Con: It's Not Our Job

*By Steven C. Krane**

Lawyers have traditionally been able to provide their clients with dispassionate legal advice based on a full understanding of the relevant facts. Because of the evidentiary privilege that attaches to attorney-client communications, and the strict ethical obligations of confidentiality in effect in all disciplinary jurisdictions in the United States, clients are allowed and encouraged to be completely candid with counsel. This protection allows lawyers, among other things, to probe the veracity of the statements their clients propose to make in offering securities to the public, and to give frank advice as to the legality and wisdom of their course of conduct. While, in some circumstances, protecting communications between lawyer and client may in an objective sense hinder the search for truth, society has long been comfortable with the judgment that this "impairment is outweighed by the social and moral values of confidential consultations. The [attorney-client] privilege provides a zone of privacy within which a client may more effectively exercise the full autonomy that the law and legal institutions allow."[1]

Unfortunately, the moral laxity of the late 1990s, during which even the President of the United States was able to get away with outright lying to the American people, helped create an environment in which perhaps even securities issuers believed it was acceptable behavior to play fast and loose with the truth. In an era characterized by hypertechnical parsing of language (a debate concerning the definition of "is" being the archetype), it should have come as no surprise that those accessing the capital markets, driven by a self-indulgent culture and a single-minded desire to increase earnings no matter the moral cost, would find creative ways to characterize transactions and enhance the appearance of their financial positions. After Enron, Worldcom and other high-flying corporations deconstructed before our eyes, we saw our lawmakers engage in their favorite pastime: finding someone to blame.[2] Inevitably, fingers began to point to the professionals serving these collapsed entities, most notably their auditors (whose job it is to detect and report fraudulent activities by their clients), but also including their lawyers.

And so it has become fashionable in recent months to propose that the attorney-client relationship be revamped by mandating conduct by lawyers that could lead to wholesale revelations of previously protected attorney-client communications and of legal advice ostensibly given in confidence. These requirements would undoubtedly diminish the willingness of securities issuers to seek and obtain effective legal advice at the time they need it most. The attorney conduct regulations proposed in November 2002 by the Securities and Exchange Commission,[3] for example, are a dangerous step in this direction.

Just as dangerous is the proposition that lawyers should become guarantors of the veracity of their client's statements to the public. A majority of the Supreme Court rejected this concept in its 1994 decision in *Central Bank*,[4] ruling that liability under section 10(b) of the Securities Exchange Act of 1934[5] could not be imposed on mere aiders and abettors: "the statute prohibits only the *making* of a material misstatement (or omission) or the commission of a manipulative act."[6] In the time since the *Central Bank* decision was handed down, most courts in cases involving section 10(b) claims against professionals have confirmed that such claims can be asserted only against a person who has actually made the statement that is challenged as materially false or misleading. As the law has evolved, the fact that a professional helped a client draft its public statements, standing alone, does not render that professional liable as a primary violator of the securities laws.[7]

This approach is consistent with section 11 of the Securities Act of 1933, which considers registration statements to be the responsibility of the issuer of the securities and the issuer's directors who are signatories of a registration statement. Liability is imposed upon those "experts" (like accountants or lawyers) who expressly consent to being "named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement," and then only "with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by" the expert.[8]

The recent corporate scandals have resulted not only in a shift in legislative and regulatory attitudes, but in a recent judicial decision that significantly muddies the waters of professional liability for section 10(b) violations. Addressing various motions to dismiss made by professionals and others in *In re Enron Corp. Securities Derivative & ERISA Litig.*,[9] District Judge Melinda F. Harmon accepted the test urged by the SEC and ruled that under *Central Bank* a professional may be held liable under section 10(b) if with the requisite scienter they "create" a misrepresentation on which investor-plaintiffs rely. Thus, "a person can be a primary violator if her or she writes misrepresentations for inclusion in a document to be given to investors, even if the idea for those misrepresentations came from someone else."[10]

This dangerous and misguided effort to impose liability on lawyers for the wrongdoing of their clients is reminiscent of the age-old tale of the gentleman who lost his keys in an alleyway one night and was seen looking for them a half-block away under a streetlamp. When asked why he wasn't searching in the alleyway, where the keys had undoubtedly been dropped, he explained, "The light is better

out here." Lawyers are prominent participants in the securities industry. This may well make them attractive targets for those seeking to allocate blame, but we should resist the temptation to look where the light may be best. Our society recognizes that even its most reprehensible members — the serial snipers, the child molesters — are entitled to the advice of competent counsel. We have historically stretched our Constitution to and beyond its limits to secure that right. Corporate America is at least entitled to the same treatment. Threatening lawyers with joint and several liability if they do not ensure the truthfulness of all statements made by their clients in offering securities to the public would pit attorney and client against one another as adversaries. Whatever the solution to the perceived dishonesty of public companies may be, it does not lie in depriving them of the right to counsel, or in corrupting the essential nature of the practice of law.

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Footnotes

[1] American Law Institute, *Restatement of the Law Governing Lawyers*, § 68 cmt. c, at 520 (2000).

[2] Few have heeded the sage words of the character Louis Degas in the film *Papillon* (1973), who remarked: "Blame is for God and small children."

[3] Securities and Exchange Commission, Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. Part 205 (Release Nos. 33-8150; 34-46868; IC-25829; File No. S7-45-02).

[4] *Central Bank of Denver v. First Interstate Bank of Denver,* 511 U.S. 164 (1994).

[5] 15 U.S.C. § 78j(b).

[6] *Central Bank,* 511 U.S. at 177 (emphasis supplied).

[7] *See Ziemba v. Cascade Int'l, Inc.,* 256 F.3d 194, 1205-07 (11th Cir. 2001); *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998), *cert. denied*, 525 U.S. 1104 (1999); *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997); *Anixter v. Home-Stake Production Co*., 77 F.3d 1215, 1225-27 (10th Cir. 1996); *In re JWP Inc. Securities Litigation*, 928 F. Supp. 1239, 1255-56 (S.D.N.Y. 1996); *In re MTC Electronic Technologies Shareholders Litigation*, 898 F. Supp. 974, 987-88 (E.D.N.Y. 1995); *Vosgerichian v. Commodore Int'l*, 862 F. Supp. 1371, 1378 (E.D. Pa. 1994); *In re Kendall Square Research Corp. Securities Litigation*, 868 F. Supp. 26, 28 & n.1 (D. Mass. 1994).

[8] 15 U.S.C. § 77k(a)(4); cf. *Cashman v. Coopers & Lybrand*, 877 F. Supp. 425, 430 (N.D. Ill. 1995) (sustaining section 10(b) claims against auditors based on alleged misstatements in the "expertising" section of the prospectus); *Austin v. Baer, Marks & Upham*, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,881 at 94,277 (D. Or. 1986) (law firm consented to being named in the registration statement as having prepared the legal opinion on the validity of partnership units under state law). A registration statement is not "'expertised' merely because some lawyer prepared it . . . ." *Escott v. BarChris Constr. Corp*., 283 F. Supp. 643, 683 (S.D.N.Y. 1968).

[9] 2002 WL 31854963 (S.D. Tex. Dec. 20, 2002).

[10] Id. (text following note 27) (quoting SEC *amicus curiae* brief).