SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
(202) 755-4846

PROFESSIONAL RESPONSIBILITY: HOW DID WE GET HERE?

An Address By

A. A. Sommer, Jr., Commissioner

Securities and Exchange Commission

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A. A. Sommer, Jr. *
Commissioner
Securities and Exchange Commission
Washington, D. C.

A large part of the history of this country has been characterized by public concern over the power, actual or potential, of corporations. Much of the fulminating of the Populists as long as a hundred years ago was directed against economic concentration in corporations. You can read the opposition of the farm element of the country to the power possessed by railroads and other powerful industrial interests. A main thread running through the economic history of this country has been the search for means of putting restraints upon the power of wealth concentrated through the corporate form. I do not contend that there is anything inherently wrong with the corporate form of doing business; rather, I would affirm that, indeed, the corporation is one of the truly great social and economic inventions of the human mind. Through it, it is possible to gather the wealth of many and efficiently direct its use, at the same time avoiding the difficulties of doing business in the trust or partnership form. However, as I suggest, there has always been in America a deep suspicion of the power of corporations. At one time it was thought to restrain this power through custom-made grants of corporate charters. By requiring that corporations could come into existence only by explicit acts of the legislature, it was possible to restrain this power, both by limiting the numbers of corporations and by explicitly delineating their powers. Later

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on, when increasing economic activity demanded a more efficient means of incorporating, other kinds of restraints were applied. It was thought that the antitrust laws would be effective in marking out boundaries beyond which corporate power could not go. During the 20's and 30's it was thought that "shareholder democracy" might be an effective means of dulling the dangers of corporate power. Thus, Congress, in the Securities Exchange Act of 1934 gave broad powers to the Commission to regulate the solicitation of proxies, and with this power the Commission has woven a network of regulations about this matter and has also authorized shareholder proposals. Likewise, the development of the class action and the derivative suit have been a further means of attempted restraint upon the exercise of corporate power to the detriment of the shareholders and the community.

As each of these means was tried, I think the American people have been disappointed. Despite the innovations in restraint, there is still a widespread belief that corporate power is abused and that there is a potential for even greater abuse. In the most recent times we have had the explosion of consumerism which has rekindled many of the suspicions and animosities of nearly a century ago. As the American people have experienced anew a distrust of corporate power, they have begun a search for a new means of exercising control over this power. I think it is this search which has led them to re-examine the role of accountants and lawyers and, hopefully, find in those roles, in those people, a new potential for restraining corporate power.

Why has this course appealed to so many, including the courts, current writers and the SEC? I would suggest that it is the characteristic of those professions of which they are most proud which brought this about: namely, their very professionalism.

Despite the misgivings of many concerning the integrity of lawyers (and I should note in all modesty that in a recent survey commissioned by a large accounting firm far more people were distrustful of lawyers than of accountants, and full disclosure demands remarking that even fewer trusted securities regulators!), nonetheless, the public is still aware that these professions have certain characteristics. For one thing they profess to have ideals that make them independent in varying degrees of their clients. Each of the professions has a code of ethics and instrumentalities for the enforcement of it. Furthermore, their members are specially educated and presumably part of their education is directed toward an understanding of the public interest as it relates to their professional employment. They are paid well in the eyes of the public for the services they render to corporate clients and the extent of the compensation is becoming increasingly well known. Most important has been the public realization that accountants and lawyers stand in a very important and sensitive relationship to their corporate clients. They are privy to much that happens, their decisions are frequently decisive in important corporate matters, they have the ear of management and they have a power that is perhaps well beyond what they have heretofore been willing to exercise. Above all else, the public places high regard on the traditions of independence that characterize the professions. Unlike that corporate executive, the lawyer's or accountant's whole economic being is not bound up with the corporation. If he finds representation or auditing for a client offensive, he can usually slough it off without improverishing his family. Granted no professional likes to throw revenue out the door, but nonetheless he does have in most cases a goodly measure of independence from the client and we all know instance after instance in which professionals, to their eternal

credit, have exercised that prerogative. For these reasons, and probably for others as well, I think the public is more and more inclined to look to these professionals as their protection against the misuse of corporate power.

I must confess that I think in some circumstances this public reliance and expectation in troublesome. While I have repeatedly supported the motion of higher standards for counsel in dealing with securities matters, nonetheless I think we must avoid asking lawyers to set themselves up, particularly when they are cast in the role of advocates, as judges of their clients' conduct. The spectre of an attorney for a powerful corporation being castigated because he defends it against environmentalists and other suits is as distressing to me as counsel for members of unpopular political sects being shunned or criticized or ostracized because of their defense.

However, I think the protection that the public expects from counsel and from accountants is not inconsistent with the client dedication that characterizes the good advocate.

The problem becomes one of reconciling historic roles and expectations with current expectations. As Chairman Garrett said last night in quoting Justice Brandeis, the problem is easy when a single principle is involved; it becomes difficult when multiple principles are involved.

The accounting profession has had a somewhat easier task in reconciling conflicting principles because historically it has always been thought that auditors should exercise a measure of independence from their client. Thus, for the accountant the problem has been not one so much of reconciling conflicting principles, as confirming and strengthening historically established independence. Through the

years, the greatest dangers to that independence have been the facts that auditors' clients pay their fees and that auditors can be fired. At the time of adoption of the Securities Act of 1933, Congress clearly contemplated that the auditors who expressed opinions with respect to financial statements contained in registration statements would be independent. At that time a proposal was seriously considered by Congress which would have required that such statements be certified by federally employed auditors. Only because of the strong assurances of representatives of the accounting profession that the task could be well done by independent auditors did Congress retreat from that position. I think it is fair to infer from this that it was the expectation of Congress that the independence of the auditors would be as full as if there were federal auditors on the job.

The problem of reconciling historic roles with new expectations is more complicated in the case of lawyers. Historically, lawyers have been seen principally in the role of advocates, and in that role the bar has taken pride in its wholehearted dedication to the interests of its clients and society, happily, has accepted this as a benefit, not only to the clients, but to society itself. As a matter of fact this notion has its echoes in the Sixth Amendment to the Constitution guaranteeing each person the right to counsel of his choice. Thus, with this historical background, to suggest that attorneys have responsibilities that transcend their clients poses an apparent contradiction. Recent pronouncements of the Commission, litigation commenced and various scholarly writings have constituted an effort to reconcile these seemingly incongruent concepts. I despair not at all in the face of the apparent conflict, for I think the demands upon the legal profession can be smoothly and adequately accommodated

without sacrificing the interests of the public either to independent representation or protection against the wrongdoing of corporate management.

Interestingly enough, this working out of seemingly inconsistent principles is being done without the intervention of legislation and, indeed, without, at least to the present time, significant judicial intervention. There has been virtually no legislation in the last 40 years delineating the responsibilities of counsel. Rather, such discussions as have occurred with regard to the extent of counsel's responsibility have been the consequence of decisions by the Securities and Exchange Commission. It is through these means, which have generated extensive discussions in legal journals and in institutes such as this, that the public expectations have been articulated. I have suggested before, and I suggest again, that this has happened because of the slowness with which state legislatures and state courts have recognized the emergence of the public demand that new and more effective means be developed to restrain the uses of corporate power. Professor William L. Cary recently showed in his article, Federalism and Corporate Law: Reflection upon Delaware, how relatively ineffective the law in one state, at least, has been in controlling various misuses of corporate position and power. Given this hesitancy, little wonder that state courts and state legislatures have been almost completely inactive in developing and articulating the role of the lawyer as society would now conceive it.

Most of the development which has occurred has been under the aegis of Rule 10b-5, that remarkable creation that has provided most of the elastic which has been made viable our system of federal securities regulation. It has not been Rule 10b-5 alone which has been responsible for what has been accomplished; statutes and rules

remain dormant and meaningless until someone activates them. It has been pre-eminently the role of the Securities and Exchange Commission, and secondarily, but not unimportantly, the role of the private bar in brining Rule 10b-5 to life in many contexts. It is interesting to speculate what would have happened if in one or more states there had been official entities like the Commission to enforce the provisions of the state laws, weak though they are. It is not stretching imagination unduly to conjure up a vision of the state law which would have been far more effective restraints than they have been, although probably such a vigorous agency would have generated strong efforts by corporate interests to further dilute the effectiveness of state corporation laws.

The extension of Rule 10b-5's reach has been troubling to many people. Professor Homer Kripke, who will "wrap up" this institute, has written me -- and perhaps he has said this publicly -- that he finds it difficult to understand how Rule 10b-5 -- 115 words long, lacking almost totally in precision -- can be the basis upon which the Commission develops a full-fledged code of professional responsibility for lawyers and accountants, as well as standards of conduct for outside directors, officers and a host of other people.

I think this is a matter of very legitimate concern, for it deprives all of us, as counsellors, of the objectivity and the certainty that we like to have in advising clients. And, yet, we cannot help but note the resemblances between the process that is going on now in explicating Rule 10b-5 and what has historically been the means of development in common law countries. I can recall very vividly the confusion I experienced during the first month of law school as I read tort case after tort case, each

of them seemingly in conflict in one degree or another with the others, searching for a common thread, a general rule, a certain statement. It was with the greatest sense of relief that one day I was told about Prosser on Torts where much of this mélange was nicely reconciled, with only occasional pieces sticking out to compromise the symmetry that Dean Prosser had developed.

We are going through the same process now that common law courts have gone through for hundreds of years in developing the law. The courts are increasingly removed from the strict wording of the rule and, instead, are relying upon previous cases in the traditional common law bay. When confronted with novel situations under Rule 10b-5, the courts have drawn upon, and in some cases expanded, traditional common law themes. It has woven together Rule 10b-5 and these common law concepts into a fabric which is not totally devoid of order and design but in which many figures are still only faintly visible.

The dimness of these outlines has resulted in repeated requests that the Commission sharpen and make them more clearly visible. We have been asked to develop guidelines for insider trading, outside directors, lawyers, accountants, and a couple of weeks ago it was suggested to me at a meeting in Texas that we should develop guidelines with respect to the information that financial officers provide to directors! I am frankly skeptical both of our ability to develop meaningful guidelines and the desirability of the end result. Obviously, if we were to seek to formulate guidelines for attorneys, as Morgan Shipman suggests, it would be the inevitable bureaucratic tendency to try to imagine every conceivable kind of wrongdoing and write a rule to cover it. This would result, undoubtedly, in a horribly lengthy and

complex litany of "thou shalt nots," and inevitably, given the limitations on any human rulemaking effort, such rules would have to also include some general caveats that might be little more than Rule 10b-5 couched in different words. Notwithstanding the inclusion of such generalities, a set of guidelines might very well lull the bar into a false sense of security by instilling the belief that compliance with the specifics provided an immunization that was not truly there. Beyond that, I think it is possible that guidelines could work to the detriment of the bar. They could easily become a check list for those who might be tempted to sue attorneys and any departure from them would be represented as a prima-facie case of professional irresponsibility.

You have heard, and will hear, during this conference, much about the particulars of attorneys' and accountants' responsibilities, their exposures to liability, the practical means that counsel may use to insulate themselves and their professional clients from these exposures. I do not wish to bore you with a repetition of what you have heard or anticipate what lies ahead, so I will forego the temptation to hark back to my days as a lawyer and advise with regard to any of these "bread and butter" matters. Rather, I would like to talk, perhaps in too broad terms, about the historical reasons which, in my estimation, have brought us to this position, to these concerns, to the proliferation of discussions like this in many for a and many offices. Perhaps with that sort of an understanding all of us can better cope with these problems and assess with greater precision the course these problems may travel in the years ahead.

First, I think there is one interesting gap in the 1933 and 1934 pieces of securities legislation which we would note carefully: nowhere in there is any liability of the lawyer suggested, except insofar as he qualifies as a "expert" under Section 11 of

the 1933 Act. The legislative history makes clear, and to some extent so does the statute, that Congress intended to impose substantial exposure in liability upon a number of classes of people: chief executive officers, chief financial officers, directors, accountants (who were clearly to be encompassed within the category "expert"), but there does not appear to be any indication that Congress was greatly concerned with expanding directly the liabilities of lawyers through these statutes.

This is somewhat strange for, during the turgid public debate on responsibility for the debacle of the late 20's and early 30's, lawyers came in for their due share of criticism, along with bankers, corporate executives, accountants and others. They were often seen as the handmaidens of the questionable entrepreneurs who indifferently lent their skills to all sorts of wrongdoing. This criticism continued after the enactment of the 1933 and 1934 Acts. We have all had dinned into our ears the remarks of Justice Stone in 1934 at the cornerstone laying of the Law Quandrangle of the University of Michigan when he rather bitterly castigated the lack of concern for the public interest evidenced by corporate lawyers. I recently read a speech by Justice Douglas in 1934 in which he blistered the legal profession in the strongest conceivable terms. Among other things, he said

> "It is sad but true that the high priests of the legal profession were active agents in making high finance a master rather than a servant of the public interest. They accomplished what their clients wanted accomplished and they did it efficiently, effectively and with dispatch. They were tools or agencies for the manufacture of synthetic securities and for the manipulation and appropriation of other people's money. In doing this they followed the tradition of the guild. In fact they were applying the teachings of their professors. They never took seriously the true nature of their public trust. They failed to act as conditioners of their clients' program. They neglected their foremost function - to create and maintain financial practices that were respectable, honest and conservative."

Given the criticism of the legal profession, one would expect that Congress would, during this epic of lawmaking, have somehow or other singled out lawyers for special treatment. I would suggest that perhaps Congress did not because, criticized though the lawyer's conduct may have been, nonetheless this conduct pretty much corresponded to what the public expected. The public expected lawyers to be partisan, to be devoted to their clients' interests, to have tunnel vision, and when it appeared that their role in the financial debacle closely corresponded to that image, the shock was not sufficient to justify legislative action.

The situation remained quiescent for 35 years or so during which corporate lawyers, and securities lawyers in particular, did not spend much time in worrying about their public responsibilities. They went about their work, for the most part responsibly, and developed increasingly high levels of technical proficiency. Occasionally, there appeared a law suit, a disciplinacy proceeding, some other form of legal action involving a lawyer, but almost invariably these addressed themselves to misconduct so gross that there was no need for subtle discussions of counsel responsibility. Then, like a torpedo, came the National Student Marketing case, followed not too far by the Vesco case. And since then there has been no surcease of laments, complaints, concerns, discussions, memoranda, and institutes about the implications of all this. I cannot, of course, comment on those cases. That would not be appropriate since we are currently involved in litigation. It is customary to think that somehow or other National Student Marketing was a watershed: before that the securities bar could ply its trade secure in the knowledge that only the most outrageous conduct would elicit official disapproval, whereas now, it is believed by some, lapses of

judgment, legitimate protection of client interests and simple good craftsmanship in a poor cause may be enough to produce liability. Yet, I would suggest that this is a terribly misleading oversimplification of the significance of these cases and that that mistake has its origins in an insensitivity to a big part of American history and its significance for us as lawyers.

Another difficulty with the development of "guidelines" or "standards" or "rules" in any area, particularly those involving professionals, is the danger of arresting dynamic development. The genius and the strength of Rule 10b-5 has been its hospitality to new concepts, new thinking and new development, its ability to be, in effect, a spokesman for developing standards in society. Rules limiting the broad standards contained in Rule 10b-5 could have a stunting effect upon the development of the law and remove the most formidable means that society now has to assure that corporate law meets its expectations. The difficulty of rule making I think can be understood if you imagine that 15 or 20 years ago the state of the law under Rule 10b-5 at that time had been codified. These rules would in today's light be dated, inflexible and ill-suited a measure of conduct or as a response to society's demands.

The diversity of our society and its business relationships is too rich, too varied, too complex to submit wholly to specifics. Rather, it seems to me that increasingly courts are going to have recourse to the sort of flexible standard that was expressed in White v. Abrams, in the dissent in Lanza v. Drexel, in the court's opinion in Hochfelder v. Ernst & Ernst, namely, that historic concepts such as scienter, negligence and the like are ill-suited to determining liabilities in today's world. As the court said in White v. Abrams.

> "The proper analysis, as we see it, is not only to focus on the duty of the defendant, but to allow a flexible standard to meet the varied factual contexts without inhibiting the standard with traditional fault concepts which tend to cloud rather than clarify. This flexible approach, as compared to the compartmentalized approach, does away with the necessity of creating a separate pigeonhole for each defendant whose involvement in the transaction in question may not fit nicely into one of the previously defined classes."
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> Further, in the Hochfelder case the court said:
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> "A claim for aiding and abetting solely by inaction can be maintained under Rule 10b-5 by a showing:
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> > 'that the party charged with aiding and abetting had knowledge of or, but for a breach of duty of inquiry, should have had knowledge of the fraud, and that possessing such knowledge the party failed to act due to an improper motive or breach of a duty of disclosure.' [*]
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> The foregoing elements comprise a flexible standard of liability which should be amplified according to the peculiarities of each case. Accordingly, where, as here, it is urged that the defendant through action as well as inaction has facilitated the fraud of another, a claim for aiding and abetting is made on demonstrating: (1) that the defendant had a duty of inquiry; (2) the plaintiff was a beneficiary of that duty of inquiry; (3) the defendant breached the duty of inquiry; (4) concomitant with the breach of duty of inquiry the defendant breached a duty of disclosure; and (5) there is a causal connection between the breach of duty of inquiry and subsequent disclosure would have led to the discovery of the underlying fraud or its prevention."

In a sense it might be said that the case of U. S. v. Simon was an expression of impatience with the adequacy of a set of principles, in that case accounting principles, to circumscribe the responsibility of professionals. There the court determined that even if generally accepted accounting principles were properly applied and used in the preparation of financial statements, there was still an overriding responsibility to be sure that the statement was a "fair" presentation of the financial position and the results of operations of the company.

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[*] Hockfelder v. Midwest Stock Exchange, CCH Fed. Sec. L. Reptr. 1973-74 ¶94,479 (7th Cir., June 5, 1974) (footnote added).

The challenge posed for professionals today, particularly lawyers, is the resolution of what at first glance appears to be a conflict between ancient and hallowed principles and the new demands of society. I do not think that this conflict is a real one, or, to the extent it exists, that it is unresolvable. I am confident that conferences like this can be a significant means of developing the needed accommodations.