

Exhibit D

§ 1:7 Special Position of Securities Lawyers

UNDERSTANDING THE SECURITIES LAW
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CHAPTER 1. APPROACHING SECURITIES LAW

§ 1:7 Special Position of Securities Lawyers

The environment in which securities lawyers practice is quite different from that of most other lawyers. That difference is probably the result of two distinguishing characteristics of securities law practice. First, it is usually a securities lawyer who decides whether a particular transaction can proceed or, because of legal problems, must be cancelled. As a matter of common practice, for example, it is often true that unless a lawyer attests to the legality of a transaction by the delivery of an opinion, the parties to the transaction will not agree to proceed. Second, a securities lawyer typically does not merely advise clients on how to accomplish a transaction, but rather he or she usually is an active participant in the transaction.

The first of those characteristics, coupled with the knowledge of the Commission that its own enforcement resources are wholly insufficient to police a significant fraction of securities transactions, has caused the Commission to advocate that a lawyer has a special responsibility to protect the public when working in the securities area. For example, the Commission has argued that when a securities lawyer has reason to believe that a client's actions will violate the securities laws, the lawyer has a duty to inform the Commission. Proponents of expanded responsibility for securities lawyers sometimes liken the position of the securities lawyer to that of the certified public accountant, who long ago was held to have an overriding responsibility to the public, rather than merely to his or her clients.³⁶

The second of these characteristics--active involvement by lawyers in securities transactions-- sometimes insures that when the legality of a completed transaction is questioned, one or more securities lawyers will find themselves in the middle of the controversy, rather than somewhat comfortably on the sidelines. It is probably when contemplating that possibility that a securities lawyer most often looks with envy on colleagues who merely advise clients, rather than help them effect transactions.

There are two cases that point up especially well the distinguishing characteristics of securities law practice and the results that can flow from these characteristics. The first is *SEC v. National Student Marketing Corp.*³⁷ National Student Marketing Corp. and Interstate National Corp. had agreed to merge. At the closing of the transaction, officers of the corporations and their lawyers discussed information, provided by NSMC's accountants, concerning problems with some of the financial statements of NSMC that Interstate had provided its shareholders in connection with their vote to approve the merger. As a condition to the closing, the law firm representing each party was to deliver an opinion covering various points, including "that all steps taken to consummate the merger had been validly taken and that [its client] had incurred no violation of any federal or state statute or regulation to the knowledge of counsel."³⁸ The law firms involved were two of the largest and most respected in the country: White & Case of New York for NSMC and Lord, Bissell & Brook of Chicago for Interstate.

If lawyers for either side had refused to deliver their opinion, Interstate almost certainly would not have proceeded with the closing. A solution to any legal question arising because of the financial statements was to give new statements to the Interstate shareholders and have them vote again on the merger. There was a problem with that alternative, however. The merger agreement contained an upset date by which if the merger was not consummated NSMC ceased to be bound, and it was impossible for the Interstate shareholders to vote before that date. Interstate's management was afraid that if it missed the upset date, NSMC might refuse to merge or might force a renegotiation of the merger's terms. That fear seemed well placed because the price of NSMC's stock, which NSMC was to give Interstate's shareholders,

had risen substantially since the parties had finalized the merger agreement.

The law firms delivered their opinions, and the merger closed in October 1969. The price of NSMC's stock continued to rise for a time, reaching its high in mid-December. Then, in the words of the court, "in early 1970, after several newspaper and magazine articles appeared questioning NSMC's financial health, the value of the stock decreased drastically. Several private lawsuits were filed and the SEC initiated a wide-ranging investigation." ³⁹

That investigation culminated in a complaint by the Commission, filed in federal district court, that alleged securities fraud against multiple parties, including NSMC, Interstate, White & Case and one of its partners, and Lord, Bissell & Brook and two of its partners. The heart of the Commission's complaint against the law firms and the individual partners was this provision:

As part of the fraudulent scheme [the law firms and their named lawyers] failed to refuse to issue their opinions . . . and failed to insist that the financial statements be revised and shareholders be resolicited, and failing that, to cease representing their respective clients and, under the circumstances, notify the plaintiff Commission concerning the misleading nature of the nine month financial statements. ⁴⁰

Protracted litigation followed. Early in this process counsel for White & Case filed a memorandum arguing its case. The following is an excerpt:

The basic question presented by the principal claim in the amended complaint against White & Case is:

Did White & Case have an obligation in the face of a determination by the representatives of Interstate that it was in their interest to proceed with the closing:

- (a) to prevent the closing from taking place;
- (b) to withdraw from representation of the client; and
- (c) to notify the SEC?

. . . It is our view that White & Case did not have either a right or duty to take the steps mentioned; that White & Case acted with propriety throughout the closing; and that the steps suggested by the SEC . . . would have violated their responsibility to their client and might have subjected their client to liability. . .

Plainly, there were good reasons why as a business matter Interstate should proceed and great difficulties as a business matter in justifying to their investors a decision not to proceed. ⁴¹

But in any event White & Case believed this was a business decision for Interstate with which NSMC and its counsel had no right to interfere and every obligation to allow merger to be consummated if that was Interstate's choice. ⁴²

Five years later, White & Case and its partner reached a settlement with the Commission. Without admitting or denying the allegations in the complaint, the partner consented to the entry of an injunction against violations of specified sections of the securities laws and also agreed that, for 180 days, he would not practice before the Commission or advise clients with respect to matters involving securities registered under the federal securities laws. Also without admitting or denying the Commission's allegations, White & Case agreed to adopt certain internal procedures in connection with its practice of securities law. ⁴³

By the time the *National Student Marketing* case was tried, only four defendants were left: the former president of Interstate; Lord, Bissell & Brook; and two of the law firm's partners, one of whom had been also a director of Interstate. The district judge found that the former president of Interstate and the

lawyer-director, when acting as a director of Interstate, had violated antifraud provisions of the federal securities laws. He also found that Lord, Bissell & Brook and its two partners had aided and abetted those violations. The one small bright spot for the law firm and its partners, coming after more than six years of litigation, was the judge's refusal to enjoin further violations because he was not convinced that an injunction was required to prevent further violations.

The other case that points up especially well the distinguishing characteristics of securities law practice, and the results flowing from them, is *In re Carter*,⁴⁴ which was a proceeding before the Commission sitting in its quasijudicial capacity. The Commission brought the action under then rule 2(e) (now rule 102) of its Rules of Practice to determine whether two partners of Brown, Wood, Ivey, Mitchell & Petty, a well-known and respected New York law firm, should be suspended or barred from practicing before the Commission because of alleged unethical or improper professional conduct.

An administrative law judge found that the lawyers had willfully aided and abetted a client's violations of various provisions of the federal securities laws. The judge also concluded that both of the partners should temporarily be suspended from practicing before the Commission. In its decision on appeal, the Commission reversed the administrative law judge, finding that the lawyers "did not intend to assist the violations by their inaction or silence," but rather, "seemed to be at a loss for how to deal with a difficult client."⁴⁵

Nevertheless, the Commission believed that the lawyers' conduct raised questions concerning the obligations of securities lawyers, and therefore it announced the interpretation of unethical or improper professional conduct it would apply in the future:

The Commission is of the view that a lawyer engages in "unethical or improper professional conduct" under the following circumstances: When a lawyer with significant responsibilities in the effectuation of a company's compliance with the disclosure requirements of the federal securities laws becomes aware that his client is engaged in a substantial and continuing failure to satisfy those disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's noncompliance.⁴⁶

Although the required prompt action could be resignation, that was not the action the Commission favored. In its view, "[p]remature resignation serves neither the end of an effective lawyer-client relationship nor, in most cases, the effective administration of the securities laws. The lawyer's continued interaction with his client will ordinarily hold the greatest promise of corrective action."⁴⁷

In both *National Student Marketing* and *In re Carter*, lawyers were accused of aiding and abetting violations of Exchange Act section 10(b). In *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*,⁴⁸ the Supreme Court determined that a private plaintiff cannot maintain an aiding and abetting action under that section. Under the Court's reasoning, which was based primarily on its interpretation of congressional intent, it was unclear whether the Commission had authority to bring actions for aiding-and-abetting violations of section 10(b). Exchange Act section 20, as amended by the Private Securities Litigation Reform Act of 1995, now provides that the Commission has Authority to bring actions for aiding and abetting the violation of any section of the Exchange Act or of any of its rules or regulations. (A general statute⁴⁹ has long created aiding-and-abetting liability for all federal criminal offenses, and a violation of the securities laws can be a criminal offense.) In private actions, one should expect securities lawyers to be named as primary violators of section 10(b), rather than aiders and abettors, whenever the facts arguably would support such a claim.

NOTES:

*Footnote 36. In this regard it is helpful to note that, in Exchange Act section 10A, auditors are given heavy responsibilities with respect to the detection and reporting of illegal acts. Included in these responsibilities are the requirements to see that information the auditor has uncovered about illegal acts (i) gets into the hands of the board of directors or its audit committee and (ii) is, under specified circumstances, reported to the Commission by the board or, if the board fails to do so, by the auditors.

✦Footnote 37. SEC v. National Student Mktg. Corp., 457 F. Supp. 682 (D.D.C. 1978).

✦Footnote 38. Complaint in *National Student Marketing*, dated February 3, 1972, 48, reprinted in Larry D. Soderquist, *Securities Regulation: A Problem Approach* 822-23 (1982).

✦Footnote 39. SEC v. National Student Mktg. Corp., 457 F. Supp. at 699.

✦Footnote 40. Complaint, *supra* n.38.

✦Footnote 41. The president of Interstate advised the SEC in testimony taken before the complaint was filed that he took this decision "in the interest of the shareholders," that "the shareholders would have been harmed far more than helped if the merger had not been completed," [and] that if the merger had been called off the Interstate stock would "plummet the next day."

Counsel for Interstate testified before the SEC that if Interstate did not proceed and its shares declined as expected, "we felt we would have a tremendous number of irate shareholders suing Interstate management for failing to go through with the deal." [Footnote in original.]

✦Footnote 42. Memorandum in *National Student Marketing* filed April 12, 1972, by Arnold & Porter, reprinted in Larry D. Soderquist, *Securities Regulation* 637-38 (3d ed. 1994).

✦Footnote 43. SEC v. National Student Mktg. Corp., [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) [para] 96,027.

✦Footnote 44. Exchange Act Release No. 17,597 (Feb. 28, 1981).

✦Footnote 45. *Id.*

✦Footnote 46. *Id.*

✦Footnote 47. *Id.*

✦Footnote 48. *Central Bank v. First Interstate Bank*, 511 U.S. 164 (1994).

✦Footnote 49. 18 U.S.C. § 2.