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PROBLEMS OF PROFESSIONAL RESPONSIBILITY

An Address By

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With all of the learned lectures and discussions you have heard this morning and will hear this afternoon and tomorrow, it is not likely that I can add much to your knowledge by a few remarks after lunch. It isn't the right time for deep learning, and I am probably not the right person to try to impart it. Let me rather share with you some reflections on the problems of law enforcement as it applies to professional persons acting in their professional capacity.

In doing so, I am not really seeking sympathy. We all have our problems, and ours on the government side are certainly no worse than yours on the private side - - less so, on the whole, I would imagine. Whether or not I tend to agonize over decisions we must make in enforcement matters might be of interest to my psychiatrist, if I had one, but not to you. What I do wish to encourage is some better understanding of what we at the Commission see as the problem, and what we are trying to do about it. And, of course, I mean "we" in the collegial sense - - not just the present Commissioners and staff, but also our predecessors and, I trust, our successors.

When the Commission filed its complaint in the National Student Marketing case a little over two years ago, the chill that went down my spine as a practicing lawyer was as icy as that of anybody, save possibly the named defendants. I was surprised, however, that the shock experienced by the bar at the inclusion of two highly regarded law firms as defendants was matched by a certain amount of shameless rejoicing by others in other quarters. Editorials remarked that lawyers were no longer immune from legal responsibility, and, if this was not good absolutely, it was at least good relatively, considering what lawyers do to other people. Of course, lawyers never imagined that they were immune from the federal securities laws when acting as principals, but it was a

blow to realize that strictly professional activity might amount to a violation, directly or by aiding and abetting - - although, of course, that is what the Commission, plaintiffs' lawyers, and even U.S. Attorneys were imposing on accountants.

Not long after that complaint became public, I participated in a panel discussion of the subject at the University of Chicago Law School. I did a lot of talking, in part to obscure the fact that my own mind was not settled on how far the law should go. We were not, of course, necessarily arguing the merits of the National Student Marketing case, about which none of us had any knowledge except the complaint and a preliminary defense memorandum, but speculating on the broader and more general question.

The students and teachers on the panel seemed to have fewer doubts than the practitioners. I have never really understood why, in some quarters, especially among some teachers, a new theory of liability is automatically regarded as progress - - as though the ideal state of the law were to have everyone liable to everyone else for everything. I don't find the problems quite so simple. The imposition of liability can provide a significant source of compensation for injured persons, or it can merely destroy defendants financially without helping plaintiffs very much. The fear of liability can provide an effective stimulant to right behavior, or it can over-terrorize to the point of psychological ineffectiveness - - something like the threat of nuclear destruction on primitive peoples.

One approach to the resolution of such imponderables is to reflect that you are not God or even the Supreme Court and resort to role-playing and advocacy. At least within very broad limits, this is quite proper for counsel for private plaintiffs. As long as proper procedures are followed such counsel are no doubt entitled to push the law as far as it

will go in seeking recovery for their clients. It is the role of defense counsel, judges and legislators to guard against the laws being pushed too far. Kant's categorical imperative has not been regarded as binding on advocates for private litigants.

The problem is somewhat more complex for a government agency charged not only with law enforcement but also the sound development of the law in the assigned areas. Are we entitled to press any plausible theory for the sake of bringing and winning injunctive actions without regard to the broader consequences of success? I think not, although, lawyers - - especially trial lawyers - - being what they are, the burden of this sort of unnatural restraint induces an occasional institutional schizophrenia which causes great travail and our resolution of such conflicts may not always be perfect.

But while we cannot play with the happy freedom from total responsibility that the counsel for private plaintiffs enjoy, we do have a responsibility to use our resources to achieve the objectives of the laws we administer. These resources include law enforcement through civil litigation - - normally the suit for injunction - - and criminal references, as well as rulemaking, exhortation through releases, guidelines and speeches, and recommending legislation. The deployment of these resources against a given problem is sometimes one of our more difficult decisions, just as it is for our jurisprudence.

The problem we perceive relevant to this Institute is the involvement of accountants and lawyers in the failure of issuers to comply with the requirements of our laws for full and fair disclosure of material information. I realize that people get tired of hearing SEC Commissioners talk about fraud - - we seem obsessed with the subject, like a Puritan preacher with sex and sin - - but there is more of it abroad than I thought there

was as a private practitioner, and there is much more of it abroad than there ought to be. If you assume this is correct, without my taking the time to cite examples and statistics, then consider what we should do about it.

We know, as you know, that a really successful fraud or failure to provide full and fair information can scarcely be accomplished in our complex financial world without the help of accountants and lawyers. This helps may be active and intentional connivance, or it may be more passive and subtle, but it is frequently essential. Put the other way, if the accountants and lawyers engaged in corporate and financial practice insist upon compliance with the law and perform in accordance with accepted professional standards, the objectives of the federal securities laws would be far closer to achievement. The independent accountants are inescapably more exposed, and the materiality of deficiencies in their product more obvious, but the lawyer's role is also often critical.

This is not a new discovery. Lawrence Nerheim, our General Counsel, for a talk on this subject some months ago, dug up an early writing, in 1934, by Mr. Justice Douglas - - not then, of course, on the bench - - quoting Westbrook Pegler. Mr. Pegler was a former sports writer, at which he had been very good, who became a political columinist generally devoted to a sort of Know-Nothing thrashing out at the New Deal and almost everything else in sight, including Wall Street and what were then popularly called "corporation lawyers." On the subject of our concern today, Mr. Pegler wrote - -

> But just as a fine, natural football player needs coaching in the fundamentals and schooling in the wiles of the sport, so, too, it takes a corporation lawyer with a heart for the game to organize a great stock swindle or income tax dodge and drill the financiers in all the precise details of their play. Otherwise, in their natural enthusiasm to rush in and grab everything that happends not to be nailed down and guarded with shotguns they would soon be caught offside and penalized, and some of the noted financiers who are now immortalized as all-time all-American

> larcenists never would have risen beyond the level of the petty thief or short-change man.

This kind of delicate perception and fine weighing of imponderables seems always to have been particularly popular in Chicago journalism, and I never thought I would be quoting Westbrook Pegler as an authority on anything more complicated than whether Babe Ruth really pointed to where he planned to hit his home run. Unfortunately, this passage, that we would all like to pass off as quaint muckraking of an earlier day, has an all too modern ring. The role of lawyers in large affairs, not just corporate, is under severe criticism and challenge.

The Commission's response in the area of its concern has been to use all of the weapons Congress has given it save, only, to date, rule-making and the recommending of legislation. We have brought injunctive actions, we have made criminal references, and we make speeches. If you accept the proposition that we should do something, should we have proceeded in some other fashion?

We are perpetually caught up in the ancient conflict between the approaches of Common and Civil Laws, between the development of the law through judicial decisions and through legislation, which, in our case, includes rule-making. When is it better to establish a point through litigation or to propose and adopt a rule? We ponder this question often and in many contexts, and perhaps we do not always make the wisest choice. We may also have a different view from the practitioners as to whether we are asserting a new theory.

When a lawyer has knowingly aided and abetted his client in deceiving investors, we are not apt to think any new rule or statute is necessary to make his conduct unlawful.

One of my favorite stories from the old days of the Common Law in England is of a trial judge who ruled against an old woman plaintiff, whereupon she pulled a dead cat from her satchel and hurled it at the judge. The judge looked at her sternly and said, "Old woman, if you do that again, I will find you in contempt!" It seems to us that we would be like that judge in proposing a rule that lawyers shouldn't help their clients commit a fraud, and forebear prosecuting any lawyer who did so until after such a rule was in effect.

At the other extreme, some aspects of professional responsibility - - as, indeed, of directors' responsibility - - may be too complex for rule-making, at least for rule-making too soon. It is the essential genius of the Common Law that the court decide only the case before it, and not purport to decide all of the other possible cases that may be more or less similar but distinguishable in material respects that may be difficult to anticipate.

Consider, for example, the amazing development of the law under Rule 10b-5. Would this have developed more satisfactorily if limited to express rules specifying specific conduct which does, and thus inferentially which does not, constitute fraud, etc.? There was a time when I shared Professor Ruder's view that the whole notion of civil liability under the rule went beyond the intent of Congress, but that issue has long since been settled. Given the proposition that it does create civil liability, it seems to me that it was better to let the courts make the law in particular situations and that an effort to do so through a series of detailed rules would have been poorer jurisprudence. It may be that the time is ripe, or will soon be, for a codification of the law under 10b-5, based on the many decisions that have explored its ramifications, but the decision of Professor Loss

and the American Law Institute in the proposed Federal Securities Code is not to attempt to freeze the law in this regard except on some procedural points.

Something like this is going on in the area of professional responsibility. Aside from existing accounting and auditing standards and the lawyer's Code of Professional Responsibility, we have so far been of the opinion that rule-making is either unnecessary or premature. One of the principal arguments asserted in favor of rule-making is the desire of persons for reasonable certainty as to what the law requires of them, and it is true that the Common Law method sometimes appears very harsh on the poor devils who serve as defendants in the cases that develop the Law. I don't want to be so cruel as to pass this off with the observation that this is the price of progress, if, in fact, a better way seemed available. But I think the truth is that we have not sought injunctions based on conduct that, if the facts are as we allege, would be regarded as all right by responsible persons in the respective professions. The defendants may have been surprised that we are doing something about it, but I doubt that they are surprised that their conduct is being viewed by us as deficient.

This is not to say that more cannot be done by the professions themselves to furnish guidance to practitioners who need it. In this respect the accounting profession is far ahead of the lawyers. We would even be glad to assist in such endeavors, provided only that we keep in mind that the final goal of full and fair disclosure must in the end govern over the mechanical adherence to any conceivable checklist.

People not only get tired of having SEC Commissioners talk about fraud and how they are against it; we have also been critized for destroying the public's confidence in the free enterprise system by emphasizing the inadequacies of corporate management,

accountants and, now, the bar. We create the impression, so it is said, that all financial statements are suspect and all managers and professionals are crooks. Well, I think the system needs improvement, and I don't know how we can improve anything without recognizing its deficiencies. I just don't believe that public confidence in our financial markets would be enhanced by our pretending not to notice the failure of some participants to perform adequately or even honestly.

But, in case there is really any doubt, we are fully aware of the high standards that govern the conduct of most accountants and lawyers most of the time. Without them our system would be impossible. Accountants and lawyers are in the front line of law enforcement, helping to achieve the goals of honesty in our business life and full and fair disclosure to investors in countless cases that never do, and never could, come to our attention. Our whole system of government regulation and supervision relies heavily on the continued exercise of such professional responsibility in your daily work. We have no desire to change this system. We want only to preserve it and improve it.