Client Confidentiality and Securities Practice: A Demurrer From the Current Controversy

I. The Issue

The American legal system is conceived as essentially an adversary process; justice, hopefully, is achieved by having competing views presented with vigor. Our courts refuse to respond to questions that are not "justiciable," that is, which present no true "case or controversy" under the Constitutional mandate.[1] It has long been the position of the bench that only when the parties have a personal stake in the outcome will the arguments be zealously presented and the issues drawn with the clarity necessary to fair and thoughtful resolution.[2]

The Code of Professional Responsibility is grounded in this adversary philosophy. Canon Seven emphasizes the duty to "represent a client zealously within the bounds of the law."[3] Canon Five prohibits conflicts of interest on the premise that one cannot adequately serve two masters.[4] Canon Four, which deals with the preservation of a client's confidential communications, grows out of our expectation that the lawyer must encourage full disclosure by his client in order that he may further that client's goals more successfully.[5]

In the popular media, the lawyer is seldom pictured drafting a will, or a real estate contract or a prospectus. The preoccupation is with litigation, with the adversary role.

It is frequently argued that such preoccupation is in conflict with the nature of the work many lawyers do and that by focusing upon the lawyer-as-advocate we fail to appreciate the duty the attorney owes to regulatory agencies and the public. Nowhere is this argument being advanced with more force than in the securities field. The securities lawyer may never go into a courtroom; the bulk of his work involves counselling corporate clients, preparing documents, submitting reports and opinions, and generally interpreting the highly complex and specialized regulations of the Securities Exchange Commission. Furthermore, a public offering affects investors who depend upon information in the prospectus—a prospectus which reflects the advice and counsel of the securities practitioner. It is undisputed that such practitioner

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[1] U.S. CONST. art. III.

[2] Poe v. Ullman, 367 U.S. 497 (1961); Muskrat v. United States, 219 U.S. 346 (1911).

[3] ABA CODE OF PROFESSIONAL RESPONSIBILITY, Canon Seven (1970).

[4] *Id.*, Canon Five.

[5] *Id.*, Canon Four.

owes a duty to the investing public, but the parameters of that duty are unclear.

What is the lawyer to do when his duty to his client conflicts with his duty to the public? When the client is attempting a patent fraud, or is involved in some other obviously illegal activity, the ethical problem is not severe; the Code clearly prohibits the lawyer from participation in illegal activities and just as clearly permits him to report the client to the appropriate authorities.[6] But instances of intentional lawbreaking are relatively rare; as any practitioner knows, it is far more common for a client to request assistance in reaching a goal with whatever leeway the law allows, leaving to the lawyer the task of determining just what the leeway is. In the securities field, where the law is developing rapidly, and where liability for non-disclosure is expanding, it is not a simple matter to determine what the law allows. The philosophy behind attorney-client confidentiality is sound. A lawyer cannot be effective unless he has access to all relevant information. The client must be encouraged to divulge those aspects of his situation that are disadvantageous as well as those which are favorable. Otherwise, the lawyer, and the client, are due for some unpleasant surprises. At the same time, the principle of disclosure is fundamental to all securities legislation. The issuer of stock is a seller in a market where *caveat emptor* is peculiarly inappropriate. The buyer, or investor, is rarely able to verify the claims made on behalf of the company issuing the securities; he must rely upon the SEC, and the legal profession, to enforce a full and honest disclosure of the condition and prospects of the issuer .

Other factors further complicate the issue. Legal debate still rages over when the attorney-client privilege attaches.[7] When the client is a corporation, different courts apply substantially different tests to determine which natural persons within the corporation are the client for purposes of the privileges.[8] Furthermore,

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[6]*Id.*, Disciplinary Rule No. 4-101.

[7]For an extended discussion of this problem, see McCormick's Handbook of the Law of Evidence § 175 (2d ed. E. Cleary 1972). For the purposes of this Note, no distinction has been drawn between the attorney-client privilege and the ethical mandate which requires that a lawyer keep his client's communication confidential. The privilege is, of course, evidentiary. See discussion at note 8 *infra.*

[8]The attorney-client privilege applies to corporations if the usual requisites for the privilege are present. In order to be privileged, a communication must be between the client and the attorney and must have been intended to be confidential. The problem arises when it is necessary to determine just which natural persons within the corporate structure comprise the client, in order to ensure that the privilege attaches and is not waived.

Courts are split over the proper test to be used. The narrowest is the so-called "control group" test. The leading case using that test is Philadelphia the Canons are by no means clear about when a lawyer may ethically disregard the privilege.

What does the lawyer do, for example, when he receives presumably privileged information from one client which concerns another client? It is hornbook law that the privilege belongs to the *client*, and that only the client can waive it,[9] but a brief hypothetical will indicate the nature of the dilemma. Suppose client A comes to lawyer B, who works for a large law firm. Client A wants to sue XYZ Corporation for a substantial amount and seems to have a good case. Lawyer B, after their initial, detailed consultation, discovers that his firm does some legal work for XYZ. He immediately informs client A and refers him to another firm because of the conflict of interest. Three weeks later, before any complaint has been filed, the firm receives a routine request for an audit letter from XYZ, before XYZ is itself aware of the impending suit. The letter asks the firm to certify that

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v. Westinghouse Elec. Corp., 210 F. Supp. 483 (E.D. Pa. 1962). However, in D.I. Chadbourne, Inc. v. Superior Court, 60 Cal. 2d 723, 388 P.2d 700, 36 Cal. Rptr. 468 (1964), an employee was said to be within the privilege if he was the natural person to speak for the corporation. In United Stattes v. United Shoe Mach. Corp., 89 F. Supp. 357 (D. Mass. 1950), and Zenith Radio Corp. v. Radio Corp. of America, 121 F. Supp. 792 (D. Del. 1954), the courts included within the privilege any information secured from an officer or employee which was not disclosed in a public document or before third persons, but did not define "public document" in this context.

> The Seventh Circuit has extended the client privilege to any employee sufficiently identified with the corporation so that his communication to the corporation's counsel is privileged where the employee makes the communication at the direction of his superiors in the corporation and where the subject matter upon which the attorney's advice is sought by the corporation and dealt with in the communciation is the performance by the employee of the duties of his employment.

Harper & Row Publishers, Inc. v. Decker, 423 F.2d 487, 491 (7th Cir. 1970).

Despite a good deal of similar case law extending the privilege beyond the control group, it is likely that the restrictive test will ultimately prevail. There are two reasons: (1) as a practical matter, the test is easier to apply, and (2) the weight of authority has restricted the use of the client privilege in the past, while recent case law has emphasized this restriction. A good brief summary of the status of the corporate attorney-client privilege can be found in Note, *The Attorney-Client Privilege in the Corporate Setting: A Suggested Approach*, 69 MICH. L. REV. 360 (1970). The author notes five elements essential to the privilege: (1) legal advice was sought, (2) from a lawyer in his capacity as such, (3) the communication related to the situation for which advice was being sought, (4) the communication was intended to be confidential, and (5) the employee is within the definition of "corporate client." See also Note, *Testimonial Privilege and Competency in Indiana*, 27 IND. L.J. 256 (1951); Annot., 98 A.L.R.2d 245 (1964).

[9] MCCORMICK'S HANDBOOK OF THE LAW OF EVIDENCE § 92 (2d ed. E. Cleary 1972).

it knows of "no contingent liabilities that would materially affect the value of XYZ stock." The suit, if successful, *might* have such an effect. What is the firm's duty? Even if the information had come from XYZ itself, there is considerable debate over whether such a broadly phrased request for an audit letter constitutes a waiver of the privilege.[10] Even if it does, it is unlikely that most firms making such requests are aware of this fact. Is it ethical

[10]Despite the frequency with which it is said that waiver can never be inadvertent or accidental but must be "knowing" and "voluntary," courts are notorious for finding waiver when the information desired is crucial and otherwise unobtainable. Note, *Testimonial Privilege and Competency in Indiana,* 27 IND. L.J. 256 (1951).

It has been said that waiver has two elements: (1) an intent to waive, which is subjective and (2) an assertion of the privilege "inconsistent" with the claim or defense being raised. Hyde Constr. Co. v. Koehring, 455 F.2d 337 (5th Cir. 1972). In practice, courts seem quite willing to infer the subjective element from the existence of the objective one. "Doing of an act inconsistent with the claim of privilege is a waiver." Newkirk v. Rothrock, 293 N.E.2d 550, 554 (Ind. Ct. App. 1973). An arrangement between insurers of two vehicles involved in a collision to exchange statements of their insureds waived any privilege that might otherwise have been invoked. Halloran v. Tousignant, 230 Minn. 399, 41 N.W.2d 874 (1950). Public discussion of the communication waives the privilege. Seeger v. Odell, 64 Cal. App. 2d 397, 148 P.2d 901 (1944).

The inclusion of a third party in a discussion otherwise privileged has generated much case law. It is generally held that the function of the third party is the determinative factor, and that if the third person's presence was reasonably necessary, confidentiality will not be considered waived. United States v. Kovel, 296 F.2d 918 (2d Cir. 1961). *See* Annot., 96 A.L.R.2d 125 (1964). The client was found to have lost his right to insist upon the privilege in a situation in which a charge of fraud implicated the corporation's legal counsel. In such situations, the law firm could use the confidential information to defend its own actions in the matter. Marco v. Dulles, 169 F. Supp. 622 (S.D.N.Y. 1959).

When a corporation is the client, a determination of whether or not a particular communication was kept confidential will depend partly upon which test the court uses to decide which individuals comprise the client. If the control group test is used, note 8 *supra,* it is easier to ascertain whether or not the requisite confidentality was maintained.

> When a firm does not keep a communication confidential—thereby demonstrating that it will tolerate disclosure—the privilege should be denied since its promise of secrecy was plainly not a factor in the decision to give counsel the information. . . .

Note, *The Attorney-Client Privilege for Corporate Clients: The Control Group Test,* 84 HARV. L. REV. 424, 428 (1970).

It is a matter of some practical difficulty to determine just when a corporation has "disclosed" information for the purposes of the waiver doctrine. Courts seem to indulge a presumption that corporate papers and records are not confidential unless clearly designated as such. In United States v. Silverman, 430 F.2d 106 (2d Cir. 1970), the Second Circuit, without elaboration or citation, said that a Union's minutes were a matter of public record. The court also ruled that only so much of the lawyer's communication to treat as a waiver that which the client did not intend as such? In our hypothetical, the privilege belongs to client A, who has assuredly not waived it.

Most firms in this position would suggest that XYZ rewrite the audit letter request, limiting its scope to matters currently being litigated or work currently being done by the law firm.[11] Does such a course give sufficient consideration to the interests of potential investors? How broad is the duty of the lawyer to disclose?

II. The Courts

Case law delineating the lawyer's obligation in such situations is still scanty. However, a brief survey of the relevant opinions indicates that courts will rule in favor of disclosure in those situations in which it can be demonstrated that the information was material and that third parties could reasonably be assumed to have relied upon either the assertions or the reputation of the lawyer. In situations in which no reliance can be demonstrated, a partial disclosure of a client's communication, as in an audit letter, will not only waive the privilege as to the remainder[12] but may also impose an affirmative duty to disclose the remainder. An example of the sort of situation mandating further disclosure is *Leland Stanford Jr. University v. National Supply Co.*,[13] in which the court found that the directors of a corporation had pointed out the advantages, but not the disadvantages, of a proposed corporate merger. Whenever partial disclosure distorts or misrepresents the true state of affairs, the law will impose a duty to disclose the remainder.[14] When such disclosure is in conflict with the duty of the lawyer to his client, or with the existence of the attorney-client privilege, the courts have generally required disclosure.

Fears v. Burris Manufacturing Co.,[15] for example, involved a state-created privilege. The Fifth Circuit construed the statute in

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to his client as would tend to reveal the client's previous communication to the lawyer was privileged.

In respect to audit letters, the client making the request is waiving the privilege and should be made aware of this. Case law suggests that once any particular matter is alluded to in an audit letter, confidentiality as to that matter is waived, and requirements of disclosure may make less than full discussion insufficient.

[11] Deer, *Lawyers' Responses To Auditors' Requests For Information*, 28 Bus. Law. 947 (1973).

[12] *See* note 10 *supra*.

[13] 46 F. Supp. 389 (N.D. Cal. 1942).

[14] Coates v. Lawrence, 46 F. Supp. 414, 423 (S.D. Ga. 1942).

[15] 436 F.2d 1357 (5th Cir. 1971). The case involved a provision of the Mississippi Employment Security Law which required each employing unit

such a way as to find that the privilege was not absolute. In *Carr v. Monroe Manufacturing Co.*,[16] in dealing with another statutory privilege, the same court pointed out that the privilege asserted did not exist at common law and found that the "policy of American Courts" was to weigh the "need of the privilege against the need for disclosure."[17] The Sixth Circuit has likewise held that a "special federal interest in seeking the truth" would overcome a state-created privilege.[18]

Whenever the relationship of the lawyer and the client has been other than purely professional, the courts have not hesitated to impose a duty to disclose. Thus, in *United States v. Benjamin*,[19] the Second Circuit found that the relationship involved was a business relationship and side-stepped the client's claim of privilege. The case involved blatant fraud, and the attorney was an active participant; however, the court noted explicitly that the government need not prove complicity but could meet its burden by proving simply that the lawyer had "deliberately closed his eyes to facts he had a duty to see."[20] In a later case, the same court held that the lawyer would be personally liable for a "reckless disregard of whether the statements made were true."[21]

Securities Exchange Commission v. Frank[22] involved false information in a prospectus. The attorney claimed he had merely "rephrased" information of a technical nature for the company and could not be held responsible for its validity. The court held that "a lawyer has no privilege to assist in circulating a statement which he knows to be false simply because the client has furnished it."[23] A lawyer would not be liable for a failure to detect discrepancies in a technical report; however, "a lawyer, no more than others, can escape liability for fraud by closing his eyes to what he saw and could reasonably understand."[24] Left open was the extent of the lawyer's duty, if any, to investigate.

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of the Employment Security Division to keep work records. The express language of the statute prohibited public access to such records and provided that the information contained therein was to be "confidential." The court held that this statutory mandate was insufficient to create a privilege and allowed contents of the records into evidence.

[16]431 F.2d 384 (5th Cir. 1970).

[17]*Id.* at 388.

[18]Patterson v. Norfolk & Western Ry., 489 F.2d 303, 307 (6th Cir. 1973).

[19]328 F.2d 854 (2d Cir. 1963), *cert denied*, 377 U.S. 953 (1964).

[20]328 F.2d at 862.

[21]United States v. Sarantos, 455 F.2d 877, 882 (2d Cir. 1972). "A conscious effort to avoid learning the truth" would be sufficient for liability to attach.

[22]388 F.2d 486 (2d Cir. 1968).

[23]*Id.* at 489.

[24]*Id.*

At least one legal writer has suggested that attorneys working in the securities field will eventually be governed by the same standards of conduct now required of certified public accountants and independent auditors.[25] While the courts have shown little inclination to go so far, cases involving accountants may provide lawyers with a useful analogy. In *Drake v. Thor Power Tool Co.*,[26] the accounting firm of Peat, Marwick, Mitchell and Company was held liable for misstatements in the company's financial report. The court found it immaterial that the firm had not benefitted from the presumably inflated market price of the securities. Noting that "the position of an independent auditor is different from that of other corporate insiders,"[27] the court emphasized that there had been reliance upon the misstatements and ruled that the firm could be prosecuted either for intentional *or* negligent misrepresentation. It is significant that in very similar situations, courts have declined to find liability where there was no public dissemination of the misinformation and, thus, no reliance.[28] In *Fischer v. Kletz*,[29] Peat, Marwick, Mitchell and Company (PMM) was involved in a suit which has particular relevance to the audit letter situation. The firm, in its capacity as an independent auditor, had certified a financial statement for a corporation. Subsequently, as an employee of the firm, it discovered inaccuracies in that report. The court discussed at length the common law duty to disclose.[30] Stressing the element of reliance, the court concluded that "good faith and common hon-

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[25]Goldberg, *Policing Responsibilities of the Securities Bar: The Attorney-Client Relationship and the Code of Professional Responsibility*, 19 N.Y.L.F. 221 (1973).

[26]282 F. Supp. 94 (S.D.N.Y. 1967).

[27]*Id.* at 105.

[28]Wessel v. Buhler, 437 F.2d 279 (9th Cir. 1971).

[29]266 F. Supp. 180 (S.D.N.Y. 1967).

[30]*Id.* at 184-85. The Court discussed at some length the common law duty to disclose and acknowledged that the law relating to "passive failure to disclose" was in a state of flux. The court noted that:

> Although the prevailing rule seems to be that there is no liability for tacit nondisclosure, Dean Prosser adds the following important qualification: "to this general rule, if such it be, the courts have developed a number of exceptions, some of which are as yet very ill-defined . . . ." One of those exceptions is that "one who has made a statement and subsequently acquires new information which makes it untrue or misleading, must disclose such information to anyone whom he knows to be still acting on the basis of the original information."

Id. The court further remarked that "Section 551 of the First Restatement of Torts, which is couched in the specific terms of a 'business transaction' is in substantial agreement with Dean Prosser." *Id.* at 185.

esty"[31] demanded disclosure, and that it was irrelevant that PMM had no pecuniary interest in the misrepresentation. "In cases involving affirmative misrepresentation, it is now the settled rule that a misrepresentor can be held liable regardless of his interest."[32] The court extended such liability to include misrepresentation by reason of nondisclosure as well. Intent to deceive is not necessary, the court noted; breach of an objective duty is sufficient. The court acknowledged the difficulty for accountants *and lawyers* under this interpretation of the law, in situations involving competing ethical mandates. The case is significant because the court actually met that issue and resolved it in favor of the duty to disclose.

Garner v. Wolfinbarger[33] contained a full and considered discussion of the factors the judiciary is most likely to weigh when faced with such competing ethical principles. In *Garner,* the court chose to base its holding in favor of disclosure on the "interfamilial" aspect of that litigation, holding that derivative suits were *"inter sese"* and that the attorney-client privilege was thus inapplicable. But the case has been cited most frequently for its dictum that a corporation's need for secrecy, and its right to claim the client's privilege, must be balanced against the stockholder's right to know.[34]

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[31]*Id.* at 188.

[32]*Id.*

[33]430 F.2d 1093 (1970).

[34]Three cases decided in 1972 make the trend of the law more explicit. In Blakely v. Lisac, 357 F. Supp. 255, 263 (D. Ore. 1972), the court ruled that "one who is presented in the prospectus as a financial advisor . . . is under a duty to at least make a minimal investigation into the accuracy of the prospectus." The court also predicated liability upon the premise that one who permits another to use his "reputation and goodwill" to further a fraudulent scheme may be independently liable under rule 10b-5 of the Securities Exchange Act, 15 U.S.C. § 78j (1970). If the attorney has not exercised due diligence, it is immaterial that he did not profit personally. Here, the court said, the attorney knew "or should have known" that certain information was misleading; he was, therefore, liable to those who had purchased in reliance on the prospectus.

How involved need a law firm be for a court to find that it has lent its "good name" to a stock offering or similar undertaking? Is any mention of the firm in a prospectus sufficient? In Black v. Nora-Tech, Inc., 333 F. Supp. 468 (D. Ore. 1971), designation of the firm as "corporate counsel" was sufficient to make the firm a "participant" in the unlawful transaction. It is likely that the court was influenced by the fact that, under a separate charge, the attorney in question had himself sold stock on the basis of undisclosed inside information; nevertheless, in its holding, the court employed negligence terminology.

In Bailey v. Meister Brau, Inc., 55 F.R.D. 211 (N.D. Ill. 1972), one of the defendants, a former vice-president of Meister Brau who had become president of the newly-acquired subsidiary, refused to testify at a deposition

Securities Exchange Commission v. National Student Marketing Corp.[35] involved a corporate merger. Pursuant to the merger agreement, National Student Marketing (NSM) was to send a so-called "comfort letter" to Interstate, the other party to the merger. The attorneys for Interstate failed to disclose to the stockholders the fact that the contents of that letter did not comport with the terms of the agreement but showed instead that NSM had materially overstated its current earnings through the issuance of unaudited interim financial statements. The attorneys for Interstate proceeded with the closing without revealing the discrepancy to the stockholders. The law firm also allegedly misrepresented the situation to the SEC by submitting a false Form 8-K. Officers and directors subsequently sold some 77,000 shares without disclosing the contents of the comfort letter. Furthermore, the firm backdated certain transactions so that the profits could be included in earlier financial statements. The court held the law firm liable, and the case has been hailed as a landmark which points the way to a new ethic of disclosure.[36] This seems an extravagent construction, since affirmative involvement of the lawyers in the illegal activity was undeniable.

In June of this year, the Second Circuit handed down a significant opinion in the case of *Meyerhofer v. Empire Fire & Marine Insurance Co.*[37] One of the principal figures in *Meyerhofer* was Stuart Charles Goldberg, a member of the New York bar specializing in securities law, a law school professor, and a vocal proponent of full disclosure in all transactions involving public offerings.[38] As an associate of a large, well-known law firm, Goldberg participated in the preparation of a public offering by Empire Fire and Marine Insurance. The registration statement filed with the SEC failed to disclose a proposed $200,000 payment to the law firm, as well as certain other "compensation arrangements." When stockholders subsequently brought suit under rule 10b-5, naming Empire, the law firm and Goldberg among the defendants, Goldberg asked plaintiff's attorneys for an op-

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about certain communications with counsel for Meister Brau. At the time those conversations occurred, he had been an officer of both companies. The court noted that there was raised a question of first impression in Illinois, that is, where does duty lie when an individual functioning in a dual fiduciary capacity faces incompatible obligations? The court found that the information plaintiff wanted was pinpointed with specificity and was unavailable elsewhere. The court, applying the balancing test enunciated in *Garner*, concluded that he had shown sufficient "good cause" to overcome the privilege.

[35] [1971-72 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93.360 (1972).

[36] Note, *A New Ethic of Disclosure*—National Student Marketing *and the Attorney-Client Privilege*, 48 NOTRE DAME LAW. 661 (1973).

[37] 497 F.2d 1190 (2d Cir. 1974).

[38] See note 25 *supra*.

portunity to demonstrate that he had no knowledge of the nondisclosures at the time. He revealed that he had resigned from the law firm in a dispute over what he regarded as excessive fees, both in the *Empire* matter and in regard to another registration. Upon resigning, he had gone directly to the SEC with a thirty page statement. All of this had occurred some three months before he was named as a defendant in the *Meyerhofer* suit. In order to verify his nonparticipation in any wrongdoing, Goldberg gave the attorneys for the plaintiff a copy of the statement he had given to the SEC, a statement which contained information not only about Empire, but also about another client as well. Plaintiffs subsequently dropped Goldberg as a defendant and amended their original complaint by adding factual matter garnered from Goldberg's statement. The District Court for the Southern District of New York agreed with the defendants that Goldberg had violated Canons Four and Nine. The Second Circuit unanimously disagreed, noting that the Code of Professional Responsibility expressly permits a lawyer to reveal confidences if necessary to defend himself against accusations of wrongful conduct.

> Under these circumstances, Goldberg had the right to make an appropriate disclosure with respect to his role in the public offering. Concomitantly, he had the right to support his version of the facts with suitable evidence.[39]

The court noted that the documents turned over to the SEC and to the plaintiffs reflected seriously upon both Goldberg's former employer and another client but concluded that the urgency of Goldberg's situation, and the absence of any evidence of bad faith on his part, justified the disclosure.

III. The Commentators

There is consensus in the legal literature that, insofar as securities law is concerned, there is a serious conflict between the attorney-client privilege and the lawyer's duty to disclose. Unfortunately, that is where consensus ends and acrimonious debate begins. That debate involves a fundamental disagreement over the nature of the role of the securities lawyer. Is he an advocate, in the traditional American sense? Or is he, by virtue of his highly specialized practice, more of an advisor-participant? If the latter, how does that alter his ethical responsibilities?

The Ethical Considerations following Canon Seven distinguish between the lawyer as advocate and the lawyer as advisor. "A

[39] 497 F.2d at 1195.

lawyer may serve simultaneously as both advocate and advisor, but the two roles are essentially different."[40] The Code draws a distinction on the basis of past versus present behavior; an attorney faced with a client's *fait accompli* is automatically an "advocate" who must take the facts as he finds them; a lawyer assisting his client in determining an ongoing or future course of conduct is an "advisor." An advisor presumably has a greater duty to third parties than does an advocate.

Many lawyers disagree sharply with this purported dichotomy of lawyering functions and fear that under such an analysis there is danger of the securities bar becoming a "wholly owned subsidiary" of the SEC.[41] Drawing a distinction between the "advocate" and "advisor," according to these lawyers, ignores the fundamental nature of our legal system. Every attorney is an advocate, whether or not he or she ever enters a courtroom; it is the essence of the attorney-client relationship that the attorney work in the client's best interests. To threaten the zealous attorney with personal liabilities is to deprive the client of a fundamental right. Even a corporate client is entitled to disclose to its attorney information about its most important affairs and to receive both counselling and advocacy based on that information, secure in the knowledge that the attorney's primary obligation is to that client. A lawyer who is, in effect, a "coerced informant" for the SEC simply cannot give his client the sort of legal representation which is his right under the Constitution.[42] "A role which depends upon the existence of the confidence a client has in his lawyer cannot endure efforts to create enforcement responsibility on the part of the lawyer."[43] Furthermore, SEC regulations are often ambiguous, and there are many situations in which the need for disclosure is arguable. If the lawyer knows that he will be held responsible for omissions which later prove to be material, his instinct for self-preservation is going to influence his advice to his client. What becomes, then, of his duty to show his client how to "avail himself to the full of what the law permits"?[44]

Lawyers taking this position view with dismay the current trend to impose legal liability on attorneys who have acted in reli-

[40] ABA CODE OF PROFESSIONAL RESPONSIBILITY, Ethical Consideration 7-3 (1970).

[41] Freeman, *Legal Ethics*, 171 N.Y.L.J. 79 (1974).

[42] *Id.*

[43] Cooney, *Implications of the Revolution in Securities Regulation for Lawyers*, 29 BUS. LAW. 129, 132 (1974). *See also* Messer, *Roles and Reasonable Expectations of the Underwriter, Lawyer, and Independent Securities Auditor in the Efficient Provision of Verified Information: 'Truth in Securities' Reinforced*, 52 NEB. L. REV. 429 (1973).

[44] See Cooney, *supra* note 43, at 153.

ance upon misrepresentations of their clients. A reading of the cases does indicate that the lawyer has some, although poorly defined, positive duty of investigation. Thus, before the securities practitioner can safely draw up documents or make presentations to the SEC, he must satisfy himself, through the exercise of "due diligence" that his client has not lied to him. The practical implications of such a duty are staggering enough; the implications for the attorney-client relationship, which is presumably grounded in trust, are even more ominous. The Code of Professional Responsibility eschews conflicts of interest; making the securities practitioner into "another cop on the beat"[45] would seem to pose a conflict of gigantic proportions. Finally, this argument continues:

> If securities regulation is worth doing, it is worth providing sufficient governmental resources to do the job in a way that comports with due process of law, and in a way that does not corrupt the attorney-client relationship and gravely threaten the independence of the Bar, which is essential to the maintenance of a free society.[46]

Other writers take a completely different view. They point to the changed nature of the legal process in modern society and particularly in respect to the securities market.[47] According to their argument, the modern securities lawyer has more in common with the traditional London merchant banker than with the orthodox barrister.[48] It is manifestly impossible for the SEC to be effective without the cooperation of the securities bar; no matter how many investigators and independent auditors the SEC might hire, there is no practical substitute for a high ethical standard on the part of those intimately engaged in the preparation of public offerings. That the lawyer is a participant in the process can hardly be denied; when he is the draftsman of documents which will be relied upon by third parties and the public, when he issues written opinions intended solely for those third parties and the public, he is a participant under any rational assessment of the situation. It is obvious that the ethical responsibility of such lawyers must be tripartite: to the public, to the SEC, and to the client.[49]

Those taking this view resist the notion that it represents a major break with traditional ethical considerations. They note that the Code of Professional Responsibility acknowledges the

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[45]Freeman, *supra* note 41, at 79.

[46]*Id.*

[47]Lipton, *Securities Bar and SEC Enforcement Defended*, 171 N.Y.L.J. 93 (1974).

[48]*Id.*

[49]*See* Goldberg, *supra* note 25.

existence of the advocate-advisor dichotomy and that the legal process has always favored disclosure over claims of privilege. Indeed, some writers feel that the attorney-client privilege is no longer applicable in the securities area, and that the doctrine of waiver should be invoked whenever there has been publication of documents based on client communications, upon which third parties might be expected to rely.[50]

There is a tremendous opportunity for fraud in securities trading. Surely the lawyer involved in preparing a public offering has a duty to those who will foreseeably rely upon the information disseminated. Indeed, since it is impossible to perpetrate a securities fraud without either the active assistance or the culpable negligence of a securities lawyer, it is only reasonable to hold lawyers accountable for such assistance or negligence. Proponents of this view support various proposals which would make securities lawyers independently accountable, much as independent auditors are. Many favor codifying the "special" obligations of securities practitioners and abolishing altogether the attorney-client privilege in the securities context.[51]

IV. Analysis

Much of the discussion being generated in this area is the result of a mistake in *focus*. The question being asked is: which is more important, disclosure or the privilege?[52] We should consider carefully whether this is really the appropriate question. The following propositions are offered for consideration.

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[50] *Id.*

[51] Sonde, *The Responsibilities of Professionals Under the Federal Securities Laws—Some Observations*, 68 Nw. U.L. Rev. 1 (1973).

[52] This was essentially the question to which the ABA Section of Corporation, Banking and Business Law attempted to respond when it issued *Proposed Guidelines on the Scope of Lawyers' Responses to Auditors' Requests for Information.* The proposed guidelines, issued October 20, 1974, are being circulated in pamphlet form for discussion and eventual approval by the Section. As the introductory comment explains, the

> fundamental issue presented is the possible implications for lawyers, in dealing with auditors' inquiries, as the position taken relates to both the traditional protections for confidences and secrets (including the attorney-client privilege) and the lawyer's responsibilities in advising clients regarding disclosure obligations under the Federal securities laws.
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> The following represents an effort by the Section to arrive at a reasonable resolution of the different viewpoints of the two professions, one bottomed on full disclosure requirements for corporate financial statements, and the other bottomed on important public policy reasons for the maintenance of confidential attorney-client relationships.

Once the question has been formulated in that fashion, what follows is inevit-

The securities practice is really *not* significantly different from other kinds of business practice. Most lawyers perform both as advisors and as advocates and, as a practical matter, it is impossible to say where advising ends and advocacy begins—the two functions complement and inform each other. This is particularly true as to clients for whom the attorney performs a wide range of services. It is not unusual to be defending a corporate client in an anti-trust suit, or a products liability suit, or a labor dispute and, at the same time, to be engaged in drafting corporate by-laws, or contracts, or documents for a public offering. Nor is reliance by third parties upon representations made by the lawyer unique to the securities transaction. Certainly, whenever any lawyer drafts a document which will affect third parties, he should be liable for negligence or for criminal misrepresentation—and so he is—under present legal principles.

To suggest abolishing the attorney-client privilege in this context is to use an axe where a penknife will do. It is instructive that the courts have very carefully *refrained* from reaching this result; instead, they have applied exceptions in situations in which disclosures have been warranted. The Code of Professional Responsibility permits a lawyer to reveal confidential communications when the client has waived confidentiality, when the information is required by law or by court order, when necessary to defend himself against accusations of wrongful conduct, and when necessary to prevent the client from consummating a fraud or a crime. These are exceptions broad enough to achieve the necessary flow of information to the public—there is simply no need to go further. The attorney-client privilege has always been strictly construed; the policy of the law has always favored exposure over secrecy. But the courts have likewise recognized the necessity of the principle of confidentiality. It seems altogether reasonable to assume that, should the attorney-client privilege be abolished, and attorneys placed under a positive duty of disclosure, the result would be massive misrepresentations by clients to their lawyers. Deprived of the assurance that the lawyer is its advocate, deprived of the knowledge that what is imparted will be kept confidential, the corporate client will simply fail to give its lawyer the whole truth. This will result in poorer representation of that client by that lawyer, and it will result in *less* public disclosure, not more.

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ably an attempt at compromise rather than a resolution of the problem. This is not to deny the merit of the proposals: they seem workable and reflect careful consideration of the questions involved. The drafters have included excellent statements of the public policy considerations which must underlie any attempt at positive rulemaking. Nevertheless, having once framed the problem in terms of two essentially antagonistic goals, the drafters have unwittingly limited the scope of any potential response.

When one speaks of the "need for disclosure," one is really aiming at two types of serious misrepresentation. One is talking about affirmative fraud and about the omission of material information—passive fraud. Both should be covered by the exception in the Code for fraudulent or illegal activity. Much of the hue and cry over the emergence of a "new ethic of disclosure" is, sadly, the result of the fact that this exception has been invoked far too infrequently. The rule isn't new, but the enforcement of the rule is. Enforcement is salutary both for the public and for the bar and is long overdue. There is no need to fashion a new ethic; there is a need to live up to the ethic currently professed.

Much the same sort of argument is pertinent when one considers imposing a "positive duty of investigation" upon the securities practitioner. Such a duty, to the extent that it is tenable, is already embodied in traditional negligence law. The standard is one of "due diligence under the circumstances," that is, the care which a prudent man, under all of the pertinent circumstances, would exercise. The utility of the standard lies in its flexibility. One suspects that it is precisely that quality, however, that frustrates many commentators. All of the debate in this area, all the discussion, has been focused upon a search for a *rule* that would cover all the contingencies, that would spell out with precision the duty of the attorney in all conceivable circumstances, that would remove the necessity for making hard decisions. It can't be done. The individual lawyer must still decide whether a given fact is material, whether a client's corporate books look suspicious, or whether a client is genuinely over-optimistic or trying to perpetrate a fraud.

Legislators have tried for untold generations to produce laws so specific, so "ironclad," that they would require no interpretation by the courts. Their efforts have been notably unsuccessful. The genius of the common law is its capacity for growth; the great strength of case law is its adaptability. A good judge approaches legal doctrines from the equity side of the bench and aims to achieve substantial justice. The price we pay for this is a certain lack of predictability, stare decisis notwithstanding.

The central question is not whether disclosure or privilege is more important. Rather, the question should be what *degree of participation* by an attorney is sufficient to justify the imposition of liability for active or passive fraud? In criminal terms, what makes a lawyer liable for "aiding and abetting"? That is the standard that needs clarification and the area in which positive rulemaking would be least inappropriate.

One can hardly speak meaningfully about a duty to investigate unless one first establishes what is meant by participation, for the investigative duty, if any, will depend upon the degree to which the lawyer is involved in the transactions of the client. To use negligence terminology, that level will determine the "standard of care."

Lawyers above all men should realize the impossibility of demanding that the law be "neat." The most difficult decisions are not choices between right and wrong, good and evil, purity and corruption. Those are easy. The difficulty comes when one must choose between competing goods; and it is precisely because those choices are so difficult that we cannot afford to legislate them. The case law in this area, as in others, has demonstrated its capacity for growth. The courts are using traditional doctrines of ethics and tort law to reach results which some commentators would reach by drastically amending some of our most basic assumptions about the law and the lawyer's role. The name of that process is overkill, and it is unwise.

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