervises or directs conforms"[93] to the attorney conduct rules. A former Commission General Counsel has said that "[i]n-house lawyers may also face legal sanctions for the actions of those they supervise."[94]

Chief Legal Officer. A company's chief legal officer is a supervisory attorney deemed to be appearing or practicing before the Commission. The Commission's rules provide that a company's "chief legal officer (or the equivalent thereof) is a supervisory attorney."[95] The chief legal officer is said to be the usual Commission target.[96]

Non-Law Department Attorney. Any inside attorney can be deemed to be appearing or practicing before the Commission regardless of where the attorney works in a company. The Commission

has said that "attorneys need not serve in the legal department of an issuer to be covered" by the attorney conduct rules.[97]

D. SEC Definition of Appearing and Practicing Before It

The Commission's disciplinary authority over an attorney arises when the attorney appears or practices before the Commission. The SEC has adopted two overlapping definitions in Rules 102(f) and 205.2(a). The definitions have a broad reach.[98]

The two definitions are not entirely congruent. Rule 102(f) defines "practice," but not "appearance." Rule 205.2(a) defines "appearing and practicing" in conjunction. Taken together, the two rules give rise to some technical uncertainties, but the SEC's intention to cast a wide net is clear.

E. SEC Designation of Attorney's Client

Inside attorneys are subject to various pressures to satisfy the desires of management rather than needs of the entity.

However, attorneys appearing and practicing before the Commission must treat the entity, and not management, as the client.[99]

IV. Disclosure Responsibilities of Inside Attorneys

A prime area where inside attorneys have gatekeeper liability is disclosure under the Securities Act of 1933 (1933 Act).

The federal courts have recognized the attorney's role in achieving the goals of the Commission's disclosure requirements.[100]

One commentator has said that "*[d]isclosures, particularly omissions in disclosures, are usually the problem*."[101]

A. Conduct Subject to SEC Rules

The Commission's definition of "appearing and practicing before the Commission" broadly covers conduct regarding *disclosure*.

The Commission has adopted two definitions involving disclosure,[102] one somewhat broader than the other.[103] But the two Commission rules, taken together, provide that "appearing or practicing before the Commission" includes an inside attorney who:

- prepares, advises on the preparation of, consents to the delivery to the Commission of, has notice of delivery to the Commission, or advises whether delivery to the Commission is required, with respect to
- any document, paper, statement, information, or other writing
- that is filed with, or submitted to, the Commission or incorporated into a document filed with, or submitted to, the Commission.

B. Application of SEC Rules

Inside attorneys typically have responsibilities regarding disclosure, particularly disclosure in prospectuses and statements of additional information used in the distribution of mutual fund shares and variable insurance products. Inside attorneys also have responsibilities for disclosure in various forms and reports filed with the Commission.

Obviously, the Commission would deem an inside attorney who drafts disclosure, to be appearing or practicing before the Commission.

The Commission has disciplined inside attorneys for operating companies who omitted material disclosure. In one case, the Commission disciplined an inside attorney who was "substantially involved in preparing, reading, reviewing and approving [the issuer's] prospectus supplement" that was "materially false and misleading" in omitting disclosure that the issuer "engaged in an unsustainable strategy to improve [the issuer's] earnings by deliberately exploiting a loophole in Medicare's reimbursement system."[104] The attorney was general counsel, as well as executive vice president and chief compliance officer of the issuer. The Commission suspended the attorney from appearing or practicing before the Commission as an attorney, pursuant to Rule 102(e).

But there are some less obvious situations, such as those noted below.

Responding to SEC Staff Comments. The Commission Staff often provides an issuer with oral or written comments and requests that the issuer respond in writing. Take the situation where an inside attorney prepares a written response that the attorney, in accordance with Commission procedures, *submits*, rather than *files*, with the Commission.

As noted above, one Commission rule defines "appearing or practicing before the Commission" solely in terms of specified documents *filed* with the Commission. However, the definition in the second rule includes the *submission*, as well as the filing, of "any document" with the Commission.

It follows that the Commission likely would deem the inside attorney *submitting* the written response to be "appearing or practicing before the Commission," even though the attorney is not *filing* the response.

Advising Disclosure Not Required. Take the situation where an inside attorney does not prepare a post-effective amendment, but advises that the federal securities laws and rules thereunder do not require some particular disclosure to be included in the amendment or some document to be filed as an exhibit.

As noted above, the Commission's rules define "appearing or practicing before the Commission" to include "[a]dvising an issuer as to whether information or a statement is required" to be filed with, or submitted to, the Commission."[105]

It follows that the Commission likely would deem the inside attorney so advising to be "appearing or practicing before the Commission," even though the attorney did not prepare, or participate in the preparation of, the amendment.

V. Opinion Responsibilities of Inside Attorneys

A second area where inside attorneys have gatekeeper liability is legal opinions under the 1933 Act. For example, inside lawyers at life insurance companies may give opinions on the status of insurance products as securities under that Act. The federal courts have recognized an attorney's role in rendering opinions.[106]

A. Conduct Subject to SEC Rules

The Commission's definition of "appearing and practicing before the Commission" broadly covers conduct regarding *opinions.*

The Commission has adopted two definitions[107] involving opinions, one somewhat broader than the other.[108] The two Commission rules, taken together, provide that "appearing or practicing before the Commission" includes an attorney who:

- prepares, or advises whether delivery to the Commission is required with respect to
- any opinion
- that is filed with, or submitted to, the Commission or incorporated into a document filed with, or submitted to, the Commission.

B. Application of SEC Rules

Responding to SEC Staff Request for Opinion. Take the following situation. A life insurance company files a post-effective amendment to a registration statement for a variable annuity adding an indexed investment option, and the Commission Staff requests[109] a representation and analysis or a legal opinion that the option is eligible to be treated as an exempt security described under Section 3(a)(8) of the 1933 Act, pursuant to the so-called Harkin Amendment under the Dodd-Frank Wall Street Reform and Consumer Protection Act.[110] An attorney, who did *not* prepare the amendment, drafts such a representation and analysis or legal opinion that is submitted to the Commission Staff.

As noted above, the Commission's rules define "appearing or practicing before the Commission" to include preparing any opinion submitted to the Commission.

It follows that the Commission likely would deem an attorney preparing the representation and analysis or legal opinion to be "appearing or practicing before the Commission," even though the attorney did not prepare the amendment.

Opining That Registration Statement for Product Offering Not Required. Take the

following situation. A life insurance company's actuaries and business people develop a fixed product with a transfer privilege that involves what could be deemed to be a market value adjustment feature. An inside attorney opines that the product is not a security and the issuer is not required to file a registration statement for the product with the Commission.

As noted above, Commission rules define "appearing or practicing before the Commission" to include providing advice "whether" information or a statement, opinion or other writing is required to be filed with the Commission.

The Commission has moved against inside attorneys for operating companies in connection with rendering legal opinions.

In one case, the Commission disciplined an inside attorney who "engaged in the unregistered offer and sale of securities," where "[n]o registration statement was in effect as to any of the securities being offered and sold" and the attorney "wrote or directed the writing of all of [the issuer's] offering memoranda."[111] The attorney was general counsel, as well as president, chief executive officer, and director of the issuer. The Commission imposed a temporary suspension pursuant to Rule 102(e), where a US District Court had entered a judgment against him permanently enjoining him from future violations of Section 5 of the 1933 Act.

In another case, the Commission disciplined inside attorneys who rendered "false and baseless attorney opinion letters," based on which company executives "distributed approximately 2.5 billion [issuer] shares in unregistered transactions," where the attorneys "made false or misleading statements in their attorney opinion letters to [the issuer's] transfer agents who then improperly removed the restrictive legends from [the issuer's] shares."[112] The Commission sought temporary and permanent injunctions enjoining the attorneys from "violating Sections 5(a), 5(c), and 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5."[113]

VI. Compliance Responsibilities of Inside Attorneys

A third area where inside attorneys have gatekeeper liability is overseeing compliance with legal requirements, particularly under the 1940 Act.

One commentator has noted[114] how inside attorneys are being pressured into participating in compliance.

A. Conduct Subject to SEC Rules

Rules 102(f) and 205.2(a) focus on information, documents, statements, opinions and other writings to be filed with or submitted to the Commission or incorporated in any such writing. Therefore, these Rules do not apply to compliance with the Commission's substantive requirements per se.

The Commission, of course, can take action against attorneys under provisions of the federal securities laws, such as Section 9(f) of the 1940 Act.[115] For further example, the Commission can hold an attorney liable as an "aider and abettor" of a violation by a corporate client.

B. Application of SEC Requirements

Rule 22c-1. There has been at least one case where the Commission has considered disciplining an inside attorney for conduct in connection with the 1940 Act, namely, Rule 22c-1 under the Act regarding the time at which a mutual fund share purchase order would be priced.

The Commission brought an administrative proceeding[116] against an inside attorney serving as general counsel for a broker-dealer and its parent. The attorney had negotiated agreements allowing his company's institutional customers to confirm, cancel, or revise 12,000 mutual fund share trades after 4:00 p.m., the time at or as of which the relevant mutual funds calculated their net asset value (NAV) after that day's fund trading, in violation of Rule 22c-1.

The Commission ultimately considered,[117] but rejected, the Staff's position that the attorney was a cause of the violations "based on acts or omissions

that he knew or should have known would contribute to those violations."[118] The Commission concluded that "the record before us does not establish by a preponderance of the evidence that [the attorney] was negligent."[119]

Rule 12b-1. Looking ahead, another area that involves distribution and where the Commission could monitor the conduct of inside attorneys concerns Rule 12b-1 under the 1940 Act, regarding such matters as revenue sharing.

Norm Champ, then Director of the Commission's Division of Investment Management, has referred to OCIE's "nationwide initiative to review distribution fees and practices."[120] Director Champ didn't give any detail on the initiative, but the Commission's report to Congress on its strategic plan for fiscal years 2010 – 2015 states that the Commission intends to "address investment company distribution fees."[121]

The Commission proposed[122] a rule in this area, but has not publicly acted on it.

VII. Conclusion

The Commission's traditional position has been not to discipline attorneys who provide, in good faith, reasonable legal advice that in hindsight turns out to be wrong. In addition, the Commission has followed certain practices that further protect attorneys against Commission disciplinary action.

It follows that the Commission is not likely to go out of its way to discipline inside attorneys of asset management companies such as mutual fund sponsors, investment advisers, broker-dealers, and life insurance companies in connection with their discharge of typical responsibilities, as distinguished from willful violation of the federal securities laws, regarding such matters as prospectus disclosure, legal opinions, and compliance with the federal securities laws, such as forward pricing requirements.

However, there have been developments that suggest that the Commission may be inclined to depart from its traditional position and discipline inside lawyers for breach of their gatekeeper responsibilities. These developments include *changes* in the law, the Commission's view of negligence, and the Commission's enforcement stance as articulated by Chair Mary Jo White.

Gary O. Cohen is of counsel at the Washington, D.C. office of Carlton Fields Jorden Burt P.A. He is on the editorial board of *The Investment Lawyer* and has regularly published articles in the publication over the past 16 years. He is a former SEC Staff official in the Division of Investment Management. He thanks his colleagues, Michael C. Kentoff and Edmund J. Zaharewicz for reviewing and making contributions to the article. The views expressed in the article are those of Mr. Cohen and do not necessarily reflect the views of his law firm, its clients, or the author's colleagues.

NOTES

1 The Commission has two principal rules: first, Rule 102 under the Commission's Rules of Practice [hereinafter *Rule 102*], *see Amendment to Rule 102(e) of the Commission's Rules of Practice*, Securities Act Rel. No. 7593, Exchange Act Rel. No. 40567, Investment Advisers Act Rel. No. 1771, and Investment Company Act Rel. No. 23489 (Oct. 19, 1998, modified Oct. 20, 1998) (amendments relating to accountants, not attorneys), available at *http://sec.gov/rules/final/33-7593.htm* [hereinafter *SEC Rel. No. 33-7593*], and *Rules of Practice*, Exchange Act Rel. No. 35833 (June 23, 1995) (comprehensive revision of Rules of Practice), available at *http://sec.gov/fnal/34-35833.htm*, and, second, Rule 205.2 and related rules under the Commission's Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer [hereinafter *Rule 205.2*], *see Implementation of Standards of Professional Conduct for Attorneys*, Securities Act Rel. No. 8185, Exchange Act Rel. No. 47,276, and Investment Company Act Rel. No. 25,919 (Jan. 29, 2003), available at *http://sec.gov/rules/final/33-8185.htm* [hereinafter *SEC Rel. No. 33-8185*].

In addition, the Commission has authority under Section 4C of the Securities Exchange Act of 1934 to censure any person or deny to any person the privilege of appearing or practicing before the Commission in language substantively similar to that of Rules 102 and 205.2. Congress added the authority in the Sarbanes-Oxley Act, as noted *infra* n.29 and accompanying text. Generally speaking, however, most of the discussion of attorney gatekeeper liability has been in terms of the Commission's Rules 102 and 205.2. Consequently, this article focuses on these Rules rather than Section 4C. For Commission denial of an inside attorney's privilege of appearing or practicing before the Commission, under *both* Rule 102(e) and Section 4(C), *see In Re Alpha Titans, LLC*, Exchange Act Rel. No. 74828, Inestment Advisers Act Rel. No. 4073, Investment Company Act Rel. No. 31586 (Apr. 29, 2015) (involving an attorney's wilfull aiding and abetting and causing violations by others of federal securities laws).

2 This article does not address related matters such as American Bar Association Model Rules of Professional Conduct, state legal requirements for attorneys, and federal sentencing guidelines (which embody the concept that inside attorneys should be held to a higher standard of conduct than other company managers).

3 As a former Commission General Counsel has stated, "[b]ecause attorneys play an active role in many securities market transactions, the SEC has long considered it critical to ensure their compliance as "*gatekeepers*." Giovanni P. Prezioso and Steven A. Haidar, "General Counsels in the Cross-Hairs: Personal Responsibilities and Enforcement Risks," SIFMA Compliance & Legal Society 2011 Annual Seminar, General Counsels' Roundtable—Global Firms (March 2011) [hereinafter *Prezioso Outline*]. The concept of attorney as gatekeeper is addressed *infra* ns.13-17, 52-53 and 65-68, and accompanying text.

4 In disciplining attorneys, the Commission has been caught between two competing considerations. As a Commission General Counsel has explained:

> *Two competing policy considerations* have driven this debate. On the one hand, the Commission has long recognized that many securities law violations *could not occur without the participation of lawyers*—who have professional responsibilities and knowledge that can often prevent misconduct harmful to investors. On the other hand, many lawyers—and the Commission itself—have identified the importance of *zealous advocacy* in securities law matters, and have thus resisted policies that might chill lawyers' capacity to advance that objective.

Giovanni P. Prezioso, SEC General Counsel, Remarks Before the Spring Meeting of the Association of General Counsel (Apr. 28, 2005) (emphasis added), available at *http://www.sec.gov/news/speech/spch042805gpp.htm* [hereinafter *Prezioso Speech*].

5 "For over thirty years now, there has been an ongoing debate about whether and when the Commission should use its powers to sanction lawyers. The debate has generally been framed in terms of *lawyers' role as 'gatekeepers.'" Id.* (emphasis added).

6 The Commission has said, as follows:

> The Commission adopted Rule 102(e) as a "means to ensure that those professionals, on whom the Commission relies heavily in the performance of its statutory duties, perform their tasks diligently and with a reasonable degree of competence." Courts have recognized that it is appropriate for the Commission to use a remedial rule such as Rule 102(e) to encourage professionals to adhere to professional standards and minimum standards of competence when they practice before the Commission. In adopting the rule, the Commission did not intend to add an "additional weapon" to its "enforcement arsenal," but to protect the integrity and quality of its system of securities regulation and, by extension, the interests of the investing public.

SEC Rel. No. 7593, *supra* n.1.

7 Congress mandated the Commission to adopt minimum standards of professional conduct in the Sarbanes-Oxley Act, as noted *infra* n.30 and accompanying text. Theretofore, the Commission had

relied exclusively on Rule 102, although the Rule had been challenged, in some quarters, on the ground that the Commission did not have authority to adopt it. The Sarbanes-Oxley Act, in effect, confirmed the Commission's authority to adopt Rule 102, as noted *infra* n.29 and accompanying text.

[8] One Commission General Counsel has stated that he generally would not recommend Commission disciplinary proceedings against attorneys appearing as advocates because such proceedings "could have a serious chilling effect on zealous representation and be a harbinger of prosecutorial abuse." Edward F. Greene, "Lawyer Disciplinary Proceedings Before the Securities and Exchange Commission," Remarks to the New York County Lawyers Association (Jan. 13, 1982), 14 *Sec. Reg. &L. Rep. (BNA)* 168 (Jan. 20, 1982) (speaking in the context of Rule 102(e)).

[9] This article does not focus on willful illegal conduct such as insider trading, backdating stock options, wire fraud, making false statements, falsifying or concealing documents, perjury, and obstructing Commission investigations. Such conduct is distinguishable from that addressed in this article. As a Commission General Counsel has stated:

> One central and recurring point, however, and one that I would like to focus on, is that the debate about lawyers as "*gatekeepers*" needs to be disentangled from consideration of the potential liability of lawyers as "*principals*." Put another way, while the two problems sometimes overlap in important ways, the Commission's approach to sanctioning lawyers who violate *professional standards of conduct* raises questions quite distinct from its approach to sanctioning lawyers for participating in *securities law violations*.

Prezioso Speech, *supra* n.4 (emphasis in original).

[10] The Commission's key statement of its traditional approach is as follows:

> If a securities lawyer is to bring his best independent judgment to bear on a … problem, he must have the freedom to make *innocent* - or even, in certain cases, *careless* - mistakes without fear of legal liability or loss of the ability to practice before the Commission. Concern about his own liability may alter the balance of his judgment in one direction as surely as an unseemly obeisance to the wishes of his client can do so in the other. … Lawyers who are seen by their clients as being motivated by fears for their personal liability will not be consulted on difficult issues.

In Re William R. Carter & Charles J. Johnson, Jr., Exchange Act Rel. No. 17597 (Feb. 28, 1981), 22 SEC Docket 292 (order dismissing proceedings) (emphasis added).

[11] The Commission reaffirmed its traditional approach in a subsequent case under the Investment Company Act of 1940, as follows:

> Over twenty-five years ago, in William R. Carter, we recognized particular concerns attendant to disciplining lawyers based on faulty legal advice and noted *a distinction between actions with scienter and those without scienter.* We held that, to sanction a lawyer pursuant to former Rule of Practice 2(e) [now, Rule 102(e)] for having aided and abetted a securities law violation, the Commission had to show "that respondents were aware or knew that their role was part of an activity that was improper or illegal." In confirming this "intent requirement" for aiding and abetting, we emphasized the "[s]ignificant public benefits [that] flow from the effective performance of the securities lawyer's role." We also recognized that, "[i]n the course of rendering securities law advice, the lawyer is called upon to make difficult judgments, often under great pressure and in areas where the legal signposts are far apart and only faintly discernible." We expressed concern that, to the extent lawyers exercising their professional judgment are excessively motivated by "fear of legal liability or loss of the ability to practice before the Commission," clients may well decide not to consult lawyers on difficult issues.

> Given these considerations, we eschewed a standard that would expose an attorney to professional discipline "merely because his advice, followed by the client, is *ultimately determined to be wrong*." The intent requirement, we said, is crucial to an allegation of wrongdoing by a lawyer because it "provides the basis for distinguishing between those professionals who may be appropriately considered as subjects of professional discipline and those who, *acting in good faith*, have merely *made errors of judgment or have been careless*."

In Re Scott G. Monson, Investment Company Act Rel. No. 28323 at 6 (June 30, 2008) (footnotes omitted; emphasis added), available at *https://www.sec.gov/litigation/opinions/2008/ic-28323.pdf* [hereinafter *SEC Monson Decision]*.

12 *See, e.g., infra* ns.118 and 119 and accompanying text.

13 Merriam Webster Dictionary Online.

14 John C. Coffee, Jr., "The Attorney as Gatekeeper: An Agenda for the SEC," Working Paper No. 221 (April 2003) (the author was Adolf A. Berle, Professor of Law, Columbia University Law School, and Director, Columbia Law School Center on Corporate Governance), available at *http://ssrn.com/abstract_id-395181* [hereinafter *Coffee Paper*].

15 *Id*. at 8.

16 A former Commissioner has espoused this school of thought as follows:

> I would suggest that 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 auditor than to that of the attorney. This means several things. It means that 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 that he will have to adopt the healthy skepticism toward the representation of management which a good auditor must adopt. It means that he will have to do the same thing the auditor does when confronted with an intransigent client—resign.

A.A. Sommer, Jr., 'The Emerging Responsibilities of the Securities Lawyer," Address to the Banking, Corporation & Business Law Section, N.Y. State Ass'n, (Jan. 24, 1974), quoted in Coffee Paper, *supra* n.14.

17 For further discussion of the Commission's treatment of attorneys as gatekeepers, *see infra* ns.52-53 and 65-67-8 and accompanying text.

18 Rule 205.2(a)(2), with emphasis added, defines "appearing and practicing before the Commission" to exclude "an attorney … who conducts the activities [defined to constitute appearing and practicing before the Commission] *other than in the context of providing legal services* to an issuer with whom the attorney has an attorney-client relationship."

Depending on the circumstances, the line could be difficult to draw. A former Commission General Counsel has explained the Commission's approach as follows:

> SEC staff has said that in cases involving a mixture of conduct and advice, the following factors may be relevant: (a) the extent to which the decision-making process depended on the lawyer, and in particular the extent to which the lawyer actually gave legal advice to management or made decisions on his or her own, (b) the nature of legal judgments and whether the decision was a close call, and (c) whether the activities occurred in the context of an investigation or enforcement proceeding or otherwise in direct representation of the client before the Commission.

Prezioso Outline, *supra* n.3, at 13 (footnote omitted).

19 Rule 205.3(a), with emphasis added, provides:

> An attorney appearing and practicing before the Commission in the representation of an issuer owes

his or her professional and ethical duties to the *issuer as an organization*. That the attorney may work with and advise the issuer's officers, directors, or employees in the course of representing the issuer does not make such individuals the attorney's clients.

[20] As originally proposed, the Commission's attorney conduct rules provided that an attorney "shall act in the best interest of the issuer." Proposed Rule: *Implementation of Standards of Professional Conduct for Attorneys*, Securities Act Rel. No. 8150 (Nov. 21, 2002), available at *http://www.sec.gov.rules/proposed/33-8150.htm* [hereinafter *SEC Rel. 33-8150*]. However, the Commission did not include that language in the rule as finally adopted, explaining as follows:

> [T]he Commission recognizes that it is the *client issuer, acting through its management, who chooses the objectives the lawyer must pursue, even when unwise*, so long as they are not illegal or unethical. However, we disagree with the comment to the extent it suggests counsel is never charged with acting in the best interests of the issuer. ABA Model Rule 1.13 provides that an attorney is obligated to act in the "best interests" of an issuer in circumstances contemplated by this rule: that is, when an individual associated with the organization is violating a legal duty, *and* the behavior "is likely to result in substantial injury" to the organization. In those situations, it is indeed appropriate for counsel to act in the best interests of the issuer by reporting up-the-ladder. However, the Commission appreciates that, with respect to corporate decisions traditionally reserved for management, *counsel is not obligated to act in the "best interests" of the issuer*. Thus, the reference in the proposed rule to the attorney having a duty to act in the best interests of the issuer has been deleted from the final rule.

SEC Rel. No. 33-8185, *supra* n.1, at footnote reference 69 (footnote omitted; emphasis added).

[21] As originally proposed, the Commission's attorney conduct rules provided that an attorney "shall act in the best interest of the issuer and its *shareholders*." *SEC Rel. 33-8150*, *supra* n.20, between footnote references 35 and 36 (emphasis added). However, the Commission did not include that language in the rule as finally adopted, explaining as follows:

> [T]he courts have recognized that *counsel to an issuer does not generally owe a legal obligation to the constituents of an issuer—including shareholders*. The Commission does not want the final rule to suggest it is creating a fiduciary duty to shareholders that does not currently exist. Accordingly, we have deleted from the final rule the reference to the attorney being obligated to act in the best interest of shareholders.

SEC Rel. No. 33-8185, *supra* n.1, at footnote reference 70 (footnote omitted; emphasis added).

[22] Rule 205.7, with emphasis added, provides:

> (a) Nothing in this part is intended to, or does, create a *private right of action* against any attorney, law firm, or issuer based upon compliance or non-compliance with its provisions.
> (b) Authority to enforce compliance with this part is *vested exclusively in the Commission*.

Arguably, the Commission would take the same position regarding owners of variable insurance products issued by a life insurance company. The Commission has taken the position that a life insurance company is the co-issuer, along with the company's separate account, of security interests under variable insurance products. Exchange Act Rel. 8389 (Aug. 29, 1968) (the Release refers to "the variable annuity interests of which it [*i.e.*, the life insurance company] and the Separate Account are co-issuers").

[23] For example, one commentator has said:

> The factor most noticeable by its absence is that very few SEC enforcement actions involve a defendant

> or respondent who relied upon the advice of an outside law firm. One could divine from this fact that inside lawyers who rely upon outside counsel rarely make mistakes. But we think it's more likely that the SEC judges [that] *enforcement actions are unlikely to succeed when inside counsel followed the advice of an outside law firm*. The inside lawyers' "advice of *outside* counsel" defense must have a significant impact on the exercise of enforcement discretion.

John K. Villa, "Inside Counsel as Targets: Fact or Fiction?," ACC Docket 23, No. 10, at 104, 105 (Nov./Dec. 2005) (emphasis in original) [hereinafter *Villa Article*].

24 Certain precedents and authorities cited in this article involve *outside* attorneys, but provide information relevant to situations involving inside attorney conduct.

25 As two practitioners have noted:

> Although much has been written about the SEC's enforcement program, through which the SEC addresses violations of the federal securities laws, *much less attention* has been focused on the agency's attorney disciplinary program, through which the SEC polices its own forum.

Dixie L. Johnson and David D. Whipple, "Securities Enforcement, Zealous Advocacy and Offending the SEC: The SEC's Lawyer Discipline Program, Insights," the *Corporate & Securities Law Advisor*, Vol. 26, No. 10, at 1 (Oct. 2012) (emphasis added) [hereinafter *Dixie Johnson Article*].

26 There is at least one precedent related to mutual funds, as noted *infra* ns.116-119 and accompanying text.

27 *Supra* n.7.

28 As the Commission's General Counsel said:

> What has *changed*—and this may seem obvious—is the *law*. The Sarbanes-Oxley Act, as you all know, *significantly expanded* the Commission's authority to adopt professional standards governing lawyers.…

Prezioso Speech, *supra* n.4, between footnote references 18 and 19 (emphasis added).

29 Section 602 authorized the Commission to discipline attorneys for professional misconduct, using the language of the Commission's preexisting Rule 102(e), as follows:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found by the Commission, after notice and opportunity for hearing in the matter—
>
> (1) not to possess the requisite qualifications to represent others;
> (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or
> (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder.

30 Section 307 mandated that the Commission:

> shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule—
>
> (1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and
> (2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring

> the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

This article does not address the so-called "up-the-ladder" reporting requirements that the Sarbanes-Oxley Act mandated in paragraphs (1) and (2) quoted above.

[31] *SEC Rel. No. 33-8185*, *supra* n.1. The Commission's proposing release is cited *supra* n.20.

[32] *Id.,* between footnote references 7 and 8.

[33] The Commission reportedly (Richard M. Humes, "Remarks of an SEC Associate General Counsel," 57 *Case W. Res. L. Rev.* 341, 345 (2007)) has handled attorney conduct through two different groups. The Division of Enforcement pursues violations of the federal securities laws, including violations by attorneys. A unit of the Office of General Counsel pursues attorney misconduct under Rule 102(e). The Commission's general practice, applicable to outside as well as inside attorneys, has been to institute attorney disciplinary proceedings *after* a state or federal court, or a state bar tribunal, has determined bad conduct by the attorney. As two prominent practitioners have explained:

> Most frequently, the SEC has instituted improper professional conduct proceedings under Rule 102(e) after another authority has imposed sanctions. Its historical deference to other tribunals rested on the notion that, to avoid the risk or appearance of using government powers to quash zealous advocacy, an independent tribunal should decide that the attorney acted improperly before the SEC itself acts.

Dixie Johnson Article, *supra* n.25, at 2.

[34] *SEC Monson Decision*, *supra* n.11, at 6 (June 30, 2008). This article discusses the case further *infra* Part VI.

[35] *Id.* at 8 (emphasis added).

[36] *See generally* Mary P. Hansen and William L. Carr, "The Future of SEC Enforcement Actions: Negligence-Based Charges Brought in Administrative Proceedings?", *The Investment Lawyer*, Vol. 21, No. 9, at 1 (Sept. 2014) [hereinafter *Hansen Article*].

[37] Rule 102(e)(1)(iv)(B) refers to "neglient conduct," defined as "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted" and "[r]epeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards that indicate a lack of competence to practice before the Commission."

[38] A prominent law school professor has discussed the potential as follows:

> Few norms are less controversial among securities attorneys than that they should perform some due diligence in preparing prospectuses or other disclosure documents. Yet, no SEC rule actually requires this. Thus, a logical first step would be for the *SEC's Rules of Practice to mandate due diligence* by the attorney (within the time realistically available to the attorney) in the preparation of disclosure documents. Indeed, such an obligation sounds very much like a "minimum standard of professional conduct" that Section 307 authorizes. Why? Because it is semantically impossible to assert that an attorney who has behaved in a grossly *negligent* fashion has behaved "professionally." Interestingly, in its existing Rules of Practice, the SEC already holds auditors to precisely such a standard and asserts the power to suspend or disbar them for merely negligent conduct. If this can be done, then it seems to follow *a fortiori* after the enactment of Section 307, that the *SEC could require attorneys to take reasonable steps to investigate the accuracy of statements* made in documents that they prepare.[38]

Coffee Paper, *supra* n.14, at 27-28 (emphasis added). *See infra* n.100 regarding a federal court's view in this regard.

39 The Commission has summarized the Staff's view as follows:

> As the case has come to us on appeal, the Division [of Investment Management] contends that [the inside attorney] caused the issuer's violations because he *negligently* departed from the standard of care for attorneys by failing to "ascertain whether the [A]greement, as used and to be used, would comply with … applicable laws and regulations governing his highly regarded client."

SEC Monson Decision, *supra* n.11 (emphasis added). The Commission Staff argued that the Commission should discipline the attorney because he was "negligent in failing to 'spot the issue' that Rule 22c-1 could be implicated." *Id*.

40 The Commission explained as follows:

> Irrespective of the Commission's record in litigating enforcement actions against lawyers for *negligent*, non-public legal advice, the Commission might assert a scienter-based charge against a lawyer for conduct related to legal advice when the facts appear to support such a charge, and then, based on many different factors including its discretion, accept a settlement with the lawyer that alleges *only a negligence-based violation*.

Id. at 9 n. 26 (emphasis added).

41 *See infra* n.59. Indeed, the Commission, in recent years, has used non-scienter-based charges in Commission actions. *See generally Hansen Article*, *supra* n.36.

42 Chair White's biographical information in the text and endnotes is paraphrased from the Commission's website at *http://www.sec.gov/about/commissioner/white.htm#.VCWX9_ldVwQ*.

43 Chair White was sworn in as the 31st Chair of the Commission on April 10, 2013. She was nominated to be Commission Chair by President Barack Obama on Feb. 7, 2013, and confirmed by the US Senate on April 8, 2013.

44 Chair White served as the US Attorney for the Southern District of New York from 1993 to 2002, specializing in prosecuting complex securities and financial institution frauds and international terrorism cases. She is the only woman to hold that position in the 200-year-plus history of the office. Prior thereto, she served as the First Assistant US Attorney and later Acting US Attorney for the Eastern District of New York from 1990 to 1993. She previously served as an Assistant US Attorney for the Southern District of New York from 1978 to 1981, becoming Chief Appellate Attorney of the Criminal Division.

45 After serving as US Attorney, Chair White became chair of the 200-lawyer litigation department at Debevoise & Plimpton in New York City. She had been a litigation partner at the firm from 1983 to 1990 and worked there as an associate from 1976 to 1978.

Chair White has an undergraduate degree from William & Mary (1970, Phi Beta Kappa) and a master's degree in psychology from The New School for Social Research (1971). She has a law degree from Columbia Law School (1974), where she was an officer of the Law Review. She served as a law clerk to the Honorable Marvin E. Frankel of the US District Court for the Southern District of New York.

46 Mary Jo White, SEC Chair, Remarks at the Council of Institutional Investors Fall Conference 3 (Sept. 26, 2013), available at *http://www.sec.gov/News/Speech/Detail/Speech/1370539841202* [hereinafter *White's Council Speech*].

47 *Id*.

48 *Id*.

49 *Id*. at 1.

50 *Id*. at 3.

51 *Id*. at 9 (emphasis added).

52 Chair White said:

> The website posting for this event says I am talking about "the most important issues" that you as *inside* and outside counsel will face.

Mary Jo White, SEC Chair, Remarks at the Securities Enforcement Forum 1 (Oct. 9, 2013) (emphasis added) [hereinafter *White's Forum Speech*].

[53] *Id*. at 7. Chair White also has referred to "deficient" gatekeepers. *Id*. at 4.

[54] Chair White has said:

> Striving to be "everywhere" is finding a way to have a presence that exceeds our physical footprint and to be felt and *feared* in more areas than market participants would normally expect that our resources would allow.

Id. at 4 (emphasis added).

Chair White also has said:

> It is important that [the Commission "strive to be everywhere"] because investors in our markets want to know that there is a *strong cop on the beat*—not just someone sitting in the station house waiting for a call, but patrolling the streets and checking on things.
>
> They want to know that would-be fraudsters are spending more time *looking over their shoulders*, and less time stepping over the line.

Id. at 1-2 (emphasis added).

[55] Chair White has said:

> [W]e *need to have a presence everywhere* and *be perceived to be everywhere* bringing enforcement actions against violators in every market participant category and in every market strata.

White's Council Speech, *supra* n.46, at 9 (emphasis added).

She later affirmed this, as follows:

> One of our goals is to *see* that the SEC's enforcement program is—and is perceived to be—*everywhere*, pursuing all types of violations of our federal securities laws, big and small.

White's Forum Speech, *supra* n.52, at 1 (emphasis added).

[56] Chair White has said:

> We need to continue to direct our attention to protecting investors from misconduct by *investment advisers* at hedge funds, private equity funds, and *mutual funds*.[56]

White's Council Speech, *supra* n.46, at 9 (emphasis added).

[57] Chair White has said:

> [W]e should neither shrink from bringing the tough cases, *nor fail to bring the smaller ones*.

Id. at 4 (emphasis added).

Chair White has explained that this so-called broken windows enforcement "approach is not unlike the one taken in the nineties by then New York City Mayor Rudy Giuliani and Police Commissioner Bill Bratton," as follows:

> They essentially declared that *no infraction was too small* to be uncovered and punished. And, so the NYPD pursued infractions of law at every level—from street corner squeegee men to graffiti artists to subway turnstile jumpers to the biggest crimes in the city. The strategy was simple. They wanted to avoid an environment of disorder that would encourage more serious crimes to flourish. They wanted to send a message of law and order.

White's Forum Speech, *supra* n.52, at 2 (emphasis added).

[58] Chair White has said that, as a "core principle," she will "pursue responsible *individuals* wherever possible," because "[r]edress for wrongdoing must never be seen as 'a cost of doing business' made good by cutting a corporate check."
White's Council Speech, *supra* n.46, at 8 (emphasis added).

Chair White has explained as follows:

> I have made it clear that the *staff should look hard to see* whether a case against individuals can be

> brought. I want to be sure we are looking first at the individual conduct and working out to the entity, rather than starting with the entity as a whole and working in. It is a subtle shift, but one that could bring more individuals into enforcement cases.

Id. at 9 (emphasis added).

59 *White's Forum Speech*, *supra* n.52, at 2 (emphasis added). Chair White has said:

> If we do not have the evidence to bring a case charging intentional wrongdoing, then *bring the negligence case that does not require intent.*
>
> Elsewhere, she has said that the Commission will "pursue all types of wrongdoing":
>
> Not just the biggest frauds, but also violations such as control failures, *negligence-based offenses*, and even violations of prophylactic rules with *no intent requirement* . . . .

White's Forum Speech, *supra* n.52, at 3 (emphasis added). The subject of negligence as a basis for the Commission's disciplining of attorneys is addressed *infra* Part VI.

60 In a change from tradition, Chair White has said that the Commission will require admissions in appropriate cases other than where there is a parallel criminal case, as follows:

> [N]o-admit-no-deny settlements are a very important tool in our enforcement arsenal that we will continue to use when we believe it is in [sic] public interest to do so. In other cases, *we will be requiring admissions*.

White's Council Speech supra n.46, at 8 (emphasis added).

61 Chair White has said:

> And when we resolve cases, we need to be certain our settlements have teeth, and *send a strong message of deterrence*. That is why in each case, I have encouraged our enforcement teams to think hard about whether the remedies they are seeking would sufficiently redress the wrongdoing and *cause would-be future offenders to think twice*.

White's Forum Speech, *supra* n.52, at 4 (emphasis added).

62 Chair White has said that the Commission is collaborating with its regulatory colleagues, as follows:

> Of course, we are not alone in our enforcement effort. We collaborate continuously and effectively with our partners at the Department of Justice, FINRA, and the state securities regulators.

Id. at 6.

63 Chair White has said that the Commission is "leveraging technology," as follows:

> The technology we are using is assisting us in many areas. We are using data analytics and related technology to enable us to conduct predictive analysis and spot trends, streamline our investigative efforts and leverage new data sources.

Id. at 7.

64 Chair White has said that the Commission's whistleblower program is incentivizing individuals to step forward, as follows:

> [T]he SEC's whistleblower program allows us to give monetary rewards for valuable information about securities law violations. And, it has rapidly become a tremendously effective force-multiplier, generating high quality tips and, in some cases, virtual blueprints laying out an entire enterprise, directing us to the heart of an alleged fraud.

Id. at 5.

She added that "[t]he program also incentivizes companies to report misconduct before a whistleblower comes to us first." *Id.*

65 Chair White has said:

> [W]e are focusing on deficient *gatekeepers*—pursuing those who should be serving as the neighborhood watch, but who fail to do their jobs.

Id. at 4 (emphasis added).

As she explained:

> [W]e also are focusing more on those who play the role of *gatekeepers* in our financial system. *Cases against delinquent gatekeepers* remind them and the industry of the important responsibilities that gatekeepers share with us to protect investors.

Id. at 7 (emphasis added).

Like Chair White, Commissioner Kara Stein has called for enforcing standards against gatekeepers at small, as well as large, companies, as follows:

> We need to be particularly *focused on gatekeepers* when there is misconduct and *hold them accountable* when appropriate. We need to send a strong message of instilling personal responsibility and accountability. These standards should apply equally for the CFO of a global bank and the CFO of a 20-person company.

Kara M. Stein, SEC Commissioner, Remarks at the American Bar Association Business Law Section's Federal Regulation of Securities Committee Fall Meeting, after footnote reference 115 (Nov. 22, 2013) (emphasis added), available at *http://www.sec.gov/News/Speech/Detail/Speech/1370540403898#.VCMe9fldVwQ* [hereinafter *Commissioner Stein Speech*].

66 Chair White has addressed the downside of the Commission's focus on gatekeepers and listed standards for diligent gatekeepers, as follows:

> It has been suggested that our focus on gatekeepers may drive away those who would otherwise serve in these roles, for fear of being second-guessed or blamed for every issue that arises. I hear and I am sensitive to that concern. But this is my response: first being a director or in any similar role where you owe a fiduciary duty is not for the uninitiated or the faint of heart. And second, we will not be looking to charge a *gatekeeper* that did her job by *asking the hard questions, demanding answers, looking for red flags and raising her hand*.

White Forum Speech, *supra* n.52, at 7-8 (emphasis added).

Commission observers believe that the SEC is targeting gatekeepers. For example, the Harvard Law School Forum on Corporate Governance and Financial Regulation has warned as follows:

> Companies and entities of all types, along with *professionals*, and other individuals, should take notice of the shift in approach, including the overall renewed emphasis on financial reporting and the focus on individual accountability, *gatekeepers*, and lesser violations.

Noam Noked, Co-Editor, "Implications of Recent Developments in SEC Enforcement" (Oct. 26, 2013) (emphasis added), available at *http://blogs.law.harvard.edu/corpgov/2013/10/26/implications-of-recent-developments-in-sec-enforcement/*.

67 Commissioner Kara Stein has expressed her intention to use the Commission's enforcement authority to ensure that attorney gatekeepers do their job, as follows:

> [W]e need to *use our enforcement powers to influence gatekeepers*. That means we need to be bringing the tough cases against those who could have prevented misconduct. Chief Compliance Officers, Chief Financial Officers, the accountants, and the *lawyers* who help individuals or firms violate the law need to be sanctioned. As we learned from the Enron case and later business scandals, gatekeeper failures became a recurring theme and contributed to significant losses for investors.

Commissioner Stein Speech, *supra* n.65 (emphasis added).

[68] The Director has so stated as follows:

> The Securities and Exchange Commission Enforcement Division staff has a long history of scrutinizing lawyers' conduct during its investigations. This scrutiny has tended to be cyclical.... There are times when the SEC's vigor in investigating the *role of professionals* in its inquiries poses a serious potential *risk for the lawyers who practice before the agency.... It appears that we are amidst another cycle*.

William McLucas, Douglas Davison, and Michael Lamson, "SEC Enforcement Developments: Renewed Focus on Lawyers," *Bloomberg Law* (Jan. 14, 2014), available at *http://www.bna.com/sec-enforcement-developments-renewed-focus-on-lawyers* (emphasis added).

[69] Rule 102(e)(1).

[70] Simon M. Lorne, "Attorney-Client Relationships after *Carter and Johnson," Journal of Comparative Corporate Law and Securities Regulation* 3, at 151,166 (1981), citing, *e.g.*, *In re Alan Lester Sitomer*, Exchange Act Rel. No. 12501 (June 1, 1976).

[71] Rule 102(e)(1).

[72] Rule 102(e)(1)(i).

[73] Rule 102(e)(1)(ii).

[74] *Id*.

[75] Rule 102(e)(1)(iii).

[76] *Id*.

[77] *See In Re* Scott G. Monson, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 9(f) of the Investment Company Act of 1940, Admin. Proceeding File No. 3-12429 (Sept. 25, 2006), available at *https://www.sec.gov/litigation/admin/2006/ic-27497-o.pdf* [hereinafter *SEC Monson Proceeding*]. This article discusses the case *supra* Part III. and *infra* Part VI.

[78] Rule 205.6(a).

[79] *Id*.

[80] *Id*.

[81] *Id*.

[82] Rule 206.6(c).

[83] *SEC Rel. No. 33-8185*, *supra* n.1, between footnote references 7 and 8.

[84] *Id*., between footnote references 2 and 3. The language "in any way," appears in Section 307, quoted *supra* n.30.

[85] Rule 205.5(a).

[86] Rule 205.5(b).

[87] It is beyond the scope of this article to discuss, in further detail, the issue of attorney as "supervisor" under the federal securities laws. For a comprehensive exploration of the issue, *see* Ann Furman, "Clear as Mud: The Status of Legal and Compliance Officers as Supervisors After the Urban Case," *ACLI Compliance and Legal Sections Annual Meeting 2012* (July 16-18, 2012).

[88] Rule 205.4(a).

[89] Rule 205.4(b).

[90] *SEC Rel. No. 33-8185*, *supra* n.1, between footnote references 119 and 120.

[91] *Id*.

[92] *Id*.

[93] Rule 205.4(b).

[94] *Prezioso Outline*, *supra* n.3, at 6.

[95] Rule 205.4(a).

[96] A prominent commentator has observed that, in Commission noncriminal enforcement actions, "[t]he top lawyer is nearly always the target," as follows:

> The most obvious common element in the SEC actions is that nearly all of them are brought against the chief legal officer of the company. The occasional exception usually involves the most senior lawyer in charge of a project or a disclosure document.

Villa Article, *supra* n.23, at 105.

[97] *SEC Rel. No. 33-8150*, *supra* n.20, between footnote references 10 and 11. However, the attorney must be providing legal services to the company within the context of an attorney-client relationship. *Id.*

[98] As a former Commission General Counsel has said: "The definition of 'appearing and practicing' under Part 205 rules is an expansive one." *Prezioso Outline*, *supra* n.3, at 19.

[99] The Commission's attorney conduct rules so provide, as follows:

> An attorney appearing and practicing before the Commission in the representation of an issuer owes his or her professional and ethical duties to the issuer as an organization. That the attorney may work with and advise the issuer's officers, directors, or employees in the course of representing the issuer *does not make such individuals the attorney's clients*.

Rule 205.3(a) (emphasis added).

[100] For example, one Court of Appeals has so recognized as follows:

> The role of the accounting and *legal* professions in implementing the objectives of the *disclosure* policy has increased in importance as the number and complexity of securities transactions has increased. By the very nature of its operations, the Commission, with its small staff and limited resources, cannot possibly examine, with the degree of close scrutiny required for full disclosure, each of the many financial statements which are filed. Recognizing this, the Commission necessarily must rely heavily on both the accounting and *legal* professions to perform their tasks diligently and responsibly. Breaches of professional responsibility jeopardize the achievement of the objectives of the securities laws and can inflict great damage on public investors.

Touche Ross v. SEC, 609 F.2d 570, 580-581(1979) (case involving accountants)(emphasis added) [hereinafter *Touche Ross*]. *See supra* n.38 regarding an inside attorney's due diligence duty.

[101] *Villa Article*, *supra* n.23, at 105 (emphasis in original). The commentator explained as follows:

> Many of the cases against inside counsel involve allegedly false and misleading disclosures—more often than not, omissions. While some instances of outright fraud have been alleged, such as totally fictitious off-shore operations or sham contracts, in other instances the SEC has pursued inside lawyers on decisions that involve matters of *professional judgment*.

Id., at 105-106 (emphasis added).

Another commentator has said:

> Today, in house counsel face an even greater temptation when it comes to issues like shading *disclosure*.

Professor Stephen Bainbridge, *Stephen Bainbridge's Journal of Law, Politics, and Culture* (Oct. 4, 2011) (emphasis added), available at *http://www.professorbainbridge.com/professorbainbridgecom/2011/10/remarks-on-in-house-counsel-as-gaatekeepers.htm* (emphasis added) [hereinafter *Prof. Bainbridge Remarks*].

The commentator explains:

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

Id. (emphasis added).

A former Commission General Counsel has said that "[e]nforcement actions frequently tend to be against a company's chief legal officer or the most senior attorney in charge of a project or *disclosure document*." *Prezioso Outline, supra* n.3, at 6 (emphasis added).

[102] The first definition, Rule 102(f)(2) includes, with emphasis added, an attorney's

> *preparation* of any *statement*…or other *paper* by any attorney…*filed* with the Commission in any registration statement, notification, application, report or other document with the *consent* of such attorney….

The second and broader definition, Rules 205.2(a)(1)(iii), includes, with emphasis added, an attorney's:

> [*p*]*roviding advice* in respect of the [federal securities laws and rules thereunder] regarding any document that the attorney has *notice* will be filed with or *submitted* to, or incorporated into any document that will be filed with or submitted to, the Commission, including the provision of such advice in the context of preparing, or participating in the preparation of, any such document, or … [*a*]*dvising* an issuer as to *whether* information or a statement, … or other writing is required under the [federal securities laws and rules thereunder] to be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the Commission. …

[103] A comparison of the two Commission rules shows that:

- regarding an *attorney's involvement*, while Rule 102(f)(2) covers only material *prepared* by an attorney, Rule 205.2(a)(1)(iii) covers material on which the attorney has *provided advice,* including advice regarding preparation;
- regarding the *materials*, while Rule 102(f)(2) covers only *statements* or other *papers* in any registration statement, notification, application, report, or other document, Rule 205.2(a)(1)(iii) and (iv) covers any *document* and, in a narrower context, any statement, opinion, or other writing;
- regarding the *delivery* to the Commission, while Rule 102(f)(2) rule covers only materials *filed*, Rule 205.2(a)(1)(iii) covers materials filed, *submitted* or *incorporated*;
- regarding an *attorney's authorization*, while Rule 102(f)(2) covers only materials filed with the attorney's *consent*, Rule 205.2(a)(1)(iii) covers materials that the attorney has *notice* will be filed, submitted or incorporated; and
- regarding the *nature of advice* that an attorney provides, although Rule 102(f) is silent, Rule 205.2(a)(1)(iv) covers *advising* an issuer as to *whether* information, a statement or other writing is *required.*

[104] *In re* Christi R. Sulzbach, Admin. Proc. File No. 3-13528, Rel. No. 34-60170 (June 25, 2009), available at *http://www.sec.gov/litigation/admin/2009/34-60170.pdf*.

[105] Rule 205.2(a)(1)(iv). The Commission has noted as follows:

> This broad definition was intended to reflect the reality that materials filed with the Commission frequently contain information contributed, edited or prepared by individuals who are not necessarily responsible for the actual filing of the materials.

SEC Rel. No. 33-8185, *supra* n.1, between footnote references 7 and 8.

The Commission has further noted as follows:

> Attorneys who advise that, under the federal securities laws, a particular document need not be incorporated into a filing, registration statement or other submission to the Commission will be covered by the revised definition.

Id., between footnote references 10 and 11.

[106] For example, one Court of Appeals has done so as follows:

> As our Court observed in United States v. Benjamin, 328 F.2d 854 (2d Cir.), cert denied, 377 U.S. 953 (1964), "In our complex society, the accountant's certificate and the *lawyer's opinion* can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar."

Touche Ross, *supra* n.100, at 581 (emphasis added).

[107] Rule 102(f)(2) includes, with emphasis added, an attorney's

> *preparation* of any … *opinion* … *filed* with the Commission in any registration statement,

notification, application, report or other document with the *consent* of such attorney . . . .

Rule 205.2(a)(1)(iv) includes, with emphasis added, an attorney's:

[a]dvising an issuer as to *whether* . . . [an] . . . opinion is required under the [federal securities laws and rules thereunder] to be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the Commission . . . .

[108] A comparison of the two Commission rules shows that:

while Rule 102(f)(2) refers only to opinions *prepared* by an attorney and *filed* with the Commission with the attorney's *consent*, Rule 205.2(a)(1)(iv) refers to any opinion on which the attorney has *provided advice* whether the opinion is required; and

while Rule 102(f)(2) refers only to opinions *filed* with the Commission, Rule 205.2(a)(1)(iv) refers to opinions filed with, or *submitted* to, the Commission or *incorporated* into a document filed with, or submitted to, the Commission.

[109] This is the procedure that the Commission Staff is understood to be following, as described more fully in Gary O. Cohen, "SEC and State Regulation of Indexed Insurance Products: The Plot Thickens," *The Investment Lawyer*, Vol. 20, No. 8 at 3, 6 (Aug. 2013). For a broad discussion of the status of indexed insurance products under the 1933 Act and the issues that inside attorneys would need to address, *see* Gary O. Cohen, "Indexed and Other Fixed Insurance Products: SEC, FINRA and State Regulation After American Equity Opinion and Dodd-Frank Act," in *ALI-ABA Conference on Life Insurance Company Products, Study Materials* 773, 791 (Oct. 2010).

[110] Pub. L. No. 111-203, § 922(a), 124 Stat 1841 (2010).

[111] *In Re* John L. Milling, Admin. Proc. File No. 3-13878, Release No. 62030 (May 3, 2010), available at *http://www.sec.gov/litigation/admin/2010/34-62030.pdf*.

[112] SEC v. Spongetech Delivery Systems, Inc., et. al., Civil Action No. 10-CV-2031(DLI) (E.D.N.Y.) (filed May 5, 2010), Litigation Release No. 21515 (May 5, 2010), available at *http://www.sec.gov/news/press/2010/2010-70.htm*.

[113] *Id. See Ira Weiss*, Exchange Act Rel. No. 52875, 86 SEC Docket 2588 (Dec. 2, 2005) (finding that school district's bond counsel negligently violated Sections 17(a)(2) and (3) of the 1933 Act through the issuance of a misleading, unqualified opinion that he knew would be communicated to, and relied upon by, prospective investors, and through his review and approval of the issuer's official statement that referenced his opinion), *aff'd*, Weiss v. SEC, 468 F.3d 849 (D.C. Cir. 2006), available at *https://www.sec.gov/info/municipal/dcccweissopinion112806.pdf*.

[114] The commentator explained as follows:

[F]ederal regulations . . . are based on a presumption that corporate compliance programs can more cheaply and effectively regulate corporate employees than can external government regulators. And that's probably right. Inside compliance program managers do not face the information and resource constraints inherent in regulatory agency oversight. As a result, however, there is a lot of pressure these days by regulators to essentially deputize corporate compliance managers as law enforcers. In turn, this compounds the *pressure on in house counsel to educate lay compliance personnel, to monitor those personnel, and to play an active role in compliance themselves*.

Prof. Bainbridge Remarks, *supra* n.101 (emphasis added).

[115] Section 9(f) of the 1940 Act, for example, provides, in relevant part, as follows:

> If the Commission finds, after notice and opportunity for hearing, that any person is violating, has violated, or is about to violate any provision of this title, or any rule or regulation thereunder, the Commission may publish its findings and enter an order requiring such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission, the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation.

[116] *SEC Monson Proceeding*, *supra* n.77.

[117] In the last stage of the case, the Commission summarized the Staff's contention of negligence as follows:

> On appeal, the Division does not argue that Monson [the inside attorney] knew that his acts or omissions would contribute to [the issuer's] violation of Rule 22c-1. Instead, it argues that Monson should have known that his work on the Agreement would have contributed to [the issuer's] violation. The Division contends that "the ultimate question in determining Monson's *negligence*," and therefore whether he can be found to have caused his company's violation, "is what a reasonable attorney in Monson's position, acting with due care, would have done." Monson allegedly "failed to conform to basic professional standards regarding competence."
>
> Thus characterized on appeal, the charges against Monson hinge on his role as a legal adviser to [the issuer]. The Division essentially contends that, by *not having requisite knowledge of the securities laws* and by *failing to conduct further legal inquiry* regarding trade timing issues in connection with the drafting of the Agreement, Monson was *negligent in providing legal advice* to his client.

SEC Monson Decision, *supra* n.11, at 5 (emphasis added).

The Commission stated that:

> the law judge found that the Division failed to demonstrate that Monson, whose ignorance of Rule 22c-1 and mutual fund trading in general is undisputed, should have known that his work on the Agreement would contribute to [the issuer's] violations because he was *negligent* in failing to "'spot the issue' that Rule 22c-1 could be implicated."

Id. (emphasis added).

[118] *SEC Monson Proceeding*, *supra* n.77, at 4.

[119] *SEC Monson Decision*, *supra* n.11, at 10. The Commission stated as follows:

> The present case, however, does not require us to address further the appropriate parameters of lawyer liability in administrative enforcement actions because the record does not show by a preponderance of the evidence that Monson acted *negligently* in drafting the Agreement.

Id. at 9 (emphasis added).

[120] Norm Champ, Director, Division of Investment Management, Remarks to the 2014 Mutual Funds and Investment Management Conference (Mar. 17, 2014), available at *http://www.sec.gov/News/Speech/Detail/Speech/1370541168327#.VCGw3fldVwQ*.

[121] "SEC, Strategic Plan–Fiscal Years 2010-2015" at 23 (undated), available at *http://www.sec.gov/about/secstratplan1015f.pdf*. The Commission explained as follows:

> Given the evolution in the investment management industry and in the uses of investment company

distribution fees, the SEC plans to reconsider the rule permitting these fees and the factors that fund boards must consider when approving or renewing them.

Id. at 27.

[122] *Mutual Fund Distribution Fees; Confirmations*, Securities Act Rel. No. 9128; Exchange Act Rel. No. 62544; Investment Company Act Rel. No. 29367; (July 21, 2010), available at *http://www.sec.gov/rules/proposed/2010/33-9128.pdf*.