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Andrew M. Lawrence, Alexandra M. Arango and Desislava K. Kireva, Appearing and Practicing Before the SEC: Ethical Considerations for Corporate Counsel

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Appearing and Practicing Before the SEC:
Ethical Considerations for Corporate Counsel

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I. Introduction

A. The scrutiny facing securities lawyers, and in particular those who appear and practice before the U.S. Securities and Exchange Commission (the "SEC" or the "Commission"), has increased substantially in recent years. The SEC continues to focus its attention on the role of corporate attorneys as gatekeepers. SEC Chairman Jay Clayton affirmed this focus in a January 2018 speech on initial coin offerings, in which he stated that the Commission expects securities lawyers to "bring expertise, judgment, and a healthy dose of skepticism to their work" and added that he has instructed the staff "to be on high alert" for attorney conduct "that may be contrary to the spirit of our securities laws and the professional obligations of the U.S. securities bar." *Opening Remarks at the Securities Regulation Institute*, Washington, D.C. (Jan. 22, 2018). As discussed below, a number of SEC staff members have made similar strong statements about the importance of enforcement actions against gatekeepers, including lawyers. In this environment, it is imperative that securities attorneys have a clear understanding of their distinct professional obligations under the SEC's rules and an appreciation for how the SEC perceives attorney conduct.

B. Evaluating the SEC's attorney discipline regime is challenging under the best of circumstances, and following Dodd-Frank, additional uncertainties have been added to the analysis. This outline sets out the framework for the SEC attorney discipline regime and discusses the significant cases and regulations.

II. The SEC's Power to Regulate and Discipline the Securities Bar

A. Rule 102(e) (formerly Rule 2(e)) of the Rules of Practice of the SEC gives the Commission wide latitude to sanction lawyers who engage in unethical conduct.

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1. Rule 102(e) provides that the SEC "may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission . . . (i) [n]ot to possess the requisite qualifications to represent others; or (ii) [t]o be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or (iii) [t]o have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder . . . ." 17 C.F.R. § 201.102(e)(1).

2. The terms "unethical or improper professional conduct," are not defined as they apply to lawyers, potentially giving the SEC wide latitude to sanction lawyers for conduct that may or may not comport with state bar rules.

B. Lawyers are also subject to general laws, including the federal securities laws. The SEC can bring judicial or administrative enforcement actions against lawyers for violating or aiding and abetting or causing violations of the securities laws.

III. Lawyer As Gatekeeper

A. The Concept of Gatekeepers:

B. The SEC conceives lawyers as gatekeepers, with duties not merely to their clients but also to the wider investment community to ensure the integrity of securities transactions.

C. According to Professor Coffee's oft-quoted formulation: "[G]atekeepers are reputational intermediaries who provide verification and certification services to investors. These services can consist of verifying a company's financial statements (as the independent auditor does), evaluating the creditworthiness of the company (as the debt rating agency does), assessing the company's business and financial prospects vis-à-vis its rivals (as the securities analyst does), or appraising the fairness of a specific transaction (as the investment banker does in delivering a fairness opinion). Lawyers can also be gatekeepers when they lend their professional reputations to a transaction, but . . . the more typical role of lawyers serving public corporations is that of the transaction engineer, rather than the reputational intermediary." John C. Coffee, Jr., *Understanding Enron:* "*It's About the Gatekeepers, Stupid,*" 57 BUS. LAW. 1403, 1405 (2002).

D. In September 2004, Stephen Cutler, a former director of the SEC's Division of Enforcement, articulated the SEC's reigning conception of the gatekeeper, declaring:

1. "On the first of [Sarbanes-Oxley]'s themes—which you'll recall is the importance of the gatekeeper function in our capital markets. What do I mean by gatekeeper? The sentries of the marketplace: the auditors who sign off on companies' financial data; the lawyers who advise companies on disclosure standards and other securities law requirements; the research analysts who warn investors away from unsound companies; and the board of directors responsible

for oversight company management. They're paramount in ensuring that our markets are clean. And Congress recognized that when it enacted Sarbanes-Oxley."

E. The SEC's focus on the lawyer as a gatekeeper continues today. In a July 2019 press release, Marc P. Berger, Director of the SEC's New York Regional Office, stated that "[a]ttorneys must not misuse their specialized skills and knowledge of the securities laws to engage in fraud at the expense of unwitting investors." At SEC Speaks 2015, Chair Mary Jo White reiterated the SEC's emphasis on lawyers serving as gatekeepers, stating: "[w]e . . . remain closely focused on gatekeepers, having recently brought . . . cases against auditors, transfer agents and attorneys." Similarly, in a March 2016 press release announcing charges against a former chief legal officer for aiding and abetting a scheme to defraud investors, the Director of the SEC's San Francisco Regional Office emphasized the gatekeeper role, stating: "[g]atekeepers play an essential role in every company. Rather than take a stand for the fund's investors, [the chief legal officer and controller] allowed [the CEO's] scheme to perpetuate and their salaries were paid out of money [the CEO] misappropriated from investors."

F. As noted above, at a January 2018 Securities Regulation Institute conference, SEC Chair Jay Clayton reminded attorneys of their critical role as gatekeepers. Clayton focused on the new ethical risks that lawyers face when providing advice related to initial coin offerings ("ICOs") and cryptocurrencies. Clayton identified two scenarios, in particular, that give him cause for concern. First, he frowned upon lawyers who appear to be assisting promoters in structuring product offerings that share key features of a securities offering but claim the products are not securities. As a result, cryptocurrency promoters proceed without complying with securities laws and investors are left without the laws' protections. Second, he criticized attorneys who have stepped away from "key issues" and provide "'it depends' equivocal advice" when assisting in an ICO, rather than advising their client that the cryptocurrency is a security and registration is likely required.

G. In early 2018, the SEC revised its website to include information for investors about the risks related to ICOs and to remind gatekeepers of their role. The SEC notes that "[g]atekeepers and others, including securities lawyers, accountants and consultants, should be guided by the principal motivation for the SEC's registration, offering process and disclosure requirements: Investor protection and, in particular, the protection of Main Street investors." These comments demonstrate the continuing role of attorneys as gatekeepers and the SEC's continued interest in pursuing attorneys who abandon this role.

H. Recent enforcement actions against attorneys acting as advisors demonstrate the SEC's continued pursuit of lawyers in their gatekeeper roles.

1. On August 29, 2019, the SEC filed a complaint against Phillip T. Howard, an attorney who served as president of investment advisory firm Cambridge Capital

Group Advisors, LLC. *See SEC v. Cambridge Capital Grp.*, No. 4:19-cv-00420 (N.D. Fla. Aug. 29, 2019). The complaint alleged that Howard—along with his co-defendant Don Reinhard—defrauded former football players who Howard represented in a class action lawsuit against the NFL. Compl. at 1–2. According to the complaint, Howard and Reinhard solicited these players to invest in two private funds managed by Cambridge Capital. *Id.* Howard and Reinhard allegedly told the players that the private funds "were invested in a diverse range of securities with a secondary focus on litigation settlement advances." *Id.* at 2. However, the funds invested with Cambridge Capital were used primarily to pay settlement advances to former NFL players in connection with the ongoing class action lawsuit against the NFL. *Id.* Howard also misappropriated the funds to pay himself fees and to cover his own residential mortgage expenses. *Id.* Moreover, Howard filed misleading disclosures with the SEC that failed to divulge that Reinhard had pled guilty to a felony in 2009 for violating the anti-fraud provisions of the federal securities laws and had been barred from being affiliated with an investment adviser. *Id.* at 3. Through its complaint, the SEC seeks to permanently enjoin the defendants from violating the securities laws and participating in the offer or sale of any securities. *Id.* at 27–28. The SEC also seeks disgorgement of all ill-gotten gains and entry of civil penalties for the alleged misconduct. *Id.* at 28. The case is currently in discovery and is scheduled to go to trial in November 2020. *See* Mot. to Extend (Dkt. No. 80), No. 4:19-cv-00420 (June 3, 2020).

2. On July 12, 2019, the SEC filed a complaint against William Lawler, an "experienced securities lawyer" from Arizona who represented microcap companies alleged to have engaged in a type of pump and dump scheme. *SEC v. Lawler*, No. 1:19-cv-04025 (E.D.N.Y. July 12, 2019). The scheme that Lawler helped to devise involved the fraudulent transfer of control over two publicly traded shell companies that had already issued "ostensibly 'unrestricted shares.'" *Id.* at 11; *SEC Charges Securities Lawyer and Microcap Agent with Fraud*, Litigation Release No. 24530 (July 15, 2019). Once control over the public shell companies was attained, the control group merged "a private company into the public company shell . . . and then use[d] false or misleading claims about the alleged business of the new company" to artificially inflate the price of its shares. Compl. at 11, *Lawler*, No. 1:19-cv-04025 (July 12, 2019). Specifically, the complaint alleges that between August 2015 and March 2016, Lawler, along with another individual, facilitated the unregistered sale of more than a million shares of Broke Out, Inc. ("BRKO"). *Id.* at 2. The complaint also alleges that Lawler carried out a similar scheme between February 2015 and April 2017 for another public shell company, Immage Biotherapeutics Corp. ("IMMG"). *Id.* Lawler sought to "orchestrate the transfer of control of these shell companies" to one of his clients ("Client A") and his client's associates (the "Client A Group") so that the Client A Group could then "resell those shares to the public." *Id.* To facilitate the sale of unregistered shares, Lawler deceived broker-dealers into accepting such shares for trading by falsely reporting that the shares were

"unrestricted," "freely tradeable," and "in the hands of non-affiliates." *Id.* at 12. In reality, members of the Client A Group were company insiders who controlled the stock being resold. *Id.* Following promotional campaigns that pumped up the share price of BRKO and IMMG, the Client A Group sold $3.2 million in stock that should have been restricted under the registration requirements found in Section 5 of the Securities Act. *Id.* at 13. As compensation for helping to devise the BRKO and IMMG schemes, Lawler was paid $5,000 in addition to the tens of thousands of dollars he received in legal fees. *Id.* at 4. The complaint further alleges that between December 2016 and January 2018 Lawler engaged in "manipulative trading in a series of coordinated, matched trades in the stock of [Nami Corp.] to create the appearance of an active market" and to inflate the value of the shares artificially. *Id.* The SEC claims that Lawler's conduct violated sections 17(a), 5(a), and 5(c) of the Securities Act and sections 10(b), 9(a)(1) and 9(a)(2) of the Exchange Act. *Id.* at 4. The SEC's charges against Lawler are still pending.

3. On June 26, 2019, the SEC filed a complaint alleging that Michael Woodford, a Denver-based divorce attorney, had violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act. *SEC Charges Colorado Divorce Lawyer in Fraudulent Microcap Scheme*, Litigation Release No. 24523 (June 28, 2019). In addition to Woodford, the complaint named Diane Dalmy, a former securities lawyer who is prohibited from practicing before the SEC and the OTC Markets Group and is current an inmate in federal prison. *See* Compl. at 1-2, *SEC v. Dalmy,* No. 19-cv-745 (June 26, 2019). The complaint alleged that in 2009, the OTC Markets Group—which operates the country's largest trading system for microcap securities—placed Dalmy on its list of prohibited attorneys after she was warned that opinion letters she had submitted were inadequate. *Id.* at 5. Dalmy sought to evade her suspension from the OTC Markets Group by contacting Woodford who agreed to sign his name on opinion letters authored by Dalmy. *Id.* at 7. As a practicing divorce attorney, Woodford had no prior securities law experience. *Id.* at 2. Nevertheless, at Dalmy's direction, Woodford signed at least 85 opinion letters between 2014 and 2016. *Id.* at 7. The complaint asserted that Dalmy created the entirety of the content in these letters and that Woodford "did nothing to check the accuracy of any factual information" contained therein and performed no legal analysis. *Id.* at 8. The letters, which were sent to transfer agents and brokerage firms, expressed the legal opinion that "certain shares of stock in microcap companies were unrestricted and could be freely traded on the public market." *Id.* at 2. In September 2016, Dalmy was permanently suspended from practicing before the SEC as a result of her participation in a pump and dump scheme involving fraudulent opinion letters. *Id.* at 6. Even after Dalmy's suspension from practicing before the SEC, however, Woodford filed with the SEC three documents that were prepared by Dalmy on behalf of her client. *Id.* at 11. In March 2017, the scheme collapsed when OTC Markets Group placed Woodford on its list of prohibited attorneys. *Id.* at 12. In a 2018 criminal action brought by

the DOJ, Dalmy was convicted of conspiracy to commit wire fraud and was sentenced to serve three years in prison and to pay $2 million in restitution in connection with "her securities-related legal work for several public companies." *Id.* at 6. On December 6, 2019, final judgment was entered against Woodford, permanently enjoining him from violating the securities laws, barring him from participating in any offering of penny stock, and ordering him to disgorge $29,700 in ill-gotten gains. Final J. as to Woodford, No. 9-cv-745 (Dec. 6, 2019). In January 2020, the court entered a similar final judgment against Dalmy, preventing her from participating in penny stock offerings and enjoining her from violating the securities laws. Am. Final J. as to Dalmy, *id.* (Jan. 9, 2020). The final judgment against Dalmy, however, also permanently suspended her from practicing before the SEC, barred her from providing any legal services in connection with the offer or sale of securities, and ordered her to disgorge $30,200. *Id.*

4. On June 27, 2019, the SEC filed a complaint against four attorneys and a real estate agent who allegedly participated in a scheme involving the transfer and sale of fraudulently registered securities. Compl. at 1, *SEC v. Sargent, et al.*, No. 1:19-cv-11416 (D. Mass. June 27, 2019). Henry Sargent, in-house counsel at Southridge Capital Management, formed BMP Holdings ("BMP") in 2014. *Id.* at 6. Sargent was the CEO, CFO, and sole director of BMP, which was a shell company with no business activities. *Id.* Shortly after BMP's formation, Sargent recruited 32 friends and family members to act as nominee shareholders by purchasing 168,000 BMP shares at the price of one cent per share. *Id.* In May 2015, Sargent filed a Form S-1 registration statement on behalf of BMP, enabling the nominee shareholders to sell off their holdings of BMP stock to the public for 15¢ per share. *Id.* at 7. The S-1 filed by Sargent was "materially false and misleading" as it stated that "[n]one of the selling security holders are affiliates or controlled by our affiliates" and that BMP's shareholders acquired such shares "pursuant to a private placement solely for investment." *Id.* In reality, the nominee shareholders were merely acting at the direction of Sargent and planned to sell their shares "whenever Sargent told them to do so." *Id.* at 8. Joseph Tomasek, an attorney affiliated with the Mintz Fraade Law Firm, was retained by Sargent to prepare the fraudulent S-1. *Id.* Tomasek ignored a number of "red flags" associated with the BMP offering (e.g., the absence of an offering memorandum) and "did nothing to determine whether [the nominee shareholders] had any relationship with Sargent." *Id.* In August 2016, Sargent arranged to transfer control over BMP to PixarBio, a Massachusetts biotechnology company that sought to use BMP "as a vehicle for unregistered sales of PixarBio stock." *Id.* at 2. Francis Reynolds, the CEO of PixarBio, hired Frederck Mintz and Alan Fraade—both attorneys in New York—to advise PixarBio in its acquisition of BMP. *Id.* at 2-3. In anticipation of the acquisition, Sargent directed BMP's nominee shareholders to sell their stock to Sargent himself as well as to two men affiliated with PixarBio. *Id.* at 3. BMP and PixarBio merged in October 2016, and the BMP shares held by the three men

became restricted PixarBio shares that could not be sold "unless the three waited the mandatory one-year holding period for stock sales by corporate affiliates" or a new S-1 was filed. *Id*. To evade these restrictions, Mintz and Fraade allegedly prepared opinion letters for a transfer agent and several brokerage firms, concluding that the shares were "free-trading." *Id*. at 3-4. Between October 31, 2016, and January 23, 2017, the three holders of restricted shares sold approximately $1.66 million in PixarBio stock. *Id*. at 4. By engaging in this conduct, the complaint alleges that Sargent, Mintz, Fraade, and Tomasek violated Section 10(b) of the Exchange Act and Section 17(a) of the Securities Act. *Id*. Through this action, the SEC seeks a permanent injunction barring the defendants from committing future violations of the securities laws; disgorgement of ill-gotten gains; penny stock bars; civil penalties; and a permanent injunction against Mintz, Fraade, and Tomasek from "directly or indirectly providing professional legal services (including the issuance of opinion letters) to any person or entity in connection with the offer or sale of securities." Compl. at 4, *Sargent*, No. 1:19-cv-11416 (June 27, 2019). On September 16, 2019, the defendants filed three separate motions to dismiss for failure to state a claim upon which relief can be granted. *See Attys Say SEC Can't Tie Firm to Sham PixarBio Merger*, LAW360 (Sept. 18, 2019). In support of their motion to dismiss, Mintz and Fraade argued that they did not represent PixarBio in its acquisition of BMP and that the SEC is unable to provide factual support demonstrating that payments made to Mintz and Fraade were compensation for drafting the allegedly fraudulent opinion letters. *See* Mem. of Law in Support of Mintz and Fraade Mot. to Dismiss, *Sargent,* No. 1:19-cv-11416 (Sept. 16, 2019). Tomasek's motion to dismiss argued that the SEC's complaint "relies on bare inferences and conclusory allegations based on hindsight and a far-reaching theory of 'guilt by association.'" *See* Mem. of Law in support of Tomasek Mot. to Dismiss, *Sargent,* No. 1:19-cv-11416 (Sept. 16, 2019). Finally, Sargent's motion to dismiss claimed that SEC's complaint relies "almost entirely on privileged information" and that absent such information "the SEC could not have supported its allegations sufficiently." *See* Mem. of Law in support of Sargent Mot. to Dismiss, *Sargent,* No. 1:19-cv-11416 (Sept. 16, 2019). The court denied the defendants' motions to dismiss on November 7, 2019, and the case is currently set to go to trial in February 2021. *See id*., Dkt. No. 66 (Nov. 7 2019).

5. On February 13, 2019, the SEC filed a complaint accusing Gene Levoff, the former Director of Corporate Law at Apple, of violating securities laws by engaging in insider trading. *SEC v. Levoff*, No. 2:19-5536 (D.N.J. Feb. 13, 2019). The complaint asserts that Levoff exploited his position as a senior attorney within the company to illegally trade Apple securities on at least three occasions in 2015 and 2016. Compl. at 2, *id.* (Feb. 13, 2019). As Apple's Director of Corporate Law, Levoff's duties included overseeing compliance with the company's insider trading policy and "determining the criteria for those employees (including himself) restricted from trading around quarterly earnings

announcements." *Id.* at 1. Levoff was also a member of Apple's Disclosure Committee, which reviewed non-public earnings reports and drafted public filings. *Id.* at 1-2. On July 10, 2015, in anticipation of an upcoming Disclosure Committee meeting, Levoff received draft earnings materials, which showed that iPhone sales failed to meet analysts' expectations for the quarter. *Id.* at 7-8. After learning about the lower-than-expected iPhone sales but before the results were publicly released, Levoff sold over 70,000 shares of Apple stock for approximately $10 million. *Id.* at 8. The value of Apple's stock fell more than 4% once the earnings results were made public on July 21. *Id.* As a result, the SEC alleged that Levoff avoided approximately $345,000 in losses. *Id.* at 9. Moreover, in October 2015, Levoff received a draft 10-K showing that the company's performance outpaced analysts' expectations. *Id.* On October 26, 2015, one day before Apple's scheduled earnings release, Levoff purchased 10,000 shares of Apple stock. *Id.* Once news of Apple's increased earnings became public, the company's share price rose more than 4 percent. *Id.* The following day, October 28, "Levoff sold the 10,000 shares he purchased two days earlier." *Id.* at 10. As a result of these trades, Levoff netted approximately $4,700 in profit. *Id.* Finally, in April 2016, Levoff engaged in similar behavior when he sold 4,000 Apple shares after learning that the company experienced its "first year over year revenue decline since 2003." *Id.* When news of Apple's revenue decline was made public a few days after Levoff executed his trade, the company's stock dropped in value by more than 6%. *Id.* As a result, Levoff avoided approximately $32,000 in losses. *Id.* In total, the SEC's complaint asserts that "Levoff profited and avoided losses of approximately $382,000." *Id.* at 2. At all times during the period in which these trades were executed, Levoff was subject to the insider trading policy he was responsible for overseeing. On May 10, 2019, the court in *SEC v. Levoff* issued an order staying the action pending the outcome of parallel criminal proceedings. *See* Order Granting Leave to Intervene and a Stay, *id.* (May 10, 2019). On October 24, 2019, Levoff was indicted on six counts each of securities fraud and wire fraud in connection with the same conduct at issue in the case brought by the SEC. *See* Ex-Senior Apple Atty Indicted on Insider Trading Charges, LAW360 (Oct. 24, 2019). The criminal charges are still pending.

6. On November 27, 2018, the SEC filed a complaint in the District of Massachusetts against two international tax attorneys and two other individuals for their role in multiple multimillion-dollar "pump-and-dump" schemes. *SEC v. Tobin, et al.*, No. 1:18-cv-12451 (D. Mass. Nov. 11, 2018). In its complaint, the SEC alleges that, since June 2013, Milan Patel, a licensed attorney living in Florida and partner in a Swiss-based international law firm; Matthew Ledvina, a Swiss-based attorney and colleague of Patel's; Morrie Tobin, a resident of California; and Daniel Lacher, a resident of Switzerland, conspired to hide Tobin's ownership in two holding companies, Environmental Packaging Technologies Holdings, Inc. ("Environmental Holdings") and CURE Pharmaceutical Holding Corp. ("CURE"). *Id.* at 1. Specifically, the defendants

disguised Tobin's ownership to make it appear as though his shares were owned by multiple unaffiliated entities and individuals, when in reality, these entities and individuals were holding the stock as nominees for Tobin, "the true owner and control person." *Id.* at 2. Patel, Ledvina, and Lacher arranged for Tobin's stock to be transferred to two offshore asset managers, including Wintercap SA, a Swiss company owned by Roger Knox, who was criminally charged in October for illegal stock sales. *Id.*; *SEC Obtains Preliminary Injunction in International Microcap Fraud Scheme*, Litigation Release 24,327 (Oct. 30, 2018). The offshore asset managers then deposited the stock into omnibus security accounts in blocks of shares constituting less than 5% of each company's outstanding shares so that the ownership did not need to be publicly disclosed. *Id.* Ledvina and Latcher served as purported "beneficial owners" of nominee accounts held at Wintercap SA. *Id.* Further, Tobin and a fifth individual ("Individual A") arranged for the CEO of Environmental Holdings, David Skriloff, to raise $1 million from investors to pay for a promotional campaign designed to artificially inflate the stock of Environmental Holdings. *Id.* at 3. In August 2019, the SEC filed an amended complaint identifying Individual A as Brian Quinn, the operator of a California-based investor relations company. Am. Compl., *id.* (Aug. 29, 2019). The amended complaint—which adds Quinn and Skriloff to the list of defendants—makes clear that Patel and Lacher helped Tobin and Quinn funnel the $1 million—Patel arranged for an entity, Svarna Ltd., to be created for the sole purpose of misleading investors into "believing that the promotional campaign was paid for by a third party" rather than Tobin or Environmental Holdings. *Id.* at 3-4. Lacher's girlfriend posed as Svarna Ltd.'s beneficial owner, and the promotional campaign touted the company's stock while falsely claiming that Svarna Ltd. had paid for the campaign. *Id.* 4. The sale of Environmental Holdings' stock generated approximately $1.5 million, and Tobin, Patel, Ledvina, and Lacher put together a similar scheme for CURE. *Id.* at 22, 26. The amended complaint also alleges that after receiving investigative subpoenas, Patel and Ledvina sought to obstruct the SEC's investigation by taking steps to change the names listed as "beneficial owners" on the Wintercap SA accounts. *Id*. at 23-24. Tobin, Ledvina, Patel, and Knox have all pled guilty to charges related to the stock scheme in a parallel criminal action. Dep't of Justice Press Release, *Founder of Swiss Brokerage Firm Pleads Guilty in Connection with Global Securities Fraud Scheme* (Jan. 13, 2020). The SEC's claims against the six defendants are pending.

7. On April 25, 2018, the SEC filed a complaint against an attorney and two other individuals in the District Court for the Middle District of Florida for their role in manufacturing companies with low market capitalization with the intent of selling them based on the false premise that they were public and had a pool of securities available for trading. *SEC v. Diane J. Harrison, et al.*, No. 18-cv-01003 (M.D. Fla. Apr. 25, 2018). In its complaint, the SEC alleges that Diane J. Harrison, a securities attorney licensed to practice in Florida and Nevada, her husband, Michael J. Daniels, and their colleague, Catherine A. Bradaick-Zolla,

participated in the scheme from 2010 to 2014. Daniels and Harrison followed a consistent pattern for each company: they would acquire a small local business and gift its securities to approximately 30 friends and family by providing them the money to purchase the shares to "give the false appearance they had actually invested in the companies." *Id.* at 2. They then filed registration statements with the Commission to register secondary public offerings of the shares. According to the SEC, Daniels and Harrison created a "mirage" of independent management and independent investors. *Id.* at 3. In the same complaint, the SEC alleges Harrison also assisted two other individuals in preparing 21 legal opinion letters in furtherance of 11 "blank check" companies. *Id.* at 4, 7 (citing *U.S. v. Mirman et al.*, No. 16-cr-20572 (S.D. Fla.)). The SEC alleges that Harrison "provided these professional services throughout the process knowing—or being reckless in not knowing—about both the fraud and falsity of her statements." *Id.* at 4. The Commission also seeks a final judgment ordering the defendants and relief defendants to disgorge ill-gotten gains and pay civil money penalties. In June 2018, Harrison raised various affirmative defenses, including an argument that the claims were time-barred under *Kokesh v. SEC*, 137 S. Ct. 1635 (2017) (applying a five-year statute of limitations to SEC claims for disgorgement of ill-gotten gains). Daniels also raised this same argument in a separate motion to dismiss. *See* Daniels Motion to Dismiss, *id*. (Dec. 6, 2018). Ultimately, the court rejected both motions, holding that the five-year statute of limitations in 28 U.S.C. § 2462 did not present a bar to the action. *See* Order Denying Daniels Motion to Dismiss, *id*. (Feb. 5, 2019). Without admitting or denying the allegations, Bradaick-Zolla consented to a permanent bar from serving as an officer or director of a public company and from participating in penny stock offerings. Order as to Catharine Bradaick-Zolla, *SEC v. Diane J. Harrison, et al.*, No. 18-cv-01003 (M.D. Fla. Sept. 9, 2018). Bradaick-Zolla was also ordered to pay a $55,299 civil penalty and to disgorge the same amount plus $11,163 in prejudgment interest. Judgment as to Catharine Bradaick-Zolla, *id*. (Aug. 8, 2019). On June 16, 2020, the court entered judgment against both Harrison and Daniels, permanently enjoining the defendants from violating the securities laws, participating in any penny stock offerings, and providing legal services in connection with the offer or sale of securities. *See* Order (Dkt. 144), *id*. (June 16, 2020). Daniels and Harris were also ordered to pay civil penalties and disgorge ill-gotten gains. *Id.*

8. On October 5, 2017, the SEC filed a complaint in the Northern District of Georgia against Marc A. Celello, the general counsel for Credit Nation Capital LLC ("CN Capital") for allegedly assisting the CEO of the company in a Ponzi scheme between 2009 and 2015. *SEC v. Celello*, 1:17-cv-03903-WSD (N.D. Ga. Oct. 5, 2017). The scheme involved a promissory note offering whereby investment returns were paid using new investor money. *Id.* at 2. The SEC's complaint alleges that Celello was an "active participant" in the fraudulent offering. *Id.* He prepared the offering memoranda that CN Capital used to solicit investors, claiming that the notes were a secure investment. *Id.* at 3. Celello also

instructed the company's sales and marketing representatives to tell investors that the promissory notes were "100% asset backed," even though he knew that CN Capital had significant operating losses and insolvency. *Id.* at 15. In 2015, Celello instructed an employee to fabricate a balance sheet with assets that were not owned by one of the company's underlying entities; he then sent the sheet to marketing representatives for use in sales pitches. *Id.* Celello's involvement also reached the company's finances. Celello directed investor funds through his IOLTA trust account, and then sent the money to the CEO for personal use. *Id.* at 18. In December 2019, the court entered judgment against Celello, permanently restraining him from violating the securities laws and ordering him to disgorge ill-gotten gains. J. as to Celello. *Id*. (Dec. 2, 2019).

9. On April 12, 2017, the SEC filed fraud charges against Mustafa David Sayid, a New York City-based securities lawyer, for taking control of two publicly traded shell companies and rigging them and their securities for use in market manipulation schemes for personal profit. *SEC v. Sayid*, No. 17-cv-02630 (S.D.N.Y. Apr. 12, 2017). Sayid allegedly gained control of Nouveau Holdings, Ltd. and Striper Energy, Inc. by installing officers and directors who would follow his direction, including his paralegal Kevin Jasper who signed false documents at Sayid's direction. Sayid is alleged to have caused the two companies to issue him convertible debt that could be redeemed for company stock for purported legal fees owed to him. Sayid allegedly sold the convertible debt to a pair of stock manipulators, setting them up to dump large blocks of the company's stock in the over-the-counter markets. Sayid hired Texas-based securities lawyer Norman Reynolds to issue false opinion letters to persuade Nouveau's transfer agent to remove restrictive legends from millions of Nouveau shares, which were then sold in a dump of Nouveau's stock. The SEC alleges that Reynolds based his legal opinion on fabricated documentation from Sayid and negotiated for payment from the proceeds of the Nouveau pump and dump. Sayid allegedly received $186,000 in the course of this scheme, and paid Jasper $21,000. Reynolds was paid $700 for the opinion letters that allowed the sale of the Nouveau shares, according to the complaint. Jasper and Reynolds were also charged for their role in the scheme. *SEC Charges Two Lawyers and a Paralegal in a Stock Manipulation Scheme*, Litigation Release No. 23,805 (Apr. 13, 2017). Jasper settled with the SEC without admitting or denying guilt; he is enjoined from committing future securities violations and the SEC agreed to delay imposing any civil penalties against him in exchange for his assistance in its investigation. J. as to Kevin Jasper, *SEC v. Sayid*, No. 17-cv-02630 (filed June 22, 2017). In November 2019, the court granted the SEC's motion for summary judgment against Reynolds and Sayid. Order (Dkt. Not. 112), *id*. (Nov. 26, 2019). Final judgment against Reynolds and Sayid has not yet been entered.

10. In December 2016, the SEC filed a complaint charging Walter "Chet" Little, a former partner at Foley & Lardner, with multiple insider trading violations. According to the SEC, "Little accessed confidential documents on his law firm's

internal computer network related to at least 11 impending announcements involving law firm clients, none of which he personally advised or billed for services." He then allegedly traded in advance of each announcement and tipped material nonpublic information to his neighbor so that he could trade similarly. The SEC alleges Little and his neighbor profited over $1 million from February 2015 to February 2016. *See* SEC Press Release No. 2017-100, U.S. Sec. & Exch. Comm'n, *Law Firm Partner and Neighbor Charged in $1 Million Insider Trading Scheme* (May 11, 2017). The Department of Justice filed criminal charges against Little in May 2017, and in November 2017 Little pled guilty to one count of conspiracy to commit insider trading. In February 2018, Little was sentenced to twenty-seven months incarceration and ordered to forfeit nearly $453,000. *See* J. as to Walter Little, *U.S. v. Little*, No. 17-cr-00450 (S.D.N.Y. Feb. 26, 2018). Little's co-defendant, Andrew Berke, was sentenced to three years of supervised release and was ordered to pay a $10,000 fine. *United States v. Berke*, No. 1:17-cr-00450 (Apr. 26, 2018). In the action brought by the SEC, the court entered final judgment against Little on February 14, 2019, enjoining him from violating the securities laws and ordering him to disgorge $452,998 in ill-gotten gains resulting from his misconduct. J. as to Walter Little, *SEC v. Little*, No. 1:17-cv-03536 (S.D.N.Y. Feb. 14, 2019).

11. On September 16, 2016, the SEC instituted administrative proceedings against Tod A. DiTommaso, an attorney licensed in California. *In re Tod A. DiTommaso*, Securities Act Release No. 10215, File No. 3-17550 (Sept. 16, 2016). The SEC Enforcement Division alleged that DiTommaso issued attorney opinion letters falsely stating that shares in Fusion Pharm, Inc. were unrestricted and could be issued into the market when in reality the stock was restricted. Between July 2012 and August 2013, DiTommaso signed at least ten attorney opinion letters for Fusion Pharm shareholders. Each of the opinion letters followed the same pattern. First, Guy Jean-Pierre, another attorney (who at the time had been barred by the OTC Markets Group Inc., from providing attorney opinion letters) emailed to DiTommaso an already drafted legal opinion and underlying documents relating to the shares. Then DiTommaso would put the legal opinion on his letterhead and would send the letter back to Jean-Pierre. DiTommaso was paid approximately $175 per legal opinion. DiTommaso's sole communication about the Fusion Pharm stock, and the transactions through which the shareholders received the stock, was through Jean-Pierre. The letters allowed entities and individuals to sell purportedly unrestricted Fusion Pharm stock into the market for over $1.2 million in proceeds. In the administrative proceedings, the ALJ concluded that DiTommaso violated Sections 5(a) and 5(c) of the Securities Act and held a hearing on sanctions. Taking into account DiTommaso's limited ability to pay a financial penalty, the administrative judge ordered him to disgorge $1,475 and to pay a civil money penalty of $1,475. *In re Tod A. DiTommaso*, Initial Decision Release No. 1142 (June 13, 2017); Notice that Initial Decision has Become Final, Release No. 10,423 (Oct. 3, 2017). Following the U.S. Supreme Court's decision in *Lucia v. SEC*, 138 S. Ct. 2044

(2018), DiTommaso was granted the opportunity for a new hearing but in December 2018 consented to settlement with the SEC. *In re Tod A. DiTommaso*, Securities Act Release No. 10597, File No. 3-17550 (Dec. 21, 2018). Without admitting or denying the findings of the SEC, DiTommaso consented to pay disgorgement of $1,475 and a civil penalty of $1,475. *Id.*

12. In September 2016, the SEC filed a lawsuit against government contractor RPM International Inc. ("RPM") and its General Counsel and Chief Compliance Officer Edward W. Moore, alleging the company failed to properly accrue for a $60.9 million False Claims Act settlement with the government. *SEC v. RPM Int'l. Inc.*, No. 16-cv-01803 (D.D.C. Sept. 9, 2016). According to the SEC, from 2011 through 2013, RPM and one of its subsidiaries, Tremco Inc., were under investigation by the U.S. Department of Justice ("DOJ") for overcharging the government on certain contracts. According to the SEC's complaint, Moore did not inform RPM's CEO, CFO, Audit Committee, and independent auditors, of material facts about the investigation. For example, Moore knew but failed to inform those parties that RPM sent DOJ estimates showing that a subsidiary substantially overcharged the government on the contracts under investigation; RPM had agreed to submit a settlement offer by a specific date to resolve the DOJ investigation; and, prior to submitting the settlement offer to DOJ, RPM's overcharge estimates increased materially to at least $28 million. Because of Moore's conduct, the company's SEC filings were inaccurate and misleading.

13. In February 2017, RPM and Moore filed motions to dismiss for failure to state a claim under Federal Rules of Civil Procedure 12(b)(6) and 9(b). *SEC v. RPM Int'l, Inc.*, No. 1:16-cv-01803, 1-2 (Sept. 29, 2017). On September 29, 2017, the District Court for the District of Columbia declined to dismiss the claims against RPM and Moore. *Id.* at 2. RPM had argued that it did not have an obligation to disclose the DOJ investigation or accrue for the losses until April 2013 when it announced it was setting aside nearly $70 million to resolve the investigation. The court disagreed, finding that the SEC had sufficiently alleged that RPM's obligation arose earlier than April 2013: "RPM and Moore had knowledge of more than just the mere existence of an open investigation; they knew that a federal civil complaint alleging violations of the False Claims Act was actually pending, and that DOJ was in the midst of determining whether it was going to intervene and take over the case." *Id.* at 28. Further, the SEC had alleged that "RPM, through its outside counsel, [had] engaged in quantifying the scope of the overcharge to the government, which, under the FCA, could be trebled." RPM had also argued that the SEC's claims should be dismissed "because the SEC filings contained opinions, not facts, and the complaint [did] not plausibly allege that RPM expressed the opinions with the knowledge that they were false." *Id.* at 37. Judge Amy Berman Jackson held that omissions of fact in SEC filings could be misleading to investors and that the SEC's complaint alleged sufficient facts to state this claim. *Id.* at 37-40 (citing *Omnicare Inc. v. Laborers Distr. Council Constr. Indus. Pension Fund,* 135 S. Ct. 1318 (2015)). Formal discovery

commenced in early 2018 and is still in progress. Order in Motion to Modify Scheduling Order*, SEC v. RPM Int'l, Inc.*, No. 1:16-cv-01803 (June 18, 2018).

14. In December 2015, Evan L. Greebel, former attorney for Martin Shkreli, was charged with aiding Shkreli's Ponzi scheme. The SEC charged Shkreli, former president of Turing Pharmaceuticals Inc., in connection with his alleged thefts from hedge funds and from the biopharmaceutical company Retrophin Inc., where he served as Chief Executive Officer ("CEO"). *See SEC v. Shkreli*, Litigation Release No. 23433 (Dec. 17, 2015). Prosecutors alleged that Shkreli misappropriated money from two hedge funds and made material misrepresentations to investors about the funds' past performance, assets under management and existing liabilities, and then prevented investor redemptions. According to the government, Shkreli and Greebel misappropriated Retrophin's assets in order to pay off Shkreli's personal and business debts. Shkreli was originally charged with seven counts of securities fraud and conspiracy, and Greebel was charged with a single count of wire fraud conspiracy. *See* Indictment, *U.S. v. Shkreli*, No. 15-cr-00637 (E.D.N.Y. Dec. 14, 2015).

15. In June 2016, federal prosecutors added a new securities fraud conspiracy charge against both Greebel and Shkreli. The superseding indictment alleges that they deceived investors and the SEC about Shkreli's control of unrestricted or free-trading shares in Retrophin. Prosecutors said Mr. Shkreli hid his control of certain unrestricted shares of Retrophin by dividing the shares among seven employees and contractors to avoid the 5% ownership threshold that would trigger reporting to the SEC. The indictment quotes email exchanges between the two defendants, including emails where Greebel appears to request payment from Shkreli. *See Christine Simmons, New Fraud Conspiracy Charge Lodged against Shkreli, Greebel*, N.Y.L.J. (June 7, 2016). Previously, the district court held that email exchanges between Greebel and Shkreli were not privileged because Retrophin Inc. had waived its own privilege to the documents. Shkreli argued that certain email exchanges with Greebel were protected by the attorney-client privilege because Greebel served as his personal counsel, independent of serving as external counsel for Retrophin. The district court disagreed and ruled that Shkreli was "entitled to no redactions." *In re Grand Jury Investigation*, 15-mc-022227, ¶ 8 (E.D.N.Y. Dec. 3, 2015). In January 2017, the district court ordered Greebel's former law firm, Katten Muchin Rosenman LLP, to turn over around 175,000 emails and documents related to the case. *Burnson, R. Shkreli Wins Access to Law Firm Records to Defend Himself*, Bloomberg (Feb. 3, 2017).

16. The district court ordered Shkreli and Greebel to be tried separately, and Shkreli's trial began on June 26, 2017. *Patricia Hurtado, Shkreli Wins Ruling to Be Tried Separately From Ex-Lawyer*, Bloomberg (Apr. 28, 2017). On August 4, 2017, a jury found Shkreli guilty on two counts of securities fraud and one count of conspiracy to commit securities fraud. The jury acquitted Shkreli on the

remaining five counts of conspiracy. *See* Jury Verdict, *U.S. v. Shkreli*, No. 15-cr-00637 (E.D.N.Y. Aug. 4, 2017).

17. In March 2018, U.S. District Judge Kiyo Matsumoto sentenced Shkreli to seven years in federal prison followed by three years of supervised release and ordered him to pay fines totaling $75,000 and to forfeit more than $7 million to the U.S. government. J. as to Martin Shkreli, *id.* (Mar. 26, 2018) (entering judgment from a March 9, 2018 sentencing hearing). Judge Matsumoto later amended the judgment against Shkreli to include nearly $400,000 in restitution. Am. J., *id.,* (Apr. 11, 2018). Shkreli appealed to the Second Circuit, requesting an order to vacate his conviction, or in the alternative a recalculation of the forfeiture amount. *U.S. v. Shkreli*, No. 18-0819 (2d Cir. Aug, 31, 2018). The Second Circuit ultimately affirmed Shkreli's conviction in July 2019, rejecting his challenges to the District Court's jury instructions and forfeiture calculation. Summ. Order J., *id*. (July 18, 2019). The U.S. Supreme Court declined to hear Shkreli's appeal of the Second Circuit's decision. *Shkreli v. United States,* No. 19-495 (Nov. 18, 2019).

18. Greebel's jury trial began in the Eastern District of New York on Oct. 20, 2017 and lasted eleven weeks. The jury convicted Greebel on both counts in the superseding indictment—conspiracy to commit securities fraud and conspiracy to commit wire fraud. A DOJ Press Release announcing the verdict included the following statement from then Acting U.S. Attorney for the Eastern District of New York Bridget M. Rohde: "Today's verdict sends a powerful message that this Office, together with our law enforcement partners, will hold lawyers accountable when they use their legal expertise to facilitate the commission of crimes." Dep't of Justice Press Release, *New York Attorney Convicted of Securities Fraud and Wire Fraud Conspiracies* (Dec. 27, 2017).

19. Greebel filed post-trial motions for dismissal of his conviction in February 2018. The court heard oral argument on Greebel's motions and on the government's motion for forfeiture in April 2018. *See* Minute Entry for Oral Argument and Motion Hearing, *U.S. v. Shkreli*, No. 15-cr-00637 (E.D.N.Y. Apr. 13, 2018). The government requested that Greebel forfeit approximately a half-million dollars, the difference between Greebel's law firm salary when he was performing work for Retrophin and the following year when he was not. The court asked for further briefing on which funds are directly traceable to Greebel's misconduct. *See Ex-Katten Atty Pushes to Deep-Six Fraud Verdict*, LAW360 (Apr. 13, 2018). In sentencing briefings, the Government highlighted that Greebel "repeatedly disregarded the ethical obligations incumbent on attorneys" and recommended at least five years of imprisonment. Pl.'s Sentencing Submission, *U.S. v. Shkreli*, No. 15-cr-00637, 77 (E.D.N.Y. July 25, 2018) ("Greebel's behavior drastically undermines not just future interactions between attorneys and clients, but it undermines the public trust in lawyers and the practice of law.") On August 17, 2018, U.S. District Judge Kiyo Matsumoto sentenced Greebel to eighteen months

in prison. Greebel was also ordered to forfeit $116,462 and pay Retrophin $10.4 million in restitution. *See Ex-Katten Atty Gets 18 Months in Prison for Shkreli Fraud,* LAW360 (Aug. 17, 2018). On August 29, 2018, Greebel filed a notice of appeal concerning both his conviction and sentence. *U.S. v. Shkreli*, No. 15-cr-00637 (E.D.N.Y. Aug. 29, 2018). On appeal, Greebel argued that the district court judgment should be vacated on grounds that the jury instructions were erroneous and an abuse of discretion. Brief of Defendant-Appellant at 27, 39, 51, and 57, *United States v. Greebel*, No. 18-2667 (2d Cir. Dec. 21, 2018). The Second Circuit affirmed Greebel's conviction in October 2019, holding that the District Court did not err by instructing the jury that lawyers owe a duty to their clients to "disclose all material facts." *See* Summ. Order J., *id.* (Oct. 30, 2019) ("Under any articulation of an attorney's duty of disclosure, Greebel would need to disclose that Retrophin was committed to pay or was paying millions of dollars to investors defrauded by its CEO.").

IV. The Swinging Pendulum: Three Eras of Securities Attorney Discipline

A. The SEC's history of regulating lawyers through disciplinary proceedings under Rule 102(e) and its predecessors, as well as through civil and administrative enforcement actions, has gone through three distinct phases.

1. More than three decades ago, the SEC began bringing aggressive enforcement actions in an effort to establish professional conduct norms for the securities bar.

2. In the face of criticism from practitioners, including accusations that the SEC was usurping the role of state bar authorities and exceeding its authority, the SEC retrenched and took a more cautious approach. During this period, the agency largely used Rule 102(e) against lawyers, only after a previous determination that they had violated the securities laws.

3. In 2002, Congress passed the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). Among other things, Sarbanes Oxley largely codified the SEC's authority under Rule 102(e), eliminating questions regarding the SEC's authority to regulate and discipline securities lawyers. Since then, the SEC has returned to its earlier, more aggressive posture, and in some ways may have exceeded it.

B. Phase 1 – Starting in the 1970s, the SEC began using its enforcement and attorney discipline powers to establish standards of professional conduct for attorneys. The SEC advanced the view that attorneys have, in addition to duties of zealous advocacy on behalf of their clients, duties to the investing public at large. This concept may be viewed as the origin of the idea—expressed frequently in the last decade—that lawyers are "gatekeepers."

1. In 1974, then-Commissioner A.A. Sommer suggested in a speech that a securities lawyer's responsibilities include duties to the public, not just clients. He stated

"that in securities matters (other than those where advocacy is clearly proper) the attorney will have to function in a manner more akin to that of the auditor than to that of the advocate. This means several things. It means he will have to exercise a measure of independence that is perhaps uncomfortable if he is also the close counselor of management in other matters, often including business decisions. He will have to be acutely cognizant of his responsibility to the public who engage in security transactions that would never come about were it not for his professional presence. He will have to adopt a healthy skepticism toward the representations of management which a good auditor must adopt. And finally, he will have to do the same thing the auditor does when confronted with an intransigent client – resign." A.A. Sommer, Comm'r, U.S. Sec. & Exch. Comm'n, The Emerging Responsibilities of the Securities Lawyer (Jan. 24, 1974).

2. In 1972, in the *National Student Marketing* case, the SEC initiated an enforcement action against several lawyers at large, well-regarded New York law firms. The case—which was a direct enforcement action for aiding and abetting fraud, not a Rule 102(e) action—is a seminal example of the SEC's effort to establish conduct norms for the securities bar.

   (a) The SEC charged, among others, White & Case ("WC") and Lord, Bissel & Brook ("LBB"), and certain associated lawyers with aiding and abetting securities fraud in connection with a merger between *National Student Marketing* Corporation ("NSMC") and Interstate National Corporation ("Interstate"). *SEC v. Nat'l Student Mktg. Corp*., Litigation Release No. 5311, 1972 WL 126645 (Feb. 3, 1972).

   (b) The WC defendants settled without admitting or denying the SEC's allegations. *SEC v. Nat'l Student Mktg. Corp*., Litigation Release No. 7891, 1977 WL 175473 (Apr. 28, 1977).

   (c) The LBB defendants proceeded to litigate the case. The SEC alleged that merger negotiations had proceeded and Interstate shareholders had been solicited on the basis of unaudited financials from NSMC. In addition, the SEC alleged that Interstate decided to proceed with the closing based on an unsigned "comfort letter." LBB allegedly issued its opinion contingent upon a representation by WC (on behalf of NSMC) that the unsigned comfort letter was the final comfort letter. Later, however, more changes were made to the comfort letter after the closing and the LBB defendants did not withdraw their opinion. *SEC v. Nat'l Student Mktg. Corp*., 457 F. Supp. 682 (D.D.C. 1978).

   (d) In connection with the consummation of the merger, Max Meyer (an LBB partner, as well as a shareholder and director of Interstate) and Cameron Brown (the president and a director of Interstate) were found to have committed fraud in violation of § 17(a) of the Securities Act of 1933 (the "Securities Act") and § 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder, by failing to disclose material changes in NSMC's financials.

(e) The LBB defendants were charged with aiding and abetting the fraud by: (1) failing to take any action to interfere with the consummation of the merger upon learning of the changed financials; (2) rendering an opinion that Interstate's actions in connection with the merger—including the solicitation and approval of Interstate shareholders—were validly taken, despite new knowledge of the changed financials; and (3) failing to withdraw the opinion upon learning of further changes to the comfort letter after the closing. *Id.*

(f) Following a non-jury trial, the U.S. District Court for the District of Columbia found that the LBB defendants aided and abetted the fraud through their inaction—specifically, their failure to at least hold up the closing until such time as changes to NSMC's financials were disclosed to Interstate's shareholders. Under the circumstances of the case, the court found that the LBB defendants' total inaction and silence constituted substantial assistance. *Id.*

(g) The court found that the issuance of the opinion did not constitute aiding and abetting, because the opinion did not play a large part in the consummation of the merger, and it was for the benefit of NSMC, which knew well that its own financials were changed. The court further held that the failure to withdraw the opinion—in essence, the failure to "undo" the merger—did not constitute aiding and abetting, because the merger was complete by that time, and was not "substantially assisted" by the LBB defendants' *post hoc* acquiescence. *Id.* Finally, the court declined to enjoin the LBB defendants, finding that the SEC had shown merely an isolated incident, and not a likelihood of recurrence. *Id.*

3. The *National Student Marketing* enforcement action led to criticism from the securities bar. In particular, the securities bar objected to assertions by the SEC (later withdrawn) that lawyers charged in that case should have blown the whistle on their clients.

(a) For example, in 1975, in response to the initiation of the *National Student Marketing* action, the Committee on Counsel Responsibility and Liability of the Section of Corporation, Banking and Business Law of the American Bar Association issued a policy statement that "a lawyer cannot, consistently with his essential role as legal adviser, be regarded as a source of information concerning possible wrongdoing by clients." *Statement of Policy Adopted by American Bar Association Regarding*

Responsibilities and Liabilities of Lawyers in Advising with Respect to the Compliance by Clients with Laws Administered by the Securities and Exchange Commission, 31 BUS. LAW. 543, 544-46 (1975).

(b) The policy statement also noted that a "client's actions should not be improperly narrowed through the insistence of an attorney who may, perhaps unconsciously, eliminate available choices from consideration because of his concern over possible personal risks if the position is taken which, though supportable, is subject to uncertainty or contrary to a known, but perhaps erroneous, position of the SEC or a questionable lower court decision." *Id.*

(c) Therefore, the Committee concluded, "liability should not be imposed upon lawyers whose conduct is in conformance with" applicable professional conduct rules. *Id.*

4. Several years later, in *Carter & Johnson*, a Rule 102(e) proceeding, the SEC again attempted to establish baseline minimum conduct standards for securities lawyers faced with apparent illegality by clients.

(a) In *Carter & Johnson*, as in *National Student Marketing*, the SEC targeted attorney inaction.

(b) With respect to attorneys' affirmative advice, the SEC articulated a principle in *Carter & Johnson* that became a touchstone for decades: attorneys should not be liable for negligent advice.

(c) William R. Carter and Charles J. Johnson, Jr. were partners at Brown & Wood who represented National Telephone Company ("NTC") in connection with certain SEC filings. They advised NTC's management that some disclosures were materially misleading, because NTC failed to disclose facts regarding its financial condition. *Carter & Johnson*, Exchange Act Release No. 17,597 (Feb. 28, 1981).

(d) The advice was ignored. Carter and Johnson did not inform NTC's independent directors of their advice, nor that management had ignored it. *Id.*

(e) The Office of the General Counsel of the SEC instituted disciplinary proceedings against Carter and Johnson. An SEC Administrative Law Judge ("ALJ") found Carter and Johnson liable for "willfully aiding and abetting" violations of §§ 10(b) and 13(a) of the Exchange Act and Rules 10b-5, 12b-20 and 13a-11 thereunder. *Id.*

(f) The ALJ's determination was based on Carter's involvement in the preparation of certain misleading disclosures, as well as Carter and

Johnson's failure to take action to correct disclosures they knew to be materially false and misleading, their failure to communicate with NTC's independent directors and their assistance with concealing certain facts concerning NTC's financial condition. *Id.*

(g) Echoing the public duty concept articulated by then Commissioner Sommer in 1972, the ALJ also held that, by failing to notify NTC's independent directors of their disclosure concerns and management's refusal to accept their advice, Carter and Johnson "failed to carry out their professional responsibilities with respect to appropriate disclosure to all concerned, including stockholders, directors and the investing public . . . and thus knowingly engaged in unethical and improper professional conduct . . . ." *Id.*

(h) On appeal, the Commission overturned the ALJ's determination that Carter and Johnson's involvement in the preparation of certain materially misleading disclosures constituted aiding and abetting. The Commission essentially articulated an intent requirement for lawyer aiding and abetting liability: "[i]t is axiomatic that a lawyer will not be liable as an aider and abettor merely because his advice, followed by the client, is ultimately determined to be wrong." Lawyers "who, acting in good faith, have merely made errors of judgment or have been careless" are not "appropriately considered as subjects of professional discipline," the Commission concluded. This is because, "[i]f a securities lawyer is to bring his best independent judgment to bear on a disclosure problem, he must have the freedom to make innocent—or even, in certain cases, careless—mistakes without fear of legal liability or loss of the ability to practice before the Commission." The Commission determined that the decision was "close," but neither Carter nor Johnson "acted with sufficient knowledge and awareness or recklessness to satisfy the test for willful aiding and abetting liability." *Id.*

(i) With respect to Carter and Johnson's inaction—*i.e.*, their failure to ensure accurate disclosures or inform the independent directors of their concerns—the Commission held that liability for aiding and abetting only attaches where a respondent consciously intends for his inaction to further the violation, or violates a duty to act. The record did not establish this level of scienter. *Id.*

(j) The Commission also reversed the ALJ's conclusion that Carter and Johnson violated ethical and professional standards. The Commission agreed with the respondents that new professional standards of conduct should not be established through after-the-fact enforcement action, and found that "[t]he ethical and professional responsibilities of lawyers who become aware that their client is engaging in violations of the securities laws have not been so firmly and unambiguously established that we believe all practicing lawyers can be held to an awareness of generally recognized norms." *Id.*

(k) Nevertheless, the Commission articulated a prospective standard. Although more flexible, the standard articulated by the Commission predicts in some ways the attorney conduct rules promulgated by the SEC in accordance with Sarbanes-Oxley.

(l) The Commission said, "[w]hen a lawyer with significant responsibilities in the effectuation of a company's compliance with the disclosure requirements of the federal securities laws becomes aware that his client is engaged in a substantial and continuing failure to satisfy those disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's noncompliance. . . . Initially, counseling accurate disclosure is sufficient, even if his advice is not accepted. But there comes a point at which a reasonable lawyer must conclude that his advice is not being followed, or even sought in good faith, and that his client is involved in a continuing course of violating the securities laws. At this critical juncture, the lawyer must take further, more affirmative steps in order to avoid the inference that he has been co-opted willingly or unwillingly, into the scheme of non-disclosure. . . . Resignation is one option, although we recognize that other considerations, including the protection of the client against foreseeable prejudice, must be taken into account in the case of withdrawal. A direct approach to the board of directors or one or more individual directors or officers may be appropriate; or he may choose to try to enlist the aid of other members of the firm's management. What is required, in short, is some prompt action that leads to the conclusion that the lawyer is engaged in efforts to correct the underlying problem, rather than having capitulated to the desires of a strong-willed, but misguided client. We recognize, however, that the 'best result' is not always obtainable, and that there may occur situations where the lawyer must conclude that the misconduct is so extreme or irretrievable, or the involvement of his client's management and board of directors in the misconduct is so thoroughgoing and pervasive that any action short of resignation would be futile. We would anticipate that cases where a lawyer has no choice but to resign would be rare and of an egregious nature." *Id.*

(m) In promulgating the foregoing standard, the SEC notably reserved "the additional question of when a lawyer, aware of his client's intention to commit fraud or an illegal act, has a professional duty to disclose that fact either publicly or to an affected third party." *Id.* Thus, to the extent that the *National Student Marketing* enforcement action raised the question whether, in some cases, it may be incumbent on lawyers to report their clients' confidences to the SEC, the question was left unanswered by *Carter & Johnson*.

C. Phase 2 – In the early 1980s, SEC enforcement and disciplinary actions against lawyers entered a period of retrenchment.

1. Starting in the early 1980s, the SEC began a retreat from the aggressive positions it had staked out in *National Student Marketing* and *Carter & Johnson*. The Commission generally followed an informal policy of initiating Rule 102(e), formerly designated Rule 2(e), proceedings against lawyers only where their conduct had already provided the basis for a judicial or administrative order finding a securities law violation. The agency also left itself room to sanction lawyers for violating professional conduct standards promulgated by state bar authorities.

2. In a 1982 speech, then-SEC General Counsel Edward F. Greene articulated an "initial tentative view . . . that as a general matter the Commission should ordinarily only institute Rule 2(e) proceedings if the misconduct alleged is (i) a violation of established state law ethical or professional misconduct rules and (ii) has a direct impact on the Commission's internal processes, such as where the lawyer participates directly or indirectly in the preparation of disclosure documents filed with the Commission." He further expressed the view that, if a lawyer aids and abets a violation of the securities law, an injunctive action is the most appropriate course of action. Edward F. Greene, Gen. Counsel, U.S. Sec. & Exch. Comm'n, Remarks to the New York County Lawyers' Association (Jan. 13, 1982).

3. Subsequently, in a 1988 rulemaking release, the Commission retreated further, declaring: "With respect to attorneys, the Commission generally has not sought to develop or apply independent standards of professional conduct. The great majority of Rule 2(e) proceedings against attorneys involve allegations of violations of the law (not of professional standards); thus, the Commission, as a matter of policy, generally refrains from using its administrative forum to conduct de novo determinations of the professional obligations of attorneys. Indeed, the Commission has generally utilized Rule 2(e) proceedings against attorneys only where the attorney's conduct has already provided the basis for a judicial or administrative order finding a securities law violation in a non-Rule 2(e) proceeding." In that rulemaking release, the Commission specifically noted that it intended to take no further action with respect to modifying or expanding the standard of conduct set forth in *Carter & Johnson*, and that, since that case, "the Commission has not attempted to set professional standards of conduct in Rule 2(e) proceedings, but has relied on a showing of violations of the securities laws." Disciplinary Proceedings Involving Professionals Appearing or Practicing

Before the Commission, Exchange Act Release No. 25,893, 1988 WL 1000021 (July 7, 1988).

D. Phase 3 – More recently, the SEC has once again adopted a more aggressive posture—perhaps even more aggressive than the agency's posture of the 1970s.

1. The Commission's 1992 order in the matter of *John H. Gutfreund* was an early indication that the SEC continued to have an expansive view of lawyers' duties beyond zealous advocacy and confidentiality, at least in the context of the directly regulated broker-dealer industry.

(a) As in *Carter & Johnson*, the Commission did not punish the lawyer involved, but it took the opportunity to provide prospective guidance for lawyers in similar situations. Unlike *Carter & Johnson*, the Commission expressly stated that, in some cases, it might be appropriate to report client misconduct to the SEC.

(b) *Gutfreund* was a failure-to-supervise matter. It involved John H. Gutfreund, Thomas W. Strauss and John W. Meriwether, three senior managers of Salomon Brothers, Inc. ("Salomon"), who were informed that Paul W. Mozer, a government bond trader at Salomon, had submitted a false bid in a U.S. Treasury bond auction. *John H. Gutfreund*, Exchange Act Release No. 31,554, 1992 WL 362753 (Dec. 3, 1992).

(c) Donald M. Feuerstein, Salomon's chief legal officer, further informed the respondents that the false bid appeared to be a criminal act, and that Salomon should report it to the government even though it was not legally required to do so. *Id.*

(d) The respondents settled charges that they had failed to supervise Mozer, in violation of the Exchange Act. *Id.*

(i) Under the Exchange Act, the Commission may censure, place limitations on the activities of, suspend or bar persons associated with a broker-dealer or investment adviser if such persons "fail[] reasonably to supervise, with a view to preventing violations of" the securities laws by another person, "if such other person is subject to his supervision." 15 U.S.C. §§ 78o(b)(4)(E), 78o(b)(6)(A)(i).

(e) Feuerstein was not charged with failure to supervise, but the SEC's consent order mentioned his name and devoted an entire section to his conduct.

(i) The Commission stated that, in his capacity as chief legal officer, Feuerstein had been notified of Mozer's illegal conduct, but he "did not direct that an inquiry be undertaken, and he did not recommend that appropriate procedures, reasonably designed to prevent and detect future misconduct, be instituted, or that other limitations be placed on Mozer's activities. Feuerstein also did not inform the Compliance Department, for which he was responsible as Salomon's chief legal officer, of the false bid." *Id.*

(ii) The Commission made clear its belief that Feuerstein was a "supervisor," explaining that, whether a lawyer or compliance officer for a broker-dealer is a "supervisor" for purposes of the supervisory requirements of the Exchange Act "depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue." The Commission stated that Feuerstein became a supervisor when misconduct was brought to his attention, management sought his advice, and because of his role and influence within the firm. *Id.*

(iii) "Once a person in Feuerstein's position becomes involved in formulating management's response to the problem," the Commission continued, "he or she is obligated to take affirmative steps to ensure that appropriate action is taken to address the misconduct. For example, such a person could direct or monitor an investigation of the conduct at issue, make appropriate recommendations for limiting the activities of the employee or for the institution of appropriate procedures, reasonably designed to prevent and detect future misconduct, and verify that his or her recommendations, or acceptable alternatives, are implemented. If such a person takes appropriate steps but management fails to act and that person knows or has reason to know of that failure, he or she should consider what additional steps are appropriate to address the matter. These steps may include disclosure of the matter to the entity's board of directors, resignation from the firm, or disclosure to regulatory authorities." *Id.*

(f) *Gutfreund* is notable because it suggests lawyers for regulated entities may become "supervisors" if they engage deeply with the clients' legal issues.

(i) Arguably, lawyers should be encouraged to engage deeply with clients' legal issues.

(ii) The risk of liability that comes with such involvement may encourage lawyers to practice defensively, which may be detrimental to clients and to general compliance with the securities laws.

(g) The Commission's suggestion in *Gutfreund* that lawyers might in some instances have a duty to disclose client misconduct was particularly controversial.

2. Following the corporate scandals of the early 2000s and the passage of the Sarbanes-Oxley Act in 2002, the SEC began explicitly invoking the concept of the lawyer as a "gatekeeper."

(a) This is reminiscent of the views expressed by then-Commissioner Sommer in the mid-1970s, and evocative of the positions staked out by the Commission in *National Student Marketing*, *Carter & Johnson* and *Gutfreund*.

(b) In a 2004 speech, then-SEC Enforcement Director Stephen Cutler said, "[c]onsistent with Sarbanes-Oxley's focus on the important role of lawyers as gatekeepers, we have stepped up our scrutiny of the role of lawyers in the corporate frauds we investigate." Stephen M. Cutler, The Themes of Sarbanes-Oxley as Reflected in the Commission's Enforcement Program (Sept. 20, 2004).

(c) Similarly, in a 2005 speech, then-SEC General Counsel Giovanni Prezioso focused on the lawyer's role as a gatekeeper. He stated that, in certain circumstances, the SEC would target lawyers for their inaction. *See* Giovanni P. Prezioso, Gen. Counsel, U.S. Sec. & Exch. Comm'n, Remarks Before the Spring Meeting of the Ass'n of General Counsel (Apr. 28, 2005).

3. Several enforcement actions from the mid-2000s—*Isselmann, Drummond* and *Weiss*—are emblematic of the SEC's focus on lawyers as gatekeepers. These three cases are helpful in terms of identifying the point at which lawyers may be liable for their clients' illegal conduct. *Isselmann* and *Drummond* show that failing to advise clients of legal risk may be enough to trigger an SEC enforcement action. More frightening, *Weiss* shows that being careless with respect to legal risk is also enough.

(a) In 2004, the SEC charged John E. Isselmann, Jr., the former General Counsel of Electro Scientific Industries, Inc. ("ESI"), in connection with an alleged scheme by ESI and ESI's CEO and chief financial officer ("CFO") to fraudulently inflate ESI's reported revenue.

(i) The SEC's complaint explicitly stated that Isselmann failed in his role as a "gatekeeper." This is notable, because the concept of the lawyer as gatekeeper was controversial and not necessarily supported by precedent.

(ii) Although Isselmann was not involved in the allegedly fraudulent scheme, he attended a meeting with ESI's Audit Committee and independent auditors to review the relevant financial results, and while there, he did not contradict a false statement by the CFO that the relevant accounting decision had been reviewed by legal counsel. *SEC v. John E. Isselmann, Jr.*, Litigation Release No. 18,896 (Sept. 24, 2004).

(iii) Isselmann later allegedly received written legal advice that contradicted assertions made to ESI's independent auditors, but despite having the opportunity to convey this advice to the auditors, ESI's Audit Committee and ESI's board, he failed to do so. This allegedly allowed the CEO and the CFO to hide the fraudulent scheme. *Id.*

(iv) Furthermore, Isselmann was allegedly involved with the process for reviewing ESI's quarterly report that was filed with the SEC. According to the SEC, this report contained materially false and misleading statements, and Isselmann was a cause of those misstatements. *Id.*

(v) Based on the foregoing allegations, the SEC brought a settled civil injunctive action against Isselmann for violating Exchange Act Rule 13b2-2, which prohibits public company officers from making or causing to be made false or misleading statements or omissions to an accountant in connection with an audit required under the securities laws. Without admitting or denying the SEC's allegations, Isselmann agreed to pay a $50,000 civil penalty and consented to an injunction. *Id.*

(vi) Separately, Isselmann consented to the entry of an administrative cease-and-desist order. The SEC's findings—which Isselmann neither admitted nor denied—included that, through its conduct, ESI violated § 13(a) of the Exchange Act and Rule 13a-13 thereunder, which require issuers to file quarterly reports with the Commission, and Exchange Act Rule 12b-20, which requires such reports to contain, in addition to disclosures expressly required, such other information as is necessary to ensure that the statements made are not, under the circumstances, materially misleading. According to the SEC, Isselmann's failure to inform ESI's independent auditors, its Audit Committee and its board of directors caused ESI's violations. Isselmann agreed to cease and desist from causing such violations. *John E. Isselmann, Jr.*, Exchange Act Release No. 50,428 (Sept. 23, 2004).

(b) In 2005, the SEC initiated a settled administrative cease-and-desist proceeding against Google, Inc. ("Google") and David C. Drummond, Google's general counsel.

(i) According to the SEC, between 2002 and 2004, Google issued over $80 million worth of stock options to the company's employees and consultants without registering the offering under § 5 of the Securities Act, and without providing financial information required to be disclosed under Rule 701, which exempts certain offerings of stock options to employees and consultants from the registration requirements, but requires detailed financial and other disclosures to the employees and consultants if more than $5 million in stock options are issued over a 12-month period. *Google, Inc. and David C. Drummond*, Securities Act Release No. 8523 (Jan. 13, 2005).

(ii) In findings that were neither admitted nor denied by Drummond and Google, the SEC concluded that Google exceeded the offering threshold without making the required disclosures and thereby issued unregistered securities without a valid exemption in violation of § 5. *Id.*

(iii) With respect to Drummond, the SEC found that he was aware that Google might be exceeding the $5 million threshold under Rule 701, but that he thought Google could rely on other § 5 exemptions. According to the SEC, Drummond attended two meetings of Google's board of directors in 2003 at which the board approved the issuance of additional options. The SEC found that Drummond did not advise the board that Google might exceed the $5 million threshold for Rule 701, that Google would be relying on other exemptions and that there was a risk that those exemptions might not apply. *Id.*

(iv) Based on the foregoing conduct, the SEC found that Drummond caused Google's violation of § 5, and Drummond agreed to cease and desist from causing such violations. *Id.*

(c) The SEC initiated an action against Ira Weiss, a bond attorney, in 2004. *Weiss*, unlike *Isselmann* and *Drummond*, was litigated.

(i) The Division of Enforcement alleged that Weiss violated § 17(a) of the Securities Act, § 10(b) of the Exchange Act and Rule 10b-5 thereunder, and caused violations of the same provisions, by "knowingly or recklessly": (a) giving an unqualified opinion that certain bonds issued by a school district were tax-exempt; (b) reviewing the offering statement for the bonds, which erroneously stated that the bonds were to provide funds for capital improvements when they were actually designed to gain an illegal arbitrage profit; and (c) issuing a supplemental opinion to the effect that he was not aware of anything that led him to believe that the Official Statement was materially inaccurate or incomplete. *Ira Weiss*, Initial Decision Release No. 275, 2005 WL 454017 (Feb. 25, 2005); *Ira Weiss*, Securities Act Release No. 8412, 2004 WL 877632 (Apr. 24, 2004).

(ii) Following a litigated administrative proceeding, an SEC ALJ found in favor of Weiss, concluding that he acted with the requisite care. *Ira Weiss*, Initial Decision Release No. 275, 2005 WL 454017 (Feb. 25, 2005).

(iii) On appeal, however, the Commission reversed the ALJ and found that Weiss was liable under §§ 17(a)(2) and 17(a)(3) of the Securities Act—which do not require scienter—for acting negligently. The Commission ordered Weiss to cease-and-desist and to disgorge his legal fee. *Ira Weiss*, Exchange Act Release No. 52,875, 2005 WL 3273381 (Dec. 2, 2005).

(iv) The SEC's order was upheld on appeal. *Weiss v. SEC*, 468 F.3d 849 (D.C. Cir. 2006).

(d) As discussed, as far back as *Carter & Johnson*, the Commission had expressed clear reluctance to sanction securities lawyers for rendering negligent legal advice. Senior SEC personnel had reiterated that principle as recently as 2005. *See* Giovanni P. Prezioso, Gen. Counsel, Remarks Before the Spring Meeting of the Association of General Counsel (Apr. 28, 2005) ("[T]he Commission ordinarily will not sanction lawyers under the securities laws merely for giving bad advice, even if that advice is negligent and perhaps worse.").

V. Attorney Disciplinary & Enforcement Actions

A. The SEC's current posture toward attorney liability is unclear regarding whether and when an attorney may be liable for negligence. Two cases—*Monson* and *Urban*—reflect this lack of clarity.

1. In *Scott G. Monson*, the SEC alleged that the general counsel of a registered broker-dealer drafted brokerage contracts that contemplated and permitted mutual fund late trading by customers. In this way, Monson allegedly caused the broker-dealer to violate Rule 22c-1 under the Investment Company Act of 1940, which prohibits any dealing in shares of a mutual fund from selling, redeeming, or repurchasing shares of a mutual fund except at a price based on the current net asset value of the shares of the mutual fund, which is computed after receipt of a tender of the shares of the mutual fund for redemption or of an order to purchase or sell the shares of the mutual fund.

(a) The SEC's "causing" theory rested in part on the assertion that Monson was negligent in drafting the contract. *Scott G. Monson*, Initial Decision Release No. 331, 2007 WL 1725777 (June 15, 2007); *Scott G. Monson*, Adm. Proc. File No. 3-12429, 2006 WL 2738883 (Sept. 25, 2006).

(b) Following a contested administrative proceeding, an SEC ALJ rejected the SEC's conclusion that Monson—who was not aware of the requirements of Rule 22c-1—acted negligently. *Scott G. Monson*, Initial Decision Release No. 331, 2007 WL 1725777 (June 15, 2007).

(c) The Division pursued its aggressive negligence theory on appeal to the Commission. In affirming the ALJ, the Commission noted its "traditional reluctance to bring an administrative action against a lawyer for the negligent rendering of non-public legal advice to his or her own client." *Scott G. Monson*, Investment Company Act Release No. 28,323, 2008 WL 2574441 (June 30, 2008).

(d) However, the Commission held open the possibility that, on different facts, it might revisit this traditional reluctance approach. *Id.*

2. *Theodore W. Urban*, is an example of an enforcement action for failure to supervise a person associated with a broker-dealer, also implicates lawyers' liability for negligent conduct.

(a) On October 19, 2009, the SEC initiated an administrative proceeding against *Theodore W. Urban*, the General Counsel and a member of the board of directors and the executive committee of Ferris Baker Watts, Inc. ("FBW"), a Washington and Baltimore-based broker-dealer. During the relevant period, Urban headed FBW's Legal & Compliance, Human

Resources and Internal Audit departments, and he sat on the firm's Credit Committee. (Notably, Urban was also a former assistant director in what was at the time the SEC's Division of Market Regulation.) *Theodore W. Urban*, Initial Decision Release No. 402 (Sept. 8, 2010).

(b) The SEC found that, merely by doing his job—*i.e.*, engaging with the client to render legal advice—a high-ranking in-house attorney at a registered broker-dealer firm can be found to be a "supervisor" of a line broker, and he may therefore be held liable for negligently failing to prevent securities law violations by that person. *See id.*

(c) Specifically, the SEC alleged that Stephen Glantz, a registered representative of FBW and one of FBW's top producers, engaged in a market manipulation scheme in violation of the antifraud provisions of the Securities Act and the Exchange Act. The Division further alleged that Urban was Glantz's "supervisor"—notwithstanding that he was not Glantz's direct line supervisor—and that, in that capacity, Urban failed to follow up on various red flags regarding Glantz's conduct. As such, the Division alleged that Urban "failed reasonably to supervise" Glantz as required by § 15(b)(6)(A)(i) of the Exchange Act and § 203(f) of the Advisers Act. *Id.*

(d) Notably, Urban had recommended that Glantz be fired. Others within FBW disagreed, but the Director of Retail Sales agreed to place Glantz under heightened supervision. Urban accepted this response. *Id.*

(e) Following a hearing on the merits, an SEC ALJ adopted the Division's aggressive legal theory. The ALJ reasoned that *Gutfreund* set the standard for who should be considered a supervisor among non-line personnel within a broker-dealer, and that legal and compliance personnel can be supervisors under certain circumstances, if they have the "requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue." *Id.*

(f) The ALJ also stated that negligence is the applicable standard for determining whether supervision is reasonable under the circumstances. *Id.*

(g) Applying these principles, the ALJ held that Urban met the definition of supervisor, "[e]ven though [he] did not have any of the traditional powers associated with a person supervising brokers and the facts and circumstances of his situation are very different than in *Gutfreund*," and "had no authority for hiring, assessing performance, assigning activities, promoting, or terminating employment of anyone outside of the people in the departments he directly supervised," because Urban's views on legal and compliance matters were considered authoritative by business units within FBW (though not by the Retail Sales unit, which directly supervised Glantz). The ALJ also found that Urban's position on the Credit Committee gave him the power to influence FBW's extension of margin credit, which Glantz allegedly used in connection with his scheme. *Id.*

(h) Despite concluding that Urban was a supervisor, the ALJ found that his conduct was reasonable under the circumstances. Specifically, the ALJ concluded that Urban acted reasonably in recommending that Glantz be terminated but deferring to the Director of Retail Sales' response. The ALJ further found no fault with Urban's failure to raise supervisory concerns regarding Glantz with FBW's CEO and Board of Directors, because Urban reasonably believed they would defer to the Director of Retail Sales. Accordingly, the ALJ ordered that the failure to supervise charges against Urban be dismissed. *Id.*

(i) The Division appealed the ALJ's order of dismissal to the Commission. Urban moved for summary affirmance, which the Commission denied. *Theodore W. Urban*, Exchange Act Release No. 63,456 (Dec. 7, 2010).

(j) Ultimately, however, three of five commissioners recused themselves, and the remaining two commissioners were evenly divided regarding whether the Division's allegations were established by the record. The proceeding against Urban was therefore dismissed. *Theodore W. Urban*, Exchange Act Release No. 66,259 (Jan. 26, 2012).

3. Attorneys should take little solace in Urban's victory. The prosecution indicates that some within the Commission continue to have a very aggressive view of attorneys' duties and potential liabilities.

4. Moreover, the technical nature of the affirmance means that the Commission's ultimate view of its role vis-à-vis counsel remains "disturbingly murky," in the words of Commissioner Daniel Gallagher during a speech. Daniel M. Gallagher, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks at "The SEC Speaks in 2012" (Feb. 24, 2012).

5. Commissioner Gallagher further warned that this lack of clarity risks deterring counsel from robust engagement for fear of being found to be a "supervisor" at a later date, and subject to liability for the misconduct of those they "supervised." Such an outcome could undermine compliance with the securities laws. *Id.*

B. While it remains unclear whether an attorney may be held liable under a negligence theory, the SEC has not hesitated to bring disciplinary actions against securities attorneys for violating, causing, or aiding and abetting federal securities law violations.

1. In 2005, the SEC filed a complaint in district court against Craig Scott, chief financial officer and general counsel for FFP Marketing Company, Inc. ("FFP"), a Texas-based company that owns and manages gas station convenience stores, alleging that Scott committed securities fraud and aided and abetted FFP in violating the reporting rules by filing misleading notices of late filing ("Forms 12b-25") in April and May 2002. The SEC also brought a Rule 102(e) administrative proceeding against Scott. From 1999 through 2001, FFP allegedly improperly accounted for the company's account payables and credit card receivables and experienced failures with its internal controls. Collectively, these problems allegedly caused the company to overstate net income by approximately $2.48 million for 1999, 2000, and the first three quarters of 2001 and to file inaccurate financial statements for those periods. FFP restated its financial statements for those periods in June 2002. *See SEC v. Scott*, Litigation Release No. 19,077 (Feb. 14, 2005).

2. Prior to filing a restatement, the SEC alleged that Scott prepared and caused FFP to file inaccurate Forms 12b-25. According to the SEC, Scott learned in March 2002 that the company's accounting problems would prevent it from timely filing its annual report for the twelve months ending December 31, 2001. Scott allegedly caused FFP to file a misleading Form 12b-25 by failing to disclose accurately that the accounting and internal control problems caused the company to delay filing its annual report and by misrepresenting the cause of a substantial part of the company's anticipated net loss for 2001. In response to the instruction to state why the company could not file its annual report, Scott responded that "[c]ertain financial and other data required to be disclosed in the Registrants Form 10-K could not be obtained by Registrant prior to the required filing date for the report." *Id.* The SEC alleged that Scott's response failed to mention the ongoing internal review of the credit card receivables or the fact that outside auditors were unable to supply an unqualified audit report. Similarly, in response to an instruction about an explanation of the anticipated changes from the corresponding period for the last fiscal year, the SEC alleged that Scott failed to include the fact that a substantial portion of FFP's expected net losses were due to a write-down of credit card receivables that the controller recorded in February 2002. The SEC further alleged that Scott prepared and caused FFP to file a second Form 12b-25 in May 2002, which failed to disclose that the company was planning to restate its financial statements for 1999, 2000 and the first three quarters of 2001. *Id.*

3. Scott settled both the civil and administrative actions with the SEC. Without admitting or denying the allegations, Scott agreed to pay a $25,000 penalty. Scott also agreed to an order in the administrative proceeding suspending him from appearing or practicing before the SEC as an attorney or accountant for three years. Scott further agreed to cease-and-desist from committing or causing future violations of the securities laws. *Id.*

C. Recent SEC Enforcement Actions

1. The SEC often pursues "follow-on" enforcement proceedings against attorneys. In follow-on cases, the SEC acts after state bar prosecutors or another authority has imposed sanctions.

D. Select 2019 and 2020 Follow-On 102(e) Actions Against Attorneys

1. On January 23, 2020, the SEC announced that it settled charges with Las Vegas-based attorney Benjamin Bunker for his role in defrauding investors in an Arizona microcap company's stock. *SEC Charges Las Vegas Attorney with Facilitating a Microcap Fraud*, Administrative Proceeding File No. 3-19668 (Jan. 23, 2020). According to the SEC's Order, Bunker prepared false and misleading attorney opinion letters for two clients to allow them to sell their shares of Greenway Design, Inc. ("Greenway") stock without filing a registration statement. *In re Benjamin L. Bunker, Esq.*, Exchange Act Release No. 88018 (Jan. 23, 2020). The clients were Greenway's undisclosed control person. *Id.* The Order further alleged that Bunker knew the clients were planning to engage in a "pump and dump" fraud, and nevertheless falsely included in the opinion letters that the clients were not affiliated with Greenway and had met the one-year holding requirement. *Id.* The SEC's Order found that Bunker violated several sections of the Securities Act of 1993, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5. *Id.* As part of the settlement, Bunker agreed to be permanently suspended from appearing and practicing before the SEC, be barred from participating in penny stock offerings, cease and desist from future violations, and pay disgorgement. *Id.* Earlier, in April 2019, Bunker and two other individuals were indicted by a grand jury for conduct related to Greenway. *United States v. Loflin, et al.*, No. 2:19-cr-00411-DJH (D. Ariz. Apr. 16, 2019). On January 22, 2020, the day before the SEC settlement, Bunker pled guilty to conspiracy and is awaiting sentencing. *Id.*

2. On March 24, 2020, the SEC filed a complaint against Todd Lahr, a Pennsylvania-based attorney, for his role in a Ponzi scheme. *SEC v. Lahr, et al.*, No. 5:20-cv-1593 (E.D.P.A. Mar. 24, 2020). The Complaint alleged that Lahr and his co-defendant, a Swiss national, targeted Lahr's clients to raise funds for various international ventures, and instead used those funds to pay earlier investors and their own personal expenses (e.g., mortgage payments and credit card bills). *Id.* Since August 2014, Lahr and his co-defendant obtained over $1.4 million from at least 10 investors. *Id.* On June 24, 2020, the SEC obtained a final judgment by consent, which enjoined Lahr from violating several sections of the Securities Act of 1993, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5. *Pennsylvania Attorney Settles with SEC in $1.4 Million Dollar Ponzi Scheme*, Litigation Release No. 24843 (June 24, 2020). Lahr must also pay over $1 million in disgorgement and prejudgment interest, and is permanently suspended from appearing and practicing before the SEC. *Id.* The

U.S. Attorney's Office for the Eastern District of Pennsylvania and the DOJ Fraud Section brought a parallel criminal action against Lahr in August 2019. *United States v. Lahr*, 5:19-cr-00496-EGS (E.D.P.A. Aug. 27, 2019). Lahr pled guilty and is awaiting sentencing. *Id.*

3. In September 2019, the SEC filed a complaint against Jan Atlas, a former partner at Florida-based law firm Kopelowitz Ostrow. *SEC v. Atlas*, No. 0:19-cv-62303 (S.D. Fla. Sept. 17, 2019). The complaint alleged that Atlas helped to defraud a cash advance company's investors by issuing materially false and misleading opinion letters in May and August of 2016. Compl. at 4-5, *Atlas*, No. 0:19-cv-62303 (Sept. 17, 2019). The company, 1 Global Capital LLC ("1 Global"), offered short-term loans to small and medium-sized businesses. *Id*. at 2. To fund these short-term loans, 1 Global raised $322 million by issuing unregistered securities to investors who were promised a "high-return, low-risk investment." *Id*. A substantial portion of the investors' funds were misappropriated, however, and were used to cover the business's operating expenses and to support "the luxury lifestyle of its founder, Chairman and CEO, Carl Ruderman." *Id*. The SEC's complaint against Atlas focused on two opinion letters in which he concluded that the notes offered to investors by 1 Global were not securities. *Id*. at 4-5. Atlas justified his conclusion in the opinion letters by asserting that the notes were offered only to sophisticated investors and had maturity dates of nine months or less. *Id*. at 4. In reality, Atlas knew that the notes were sold to unsophisticated investors and had an automatic renewal feature that extended the maturity date beyond nine months. *Id*. at 4-5. Further, Atlas knew when 1 Global engaged him to author the opinion letters that other attorneys had already rendered opinions concluding that the notes were, in fact, securities. *Id*. at 5. On the same day the SEC filed its complaint, the DOJ filed a criminal action against Atlas that charged him with securities fraud. *United States v. Atlas*, No. 0:19-cr-60258 (S.D. Fla. Sept. 17, 2019). Atlas pled guilty to one count of securities fraud on October 24, 2019. Plea Agreement, *id*. (Oct. 24, 2019). As part of his plea agreement, Atlas acknowledged that his actions were directed by 1 Global CEO Carl Ruderman who was "not interested in accurate legal advice based on real facts, but instead wanted false legal cover." *Id*. at 10. Following entry of Atlas's plea agreement in the criminal case, judgment was entered against him in the civil case brought by the SEC. J. as to Jan Atlas, No. 0:19-cv-62303 (Oct. 28, 2019). The judgment permanently enjoins Atlas from committing future violations of the securities laws and preserves the SEC's ability to seek disgorgement and a civil penalty from Atlas at a future date. *Id*. On November 1, 2019, the SEC, pursuant to Rule 102(e), suspended Atlas from appearing or practicing before the Commission as an attorney. *In re Atlas*, Exchange Act Release No. 87446 (Nov. 1, 2019). As of July 2020, Atlas has not been sentenced.

4. On August 30, 2019, the SEC filed a complaint in the United States District Court for the Northern District of Georgia against Jayat P. Kanetkar, a New

Jersey attorney and former FBI agent. *SEC v. Kanetkar*, No. 1:19-cv-03915 (N.D. Georgia Aug. 30, 2019). The Complaint charges Kanetkar and his company of violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Specifically, the SEC alleged that Kanetkar aided and abetted fraudulent banking schemes by accepting and disbursing investor funds when he knew or should have known that the transactions were fraudulent. *SEC Charges Attorney with Role in Investment Schemes*, Litigation Release No. 24584 (Sept. 3, 2019). Kanektar settled the charges without admitting to the allegations, paid disgorgement as well as a civil penalty, and agreed to be barred from appearing or practicing before the Commission as an attorney. The Court entered the final judgment on September 4, 2019.

5. On April 9, 2019, the SEC filed a complaint alleging that Paul Powers, SeaWorld's Associate General Counsel and Assistant Secretary, violated securities laws by engaging in insider trading. *SEC v. Powers*, No. 6:19-cv-00664 (M.D. Fla. Apr. 9, 2019). The allegations set forth in the complaint assert that, prior to SeaWorld's Q2 2018 earnings release, Powers traded on material non-public information made available to him by virtue of his position within the company. Compl. at 1, *Powers*, No. 6:19-cv-00664 (Apr. 9, 2019). Between 2013 and 2017, SeaWorld experienced a multi-year decline in attendance and revenue. *Id*. at 1-2. As a result, the value of the company's shares dropped approximately 60% during that same period. *Id*. at 3. Beginning in May 2018, however, the company observed a "significant improvement" in its business and internal projections anticipated an 8% increase in attendance and revenue at the close of Q2 2018. *Id*. at 3-4. During the summer of 2018, Powers received materials prepared in anticipation of revenue committee meetings that showed growth in revenue and attendance across SeaWorld's parks. *Id*. at 4-5. On July 31, 2018, Powers sold all equities that he retained in his personal brokerage account. *Id*. at 5. The next day, Powers received drafts of an earnings release and a 10-Q filing prepared for an upcoming audit committee meeting. *Id*. The materials reflected that, as compared to the same period in 2017, SeaWorld experienced a 59% increase in earnings before interest, taxes, depreciation, and amortization. *Id*. Further, the materials revealed that SeaWorld had agreed to settle, without admitting or denying, charges arising out of a previously disclosed SEC investigation for which the company had recorded a $4 million estimated liability. *Id*. On August 2, 2018, Powers used the proceeds from the liquidation of his personal trading account to purchase 18,000 SeaWorld shares at a cost of $385,592. *Id*. Four days later, on August 6, SeaWorld issued the earnings release reflecting the better-than-expected performance, and the company's share prices rose 17%. *Id*. at 6. That same day, Powers sold all 18,000 of his SeaWorld shares, realizing $64,645 in gains. *Id*. These trades violated SeaWorld's Securities Trading Policy, which permitted Powers to buy or sale SeaWorld shares only during designated trading windows and only with pre-approval from the company's General Counsel. *Id*. On March 25, 2019, the DOJ

charged Powers with securities fraud for the same conduct alleged in the SEC's complaint. *United States v. Powers*, No. 6:19-cr-00057 (M.D. Fla. Mar. 25, 2019). Powers pled guilty to one count of securities fraud and was sentenced to probation for a term of five years. J. as to Powers, *id.* (July 8, 2019). In addition, Powers was ordered to pay a $10,000 fine and to forfeit the $64,645 in ill-gotten gains. *Id*. Following Powers' sentencing, judgment was entered against him in the civil case brought by the SEC. J. as to Powers, No. 6:19-cv-00664 (Aug. 1, 2019). The judgment permanently enjoins Powers from committing future violations of the securities laws and deems his criminal conviction to satisfy any disgorgement obligations. *See* Order Granting Pl.'s Mot. for Entry of J., *id*. (July 31, 2019). On May 20, 2019, the SEC, pursuant to Rule 102(e), suspended Powers from appearing or practicing before the Commission as an attorney. *In re Powers*, Exchange Act Release No. 85897 (May 20, 2019).

6. On October 22, 2018, the SEC obtained a judgment against a fourth individual, Christopher P. St. Lawrence, the former Town Supervisor and President of Ramapo, New York. The judgment from the U.S. District Court for the Southern District of New York prohibits St. Lawrence from participating in municipal securities offerings and orders him to pay $327,000 in civil penalties. *SEC v. Town of Ramapo*, Litigation Release No. 24,351 (Nov. 15, 2018). According to the SEC's complaint, St. Lawrence directed the operation to inflate the balance of the general fund in financial statements for fiscal years 2009 to 2014. SEC: *Town Officials in New York Hid Financial Troubles From Bond Investors*, 2016-68 (Apr. 14, 2016). On November 19, 2018, St. Lawrence filed a notice to appeal the judgment against him. *SEC v. St. Lawrence*, No. 16-cv-02779-CS (S.D.N.Y. Nov. 19, 2018). On July 1, 2019, St. Lawrence filed a motion to withdraw the appeal, which the Court granted.

7. On October 11, 2017, the SEC filed complaints in the Southern District of Florida against James M. Schneider and Andrew H. Wilson for facilitating the creation of 22 "blank check" companies that had no operations. *SEC v. Schneider*, No. 9:17-cv-81142 (S.D. Fla. Oct. 11, 2017); *SEC v. Wilson*, No. 1:17-cv-23712 (S.D. Fla. Oct. 11, 2017). Schneider, a "seasoned securities lawyer" based in Florida allegedly participated as primary attorney in the scheme. Compl. at 1, *Schneider*, No. 9:17-cv-81142. Schneider prepared at least 40 opinion letters regarding the issuance of the securities. *Id.* at 2. The U.S. Attorney's Office for the Southern District of Florida also filed criminal charges against Schneider, and he was arrested the same day. In furtherance of the scheme, Wilson, an attorney licensed to practice in California, also assisted by providing at least five of the opinion letters. Compl. at 1, *Wilson*, No. 1:17-cv-23712 . Eric I. Bustillo, Director of the SEC's Miami Regional Office said, "Schneider and Wilson failed as gatekeepers and, as our complaints allege, played a crucial role in facilitating a wide-ranging microcap fraud." *See* SEC Press Release No. 2017-194, U.S. Sec. & Exch. Comm'n, *Lawyers Charged With Assisting a Microcap Fraud Scheme*, (Oct. 11, 2017). The owners of the

companies made approximately $6 million in sales. They were previously convicted and sentenced to prison terms, along with New York Attorney, David Lubin. *See* Dep't of Justice Press Release, *New York Attorney Charged With Scheme To Fraudulently Register Shell Companies and Secretly Sell Stock* (July 19, 2017). Wilson settled the civil charges against him in November 2017; he did not admit or deny guilt and is permanently enjoined from committing securities violations, receiving compensation for services provided in connection with securities offerings, and from participating in any penny stock offering. J. of Permanent Injunction and Other Relief, *Wilson*, No. 1:17-cv-23712 (S.D. Fla. Nov. 7, 2017). He was criminally charged in December 2017, and in January 2018, pled guilty to one count of conspiracy to sell unregistered securities. Plea Agmt., *U.S. v. Wilson*, No. 17-cr-20883 (S.D. Fla. Jan. 25, 2018). Wilson was ultimately sentenced to probation for a term of five years. J. as to Andrew H. Wilson, *id.* (Jan. 23, 2019). In February 2018, Wilson was suspended from appearing or practicing before the Commission as an attorney. *In re Wilson*, Exchange Act Release No. 82,632 (Feb. 5, 2018). On December 7, 2018, Schneider was convicted of five counts of securities fraud, six counts of wire fraud, 21 counts of money laundering and one count of conspiracy. Verdict, *United States v. Schneider*, No. 17-cr-20712 (S.D. Fla. Dec. 7, 2018). He was found not guilty of one count of false statement and one count of obstruction of official proceedings. *Id.* Schneider was sentenced to seven years' imprisonment and was ordered to pay $19.7 million in restitution to defrauded investors. Dep't of Justice Press Release, *South Florida Securities Lawyer Sentences to Seven Years' Imprisonment for Role in Pump-and-Dump Securities Fraud Scheme* (Feb. 15, 2019). Following Schneider's conviction, the SEC moved to reopen its civil case against him, which had been stayed pending the outcome of the criminal trial. *See* Motion to Reopen the Case, No. 17-81142 (S.D. Fla. Dec. 26, 2018). On April 5, 2019, the court permanently enjoined Schneider from violating the securities laws, receiving compensation for services provided in connection with securities offerings, and from participating in any penny stock offering. Final Judgment, *id*. (Apr. 5, 2019). Further, Schneider was ordered to disgorge $14,703 in profits gained from the scheme and $3,152 in prejudgment interest accrued thereon. *Id*. On April 10, 2019, the SEC, pursuant to Rule 102(e), suspended Schneider from appearing or practicing before the Commission as an attorney. *In re Schneider*, Exchange Act Release No. 85,583 (Apr. 10, 2019).

E. Select Direct 102(e) Actions Against Attorneys

1. On occasion, the SEC files direct Rule 102(e) actions to discipline attorneys where another tribunal had not first determined that there had been a violation. Many of these direct Rule 102(e) charges are "added on" to administrative proceedings, which include other alleged substantive violations. Since late 2017, the SEC has not issued any direct Rule 102(e) actions against attorneys. This "add-on" phenomenon seems to be less prevalent in recent years.

2. On September 5, 2017, Alan M. Stark, an attorney licensed to practice in Florida, consented to the entry of a cease-and-desist order and agreed to be barred from appearing or practicing before the Commission. *In re Alan M. Stark*, Exchange Act Release No. 81523, 5 (Sept. 5, 2017). Stark purchased stock based on information he learned from communications with his client. *Id.* at 2. Stark became aware that the hedge fund manager had crossed beneficial ownership thresholds, which would require public disclosure of his securities holdings of, or transactions in, publicly traded companies. *Id.* On seven occasions, Stark purchased stock from companies immediately before filing the beneficial ownership reports to the same companies on behalf of his client. *Id.* at 4. After the filings, the company's stock price increased, and Stark benefited financially. *Id.* Stark was ordered to pay disgorgement and prejudgment interest of $8,513 and a $7,608 civil money penalty. *Id.* at 5.

3. On August 15, 2017, the SEC found that David Osunkwo, a New York attorney and "consultant chief compliance officer" caused two companies to fail to file timely and accurate reports with the Commission. *See In re David I. Osunkwo*, Exchange Act Release No. 81,405 (Aug. 15, 2017). First, Osunkwo and his company failed to file Aegis Capital LLC's annual update to its Form ADV. Further, Osunkwo materially overstated the assets under management ("AUM") and total client accounts in an annual amendment filed for Circle One Wealth Management LLP. *Id.* at 2. The AUM was overstated by $119 million and the number of client accounts by at least 1,000. *Id.* at 4. The SEC alleged that he relied on an email with estimates that he received from the CEO and failed to ascertain their accuracy. *Id.* Further, pressured to file on time, Osunkwo listed the CIO as a signatory certifying the form without confirming with the CIO. *Id.* Osunkwo consented to the entry of a cease-and-desist order and agreed to be barred from serving as an employee or officer of a registered investment company. *Id.* at 5. The SEC also ordered Osunkwo to pay a $30,000 civil money penalty. *Id.* at 5. Further, on November 14, 2017, Osunkwo was temporarily suspended from appearing or practicing before the Commission as an attorney. *In the Matter of David I. Osunkwo*, Exchange Act Release No. 82,070 (Nov. 14, 2017).

4. In July 2017, the SEC found that David Lubin, a New York attorney, committed fraud while serving as a director and corporate counsel of Entertainment Art, Inc. ("Entertainment Art"), a public company that specialized in the import and sale of leather goods. *See In re David Lubin*, Exchange Act Release No. 81,172 (July 19, 2017). In 2008, Lubin negotiated the sale of 1.81 million restricted and free-trading shares of Entertainment Art to Medford Financial, an entity controlled by an acquaintance. *Id.* at 3. Lubin's acquaintance however, wanted to make it appear as if he did not own the free-trading shares, as common ownership of all of Entertainment Art's shares would cause all of the free-trading shares to become restricted shares and require the resale of such securities to either be registered or comply with an applicable exemption. *Id.* To accommodate the

acquaintance's request, Lubin drafted a false share purchase agreement stating that Medford Financial purchased only the restricted shares, when in fact it purchased both restricted and free-trading shares. *Id.* at 4. Lubin also drafted separate share purchase agreements to influence the transfer of the free-trading shares. Instead of listing Medford Financial as the purchaser, Lubin left the purchaser, purchase price, and date of sale blank on the agreements. *Id.* This left the false impression that the free-trading shares remained immediately available for public resale. From 2009 to 2011, Lubin drafted and signed ten public filings that misrepresented the history and status of Entertainment Art's shares. *Id.* at 5. Lubin was permanently suspended from appearing and practicing before the SEC as an attorney. *Id.*; *see also* SEC Press Release 2017-127, *SEC Bars Lawyer Who Committed Fraud* (July 19, 2017).

5. In April 2017, the SEC found that Lawson Financial Corporation ("LFC"), an Arizona-based brokerage firm, "failed in its role as a gatekeeper" to conduct reasonable due diligence when underwriting bond offerings to purchase and renovate nursing homes and senior living facilities. *See* SEC Press Release No. 2017-100, U.S. Sec. & Exch. Comm'n, *SEC Charges Muni Bond Underwriter with Gatekeeper Failures* (Apr. 5, 2017). Then-underwriter's counsel John T. Lynch Jr. was charged with failing to conduct reasonable due diligence. *In re John T. Lynch, Jr.*, Exchange Act Release No. 10,335 (Apr. 5, 2017). The company's CEO and founder, Robert Lawson, was also charged. The SEC found that Lynch failed to disclose that he was not actually authorized to practice law at the time, as was represented to investors in the bond offering documents. Lynch was an inactive member of the Pennsylvania state bar and had not been an active member of any state bar since 1983. The SEC looked to titles and statements in documents to show how Lynch misrepresented to investors and LFC that he was qualified and permitted to serve as LFC's underwriter's counsel. Letters Lynch drafted represented that he was an "Attorney at Law," and bond offerings listed "John T. Lynch, Jr., Esquire, Phoenix, Arizona," as underwriter's counsel for LFC. Those letters further represented that "[c]ertain legal matters will be passed upon . . . [for LFC] by its counsel, John T. Lynch, Jr., Esquire, Phoenix, Arizona." *Id.* at 9. Lynch agreed to a partial settlement without admitting or denying the SEC's findings. Lynch was ordered to pay disgorgement of $20,000, prejudgment interest of $2,338.00, and a civil money penalty of $22,338. He also agreed to the entry of an order permanently suspending him from appearing and practicing before the SEC as an attorney. *Id.* *See* also *In re Lawson Fin. Corp. et al.*, Exchange Act Release No. 80,376 (Apr. 5, 2017). Lynch agreed to further proceedings to determine the appropriateness of non-financial sanctions. The Commission subsequently filed for summary disposition, which the Commission denied, finding that a hearing was necessary to determine which sanctions were in the public interest. *In re John T. Lynch Jr.*, Admin. Release No. 4989 (Aug. 22, 2017). The Commission reasoned that it was unclear whether Lynch acted with scienter and to what extent his conduct was recurring and egregious. *See In re John T. Lynch Jr.*, Admin. Release No. 5011 (Aug. 29,

2017). On February 6, 2018, the SEC announced that Lynch had consented to an order barring him from associating with various types of entities, including, but not limited to, any broker, dealer, or investment adviser, and prohibiting him from serving as an employee, officer, director, advisory board member, investment advisor, or underwriter for a registered investment company or an affiliate thereof. The order allows Lynch to apply for reentry after one year. *See In re John T. Lynch, Jr.*, Exchange Act. Release No. 82, 634 (Feb. 6, 2018).

6. On January 9, 2017, Peter Hershman, an attorney licensed to practice in Connecticut, was charged in an action alleging that he disguised referral payments as payments for legal services. *In re Peter Hershman*, Exchange Act Release No. 79,756 (Jan. 9, 2017). The SEC found that from 2011 to April 2013, Hershman and John Rafal, an investment advisor, circumvented the rule regarding payments for client solicitations. Rafal agreed to pay Hershman for the referral of Hershman's client. The solicitation arrangement, and the resulting conflict of interest, was not disclosed to this client—an elderly widow with accounts valued in excess of $100 million. Rafal and Hershman agreed that Hershman would receive an annual fee of $50,000, paid quarterly, from the advisory fees paid by that client on the referred accounts. As part of that arrangement, Hershman agreed to register as an investment adviser agent; however, Hershman never took the exam and never became an investment adviser agent. Rafal and the investment company knew that Hershman had not taken the test or been registered as an investment adviser agent. Hershman agreed to a settlement without admitting or denying the SEC's allegations. Pursuant to the settlement agreement, Hershman was ordered to disgorge $49,760.00, pay $4,923.57 in prejudgment interest and $37,500 in civil penalties. Hershman is also barred from working in the securities industry and serving as an officer or director of a publicly traded company or affiliate thereof. Finally, Hershman consented to the entry of a cease-and-desist order and agreed to be permanently suspended from appearing and practicing before the SEC. *Id.*

VI. Reciprocal Disciplinary Actions Following Rule 102(e) Actions

A. Attorneys can face reciprocal disciplinary actions from state bars following an SEC order suspending the appearance or practice before the Commission under Rule 102(e). Whether a Rule 102(e) action can trigger reciprocal discipline turns on the state laws and rules governing attorney practice in a particular state.

B. In December 2016, in *In re Vincent L. Verdiramo*, the New Jersey Supreme Court denied a motion to suspend Verdiramo from practicing in New Jersey under the state's reciprocal discipline rule, filed by the New Jersey Office of Attorney Ethics ("OAE"), following the entry of an order by the Commission pursuant to Rule 102(e)(3)(i) temporarily suspending him from appearing or practicing before the SEC. *In re Vincent L. Verdiramo*, No. DRB 16-181 (N.J. Dec. 13, 2016); *In re Vincent L. Verdiramo,* No. 078679 (N.J. June 15, 2017) (order denying motion for reciprocal discipline).

Previously, in September 2011, a district court for the Southern District of New York had found that Verdiramo violated Section 5 of the Securities Act by selling shares of a public company in unregistered transactions between July 2005 and February 2006. *Id.* The district court enjoined him from future violations and ordered that he pay disgorgement. *Id.* In November 2011, the SEC entered an order instituting an administrative proceeding against Verdiramo and temporarily suspending him pursuant to Rule 102(e)(3)(i). Exchange Act Release No. 65739. On April 29, 2013, the district court entered final judgments against Verdiramo, ordering him to pay additional disgorgement and civil penalties, prohibiting him from serving as an officer or director of public companies and barring him from penny stock offerings. *See* Litigation Release No. 22697 (May 7, 2013).

C. The OAE argued in its motion for reciprocal discipline that the SEC's administrative order was a "final, adjudication, conclusively establishing the facts on which it rests, thereby permitting [the Court] to discipline [Verdiramo]." *In re Vincent L. Verdiramo*, No. DRB 16-181 at 2 (N.J. Dec. 13, 2016). Verdiramo argued that the court lacked jurisdiction to impose reciprocal discipline because "the SEC is not a disciplinary authority for the purpose of the [state's reciprocal rule]; its order arose out of a civil action that did not involve a finding that respondent had engaged in unethical conduct; and the standard upon which the SEC made its finding in that civil action was preponderance of the evidence, rather than the clear and convincing evidence required in a New Jersey disciplinary proceeding." *Id.* at 11. The Court agreed that it lacked jurisdiction. *Id.*

D. The court held that the SEC was not a "disciplinary authority" for purposes of the reciprocal discipline rule, reasoning that, with one non-applicable exception, the SEC does not have rules for professional conduct pertaining to attorneys. *Id.* at 16. The court also held that the SEC had not suspended Verdiramo because he "'engaged in unethical or improper professional conduct' in connection with the practice of law before the SEC, [rather Verdiramo] was suspended simply as a consequence of a judgment entered against him in a civil action based on his violation of a civil law." *Id.* at 17.

E. *See also Florida Bar v. Teeps*, 601 So.2d 1174 (Fl. 1992) (holding that an SEC order of suspension does not constitute a "final adjudication of discipline by a foreign jurisdiction," for Florida's reciprocal discipline rule); *Disciplinary Counsel v. Lapine*, 128 Ohio St. 3d 87 (Oh. 2010) (holding an SEC suspension order in which an Ohio attorney voluntarily agreed not to practice before the SEC for five years, and which reflects no admission of wrongdoing by the attorney nor affirmative finding of misconduct by the SEC, is not a disciplinary order by another jurisdiction that requires reciprocal discipline).

F. It is important to note that the Court, in *In re Vincent L. Verdiramo*, did not foreclose the OAE from disciplining Verdiramo. According to the court, the OAE may file a complaint, conduct an investigation, and proceed to a hearing, or if Verdiramo is amenable, the OAE also could enter into a disciplinary stipulation with Verdiramo.

VII. SEC Charges Dewey & LeBoeuf, LLP

A. On March 6, 2014, the SEC filed a complaint against several former executives of Dewey & LeBoeuf, LLP ("Dewey") in the United States District Court for the Southern District of New York for violations of various provisions of the securities laws. The complaint charged the firm's senior financial professionals including Joel Sanders (CFO), Frank Canellas (Director of Finance), and Thomas Mullikin (Controller). The complaint also included charges against the firm's senior management including Steven Davis, the firm's chairman, and Stephen DiCarmine, the firm's executive director. *Complaint, SEC v. Davis*, No. 14-cv-1528 (S.D.N.Y. Mar. 6, 2014).

B. According to the SEC, these members of the firm perpetuated an accounting fraud that led to materially misleading financial statements in a private placement memorandum for a 2010 bond offering the firm issued to alleviate its financial troubles. Over the course of two years, the firm's top management allegedly engaged in various accounting maneuvers to hide the company's declining profit, often referring in emails to their accounting tactics as "fake income," "accounting tricks," and "cooking the books." For example, the firm allegedly reclassified some of its compensation paid to three of-counsel attorneys from an expense account to an equity distribution account, appearing to increase the firm's profit by $14.3 million. The firm also allegedly double-booked income received from a client and mischaracterized $2.5 million in credit card debt that several Dewey executives incurred as unbilled client disbursements. These accounting tactics, among others, led the SEC to charge the named defendants with violations of § 17(a) of the Securities Act and § 10(b) of the Exchange Act. *Id.*

C. In October 2015, in the related criminal trial against former executives Davis, DiCarmine, and Sanders, the Supreme Court of the State of New York declared a mistrial after jurors deliberated for 21 days without reaching a verdict on grand larceny, scheme to defraud, and other more serious charges. *See* Nell Gluckman and Christine Simmons, *Marathon Dewey Deliberations End in Mistrial*, The American Law Daily (Oct. 19, 2015). The jury had earlier acquitted the former executives on counts of falsifying business records. The trial lasted for over four months, with the prosecution calling more than 40 witnesses. Lawyers for the defendants chose not to call a single witness, instead relying on cross-examination to build their defense. Mullikin, who pled guilty to a criminal count of a scheme to defraud and settled civil charges with the SEC in September 2014, testified as a cooperating witness at trial. His testimony detailed a plan to inflate Dewey's earnings and hide accounting adjustments from the law firm's banks and outside auditors.

D. In December 2015, New York state prosecutors announced that Davis would not be retried following the mistrial. In January 2016, Davis consented to the entry of a judgment permanently enjoining him from future securities law violations and barring him from serving as an officer or director of a publicly traded company. The District Court for the Southern District of New York also ordered the payment of disgorgement plus prejudgment interest and civil monetary penalties. *SEC v. Davis, et al.*, Litigation

Release No. 23,443 (Jan. 11, 2016). Davis also consented, without admitting or denying the findings, to an order suspending him from appearing or practicing before the Commission as an attorney. *In re Steven H. Davis*, Exchange Act Release No. 77,325 (Mar. 8, 2016).

E. DiCarmine and Sanders rejected plea deals proposed by the prosecutors in December 2015. In February 2015, Judge Robert Stolz, of the Supreme Court of the State of New York, dismissed fifteen counts of grand larceny charged against both defendants; however, the charges of securities fraud, scheme to defraud, and conspiracy were preserved. In May 2016, Judge Stolz also exonerated the defendant's $200,000 bail based on the dismissed larceny charges. *See* Stewart Bishop, *Dewey DiCarmine Wants to Represent Himself at Retrial,* LAW360 (May 6, 2016). The second trial for DiCarmine and Sanders began in January 2017 and resulted in a split verdict five months later. Over the course of the trial, the prosecution called more than 30 witnesses, including, Francis Canellas, Dewey's former finance director. Just as at the first trial, the defense did not call any witnesses. On May 8, 2017, a jury convicted Joel Sanders, the law firm's former CFO, on three criminal counts arising from what prosecutors said was a scheme to hide the firm's failing finances from financial backers. In August 2017, former Dewey partners and other attorneys filed letters urging the judge to show leniency at Sanders' sentencing. *See* Christine Simmons, *Convicted Dewey & LeBoeuf Exec Gets Support From Florida Firm, Dewey Alums*, N.Y.L.J. (Aug. 8, 2017). On September 1, 2017, prosecutors submitted a sentencing memorandum recommending 15 months to four years in prison: "Joel Sanders has refused to accept even an iota of responsibility for his crimes and has consistently derided those who have. If this is not the sort of white collar conduct that demands a prison sentence, what is?" *State v. Sanders*, No. 00773/2014, (N.Y. App. Div. Sept. 1, 2017). Sanders submitted his reply brief later that month, emphasizing that he did not cause losses to the purported victims in the case, and that there was no evidence he had criminal intent, *State v. Sanders*, No. 00773/2014, 8 (N.Y. App. Div. Sept. 18, 2017). On October 10, 2017, New York Supreme Court Judge Robert Stolz ordered Sanders to complete 750 hours of community service and to pay a $1 million fine over the next three years. Sara Randazzo, *Dewey CFO Escapes Jail Time in Fraud Case Sentencing*, WALL ST. J. (Oct. 10, 2017). Sanders is appealing the decision. Status Report, *SEC v. Davis*, No. 14-cv-01528 (Oct. 1, 2018).

F. Stephen DiCarmine, on the other hand, was acquitted of the same charges. *See* Matthew Goldstein and Liz Moeyer, *Former Dewey & LeBoeuf Executive Convicted in Split Verdict*, N.Y. TIMES (May 8, 2017). Post-trial, jurors indicated that prosecutors provided insufficient evidence connecting DiCarmine with the purported scheme to defraud. Jody Godoy, *Weary Dewey Jurors Say Case Against Sanders Far Clearer*, LAW360 (May 8, 2017).

G. DiCarmine and Sanders still faced civil charges brought by the SEC relating to Dewey's $150 million bond offering in April 2010. In April 2018, Sanders consented to an order permanently enjoining him from violations of the charged securities laws and from serving as an officer or director of any issuer with securities registered under Section 12 of the Exchange Act. The court is to determine the appropriateness of penalties and disgorgement at a later date. J. as to Joel Sanders, *SEC v. Davis*, No. 14-cv-01528 (S.D.N.Y. Apr. 18, 2018). In June 2018, the district court stayed discovery in the SEC's case against Sanders pending his appeal of his criminal conviction. Status Report, *SEC v. Davis*, No. 14-cv-01528 (S.D.N.Y. July 26, 2018). DiCarmine also consented to an order permanently enjoining him from violating the charged securities laws and ordering him to pay a civil penalty of $35,000. Final J. as to Stephen DiCarmine, *SEC v. Davis*, No. 14-cv-01528 (S.D.N.Y. Apr. 18, 2018). Also in June 2018, the Supreme Court of New York disbarred Sanders. *In re Joel I Sanders,* No. 2017-09814 (N.Y. A.D.2d, June 20, 2018).

H. In September 2018, Sanders failed to make the first of three installment payments on the $1 million fine imposed by New York Supreme Court Judge Robert Stolz. On November 15, 2018, Judge Stolz ordered Sanders into custody, finding that he willfully failed to pay the fine. Sanders was released from jail the following day after his current law firm, Greenspoon Marder, paid the full $1 million fine. *See* Debra Cassens Weiss, *Former Dewey CFO Released from Jail After His Current Firm pays his $1M Fine*, ABA J. (Nov. 15, 2018). As of July 2020, the SEC's case against Sanders is on hold, pending Sanders's appeal of his criminal conviction. Status Report, *SEC v. Davis*, No. 14-cv-01528 (S.D.N.Y. July 9, 2020).

VIII. Disciplinary Action Before the Oregon State Bar

A. Securities attorneys also face the possibility of sanctions by state bars.

B. In March 2013, in *In re Barnes H. Ellis and Lois O. Rosenbaum*, two securities attorneys were found by a three-member panel to have violated Oregon ethics rules governing conflicts of interest and misrepresentation while representing Flir Systems, Inc. ("Flir") and various Flir employees during an SEC and DOJ investigation. *In re Ellis and Rosenbaum*, OSB Nos. 09-54, 09-55 (Or. State Bar, Mar. 5, 2013).

C. Notably, the disciplinary actions were not prompted by a client complaint from Flir or any Flir employee. The Oregon Bar initiated the actions on its own.

D. The Oregon State Bar filed disciplinary actions against Ellis and Rosenbaum in 2008. In its 2013 order, the trial panel rejected the majority of the Oregon State Bar's claims. In particular, claims alleging that the attorneys violated conflicts rules by representing Flir and certain individuals during the SEC investigation were dismissed. The panel appeared to credit testimony from expert Jeffrey B. Maletta, identifying the benefit of representing a company and multiple clients. According to Maletta, "having multiple corporate officers and employees represented by the same attorney makes it more difficult for the SEC to divide and conquer. This is because that attorney has knowledge that is far more complete and extensive than multiple attorneys representing individual witnesses." *Id.* at 22.

E. The panel recognized the importance of understanding the nature of an SEC investigation and how it differed from other forms of litigation. Specifically, the panel recognized that during an SEC investigation, "an attorney is not permitted to advocate on behalf of a client" and thus, "a lawyer cannot engage in an actual conflict of interest where he or she contends for something on behalf of one client that the lawyer has a duty to oppose on behalf of another client." *Id.* at 24.

F. The trial panel found that a conflict of interest arose with regard to a statement made in Flir's Wells submission. Specifically, the panel took issue with the sentence, stating that "[f]inally, to the extent wrongdoing may have occurred, we understand that the SEC is pursuing fraud claims against one or more individuals who may have been responsible." According to the panel, the individuals formerly represented by Ellis and Rosenbaum had an interest to not have Flir and their former lawyers state that a wrongdoing may have occurred, and that fraud claims are being pursued against the individuals responsible. The panel also noted that to the extent the attorneys believed that the statement was necessary, "the proper course of action would have been to send a draft of Flir's Wells response to the attorneys for [the individuals] and ask for their consent after full disclosure to send it to the SEC." *Id.* at 35-37.

G. The trial panel further found that a conflict of interest arose when Rosenbaum contacted the SEC to notify it about a certain transaction. According to the panel, Rosenbaum should have known, as a result of the nature of the transaction, that there was a possibility that analysis of the transaction by the SEC might have led to criminal charges being brought against an individual she represented. Criminal charges related to the transaction were ultimately brought against the individual. Interestingly, the panel recognized that the disclosure to the SEC may not have been the source which alerted the DOJ to this transaction. Nonetheless, the panel found that "[w]hether Rosenbaum's informing the SEC of the . . . transaction actually caused damage to [the individual] does not negate Rosenbaum's misconduct." *Id.* at 47-48.

H. Rosenbaum and Ellis were also found to have failed to disclose material information to former individual clients when requesting those clients to consent to their continued representation of Flir after the DOJ had initiated a criminal investigation. Specifically, the panel found that Ellis and Rosenbaum should have disclosed to the former clients, among other information, a letter from the DOJ related to Flir's cooperation in exchange for an agreement not to prosecute the company, the fact that compensation information pertaining to the former clients was being requested by the DOJ and was provided, and the fact that the SEC and the DOJ were investigating accounting transactions that had not been alleged in the SEC civil enforcement proceeding. The panel found that in each instance of non-disclosure, "Ellis and Rosenbaum had the facts in mind, they knew they were material, and the disclosure of those facts may have influenced the decision-making process significantly." *Id.* at 71-72.

I. On February 20, 2015, the Supreme Court of Oregon in a 76-page opinion ruled that the Oregon State Bar had not proved the allegations against Rosenbaum and Ellis by clear and convincing evidence and dismissed the complaints against the two attorneys. *In re Conduct of Ellis*, 356 Or. 691 (2015).

J. The Oregon Supreme Court affirmed the panel's conclusion that Ellis and Rosenbaum did not violate the state's conflict of interest rules by representing both Flir and certain of its executives at the outset of the SEC investigation. The Supreme Court followed the panel in crediting testimony by Maletta, who testified that "it was common practice for a single firm to individually represent the company and subpoenaed company officers and employees." The court also emphasized that both the company and its officers had a mutual interest in learning as much as possible about the SEC's investigation, which the joint representation permitted them to do. *Id.* at 717.

K. The Oregon Supreme Court reversed the panel's determination that there was a conflict of interest with the two Flir executives based on a statement in Flir's Wells submission. The court determined that in submitting the Wells submission on behalf of Flir, Rosenbaum and Ellis did not make any negative characterizations about either of the company's executives. Rather, the Wells submission was aimed at convincing the SEC about the sincerity of Flir's remediation efforts. The court also highlighted that "[n]one of the lawyers involved—including independent lawyers [representing the Flir executives]—thought that a conflict existed." *Id.* at 733.

L. The panel's determination with respect to Rosenbaum's phone call to the SEC was also reversed. The Oregon Supreme Court concluded that the Bar failed to allege facts sufficient to inform Rosenbaum of the nature of the charge against her, as is required under Bar Rule of Procedure 4.1(c). Since Rosenbaum's phone call to the SEC occurred after the SEC's judgment against Flir and its executives had been entered and after the time frame referred to in the Bar's cause of action, Rosenbaum was not given sufficient notice. *Id.* at 739.

M. Rosenbaum's March 3, 2003 letter to the two Flir executives was found to be sufficient to disclose any potential conflict that may arise from the attorneys' representation of Flir in the DOJ investigation. The court assumed that the Bar had sufficiently proved a likely conflict of interest before analyzing whether Rosenbaum made sufficient disclosure to her clients. The court first emphasized that "the nature of the accused's' limited representation of Flir in the DOJ investigation consisted of only producing documents and scheduling witnesses." Rosenbaum's letter to the Flir executives was sufficient to disclose the potential conflict of interest for three reasons. First, the letter informed the executives of the nature of the representation and how the representation may lead to potential adverse consequences to the two executives. Second, the letter notified the two executives that Rosenbaum and Ellis had informed the DOJ that they would not disclose information that was subject to confidentiality claims by the two executives and would inform the two executives' independent counsel if such requests were made. Third, the letter asked the executives to seek the assistance of independent counsel to determine whether they should give consent to the attorneys' representation of Flir in the DOJ investigation. Combined, the court found these disclosures sufficient to mitigate any potential conflict of interest. *Id.* at 762.

N. The Oregon Supreme Court decision is significant in several respects. The ruling acknowledges that SEC investigations are unique in that they often require attorneys to represent both the company and some of its executives, which could trigger potential conflicts of interest. The deference to the unique nature of SEC investigations in overruling the panel's decision may act as a signal to future courts asked to evaluate the conduct of securities lawyers facing potential sanctions for representing multiple clients. The decision also serves as useful guidance to securities attorneys considering multiple representations in the context of an SEC or other government investigation. The emphasis on Rosenbaum's letter disclosing to her clients the potential conflicts of interest that could arise and Rosenbaum's suggestion to the Flir executives to seek independent counsel exemplify methods securities attorneys can utilize when representing multiple clients in an investigation.

O. After the Oregon Supreme Court decision, the State Bar's Disciplinary System Review Committee ("DSRC") proposed a number of changes recommended by the ABA evaluation team and other changes developed solely by the Committee. *See* Oregon State Bar, Report of the Discipline System Review (Nov. 19, 2015), *available at* http://invw.org/2016/02/08/should-the-oregon-state-bar-keep-complaints-secret/ (last visited July 12, 2016). The most controversial proposal was to keep complaints against attorneys confidential until the State Professional Responsibility Board ("SPRB") charged the attorney. The proposal stated: "Amend the Bar Act to provide that complaints of misconduct and all information and documents pertaining to them are confidential and not subject to public disclosure until either (a) the SPRB has authorized the filing of a formal complaint, or (b) the complaint has been finally resolved without SPRB authorization to file a formal complaint."

1. Barnes Ellis was among the proponents, citing his own experience in support for the change. Ellis' case lasted seven years. In his concurrence for the proposal he explained that the processing time can take several years and "[t]he result is a system that clearly is far too slow." Ellis argued that "[t]he public is not protected when respondents that should be sanctioned continue to practice during the several years the process now takes. And respondents that should be vindicated experience during this lengthy process significant reputational, financial and emotional harm." Letter from Barnes H. Ellis to the Members of the Oregon State Bar regarding the OSB Disciplinary System Review Committee Report (Nov. 23, 2015), *available at* http://bog11.homestead.com/DSRC/MinorityReports/EllisConcurrence.pdf (last visited June 30, 2016).

2. On March 11, 2016, the Oregon State Bar Board of Governors rejected the proposal, writing: "although many bar complaints do not result in discipline, some complaints reveal matters that are of public concern. For this reason, the

public deserves to know about complaints early in the process." The Board voted unanimously against the motion. *See* Oregon State Bar, Minutes of the Special Open Session of the Board of Governors (Mar. 11, 2016), *available at* https://www.osbar.org/_docs/leadership/bog/minutes/20160311BOGminutesSpecial.pdf (last visited June 30, 2016).

IX. Disqualifying Counsel for Breach of Fiduciary Duty – Private Action

A. The New York Appellate Division, First Department, reversed a lower court's summary judgment decision in favor of a law firm alleged to have violated its fiduciary duty to a former client. Plaintiff Dennis T. Palmeri, Jr., a former manager at Ramius Securities LLC ("Ramius"), brought several claims against defendant Willkie Farr & Gallagher LLP ("Willkie") stemming from Willkie's simultaneous representation of both Palmeri and Ramius in a FINRA investigation. *See* Complaint, *Palmeri v. Willkie Farr & Gallagher LLP*, No. 650501 (N.Y. App. Div. Feb. 15, 2013).

B. Palmeri hired Willkie to represent him in connection with FINRA's investigation of Ramius in 2009, shortly after he had left the company. *See Palmeri v. Willkie Farr & Gallagher LLP*, No. 05794 slip op. at 1 (N.Y. App. Div. July 25, 2017). Willkie also represented Ramius in the same investigation. Several months later, Willkie informed Palmeri it could no longer represent him because of a conflict of interest arising from the concurrent representation. *Id.* FINRA eventually resolved its investigation of Ramius, but brought a disciplinary proceeding against Palmeri that was later dismissed for lack of evidence. *Id.* at 2.

C. Palmeri brought suit, alleging that Willkie shifted all responsibility for the improper conduct from Ramius to Palmeri and disclosed his privileged communications with Willkie. Willkie moved for summary judgment, arguing that Palmeri's claims were time-barred. *Id.* The lower court agreed and, after merging several claims, dismissed Palmeri's malpractice and breach of fiduciary duty claims as untimely. *Id.*

D. The appellate court reversed in part, finding that the lower court improperly dismissed Palmeri's breach of fiduciary duty claim. *Id.* It reasoned that although the lower court was correct in applying a three-year statute of limitations, the breach was a continuing harm that lasted throughout Willkie's representation of Ramius in the FINRA investigation. As such, the appellate court held that Palmeri had presented sufficient evidence for a fact finder to determine that Willkie breached its fiduciary duty to Palmeri. *Id.* at 4.

E. In January 2018, Willkie's attorney requested that the parties engage in mediation. They mediated the dispute the following month and executed a settlement agreement. In late March 2018, however, Palmeri requested that a pretrial conference be scheduled because Willkie had rescinded the settlement agreement. *See Willkie Abandoned Binding Settlement Deal, Ex-Client Says*, LAW360 (Mar. 29, 2018).

F. By April 2018, after more than five years of litigation, the parties stipulated to discontinue the case with prejudice. Stipulation of Discontinuance with Prejudice, *Palmeri v. Willkie Farr & Gallagher LLP*, Index No. 650501/2013 (N.Y. Sup. Ct. Apr. 5, 2018).

X. Attorney Conduct Rules – Sarbanes-Oxley

A. "Reporting Up" and "Reporting Out" – Sarbanes-Oxley and the Federalization of Attorney Conduct Regulation

B. Perception that state regulation of the legal profession had failed.

1. In the wake of Enron and other corporate scandals, questions arose regarding the conduct of lawyers. There was a perception that they did not respond appropriately when faced with evidence of illegality.

2. Questions also arose regarding effectiveness of state regulation of the legal profession.

(a) During a floor debate a few weeks before Sarbanes-Oxley was enacted, Senator Enzi said, "the State bars as a whole have failed. They have provided no specific ethical rule of conduct to remedy this kind of situation. Even if they do have a general rule that applies, it often goes unenforced." 148 Cong. Rec. at S6555 (July 10, 2002).

(b) In a 2002 speech a few weeks after Sarbanes-Oxley was enacted, then-SEC Chairman Harvey Pitt expressed disappointment with "the generally low level of effective responses we receive from state bar committees when we refer possible disciplinary proceedings to them." Harvey L. Pitt, Chairman, U.S. Sec. & Exch. Comm'n, Remarks Before the Annual Meeting of the American Bar Association's Business Law Section (Aug. 12, 2002).

C. Sarbanes-Oxley

1. The policy response to the corporate scandals of the turn of the century has been largely to federalize the regulation of securities lawyers.

2. Section 307 of Sarbanes-Oxley, "Rules of Professional Responsibility for Attorneys," provides as follows:

Not later than 180 days after the date of enactment of this Act, the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule:

(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and

(2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

D. Part 205: the SEC's Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission

1. The SEC promulgated rules and procedures implementing Sarbanes-Oxley § 307. Implementation of Standards of Professional Conduct for Attorneys, Exchange Act Release No. 47,276, 2003 WL 193527 (Jan. 29, 2003) (codified at 17 C.F.R. Part 205).

(a) Preemption

(i) It is the position of the SEC that Part 205 "sets forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in the representation of an issuer. These standards supplement applicable standards of any jurisdiction where an attorney is admitted or practices and are not intended to limit the ability of any jurisdiction to impose additional obligations on an attorney not inconsistent with the application of this part. Where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with this part, this part shall govern." 17 C.F.R. § 205.1.

(ii) In other words, Part 205 purports to preempt any less-rigorous or conflicting state ethical canons.

(iii) Conflicts with varying rules and canons in some jurisdictions pose challenges for lawyers.

(1) *Compare* North Carolina Formal Ethics Op. 2005-9 (finding that state confidentiality rules conflict with the permissive reporting-out scheme adopted by the SEC in

Part 205, and opining that disclosures contemplated by Part 205 will not constitute violations of North Carolina ethics rules);

(2) *With* The New SEC Attorney Conduct Rules v. California's Duty of Confidentiality, Ethics Hotliner, Corporations Committee of the Business Law Section and Committee on Professional Responsibility and Conduct, State Bar of California (Spring 2004) ("Given the apparent conflict between the provisions of the Part 205 Rules permitting disclosure of client confidences to the SEC and the fiduciary duty of California attorneys to maintain client secrets and confidences, it may be safer for California attorneys not to accept the SEC's invitation to disclose client confidences to the SEC, at least until such time as the preemption and good faith issues have been decided by a court of competent jurisdiction.").

(b) Part 205 applies to all attorneys "appearing and practicing" before the SEC in the representation of an issuer.

(i) "Appearing and practicing" is extremely broad. It means:

(1) Transacting any business with the Commission, including communications in any form;

(2) Representing an issuer in a Commission administrative proceeding or in connection with any Commission investigation, inquiry, information request, or subpoena;

(3) Providing advice in respect of the United States securities laws or the Commission's rules or regulations thereunder regarding any document that the attorney has notice will be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the Commission, including the provision of such advice in the context of preparing, or participating in the preparation of, any such document; or

(4) Advising an issuer as to whether information or a statement, opinion, or other writing is required under the United States securities laws or the Commission's rules or regulations thereunder to be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the Commission.

17 C.F.R. § 205.2(a).

(ii) "In the representation of an issuer means providing legal services as an attorney for an issuer, regardless of whether the attorney is employed or retained by the issuer." 17 C.F.R. § 205.2(g).

(iii) "Issuer" includes persons issuing securities that are registered or required to be registered with the Commission, as well as persons controlled by the issuer. 17 C.F.R. § 205.2(h).

E. New professional obligation for securities lawyers: reporting "up the ladder"

1. The central obligation imposed by the SEC's professional conduct rules is the duty of attorneys appearing and practicing before the Commission in the representation of an issuer to report to the issuer's chief legal officer ("CLO"), or both the CLO and the CEO of the issuer, "forthwith," if he "becomes aware of evidence of a material violation by the issuer or by any officer, director, employee, or agent of the issuer." 17 C.F.R. § 205.3(b)(1).

2. The rule flatly asserts that reporting up "does not reveal client confidences or secrets or privileged or otherwise protected information related to the attorney's representation of the issuer." *Id.*

3. This view is premised on the proposition, stated elsewhere in the attorney conduct rules, that "[a]n attorney appearing or practicing before the Commission in the representation of an issuer owes his or her [professional and ethical] duties to the issuer as an organization," and not to particular "officers, directors, or employees" of the company. 17 C.F.R. § 205.3(a).

4. This view is also consistent with the SEC's position that Part 205 preempts any conflicting state rules.

F. The reporting-up rule is notable because it requires covered attorneys to report evidence of violations of state law, including fiduciary breaches, as well as the federal securities laws.

1. A "material violation" includes "a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law." 17 C.F.R. § 205.2(i).

2. "Breach of fiduciary duty refers to any breach of fiduciary or similar duty to the issuer recognized under an applicable Federal or State statute or at common law, including, but not limited to, misfeasance, nonfeasance, abdication of duty, abuse of trust, and approval of unlawful transactions." 17 C.F.R. § 205.2(d).

3. “Evidence of a material violation means credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur.” 17 C.F.R. § 205.2(e).

   (a) When is a lawyer “aware” of evidence of a material violation? This is unclear, but the rule does not contemplate an “actual knowledge” standard. The threshold is (much) lower than that.

   (b) In its adopting release, the SEC observed that the standard is “objective,” that evidence of a material violation must be “credible” to be reportable and that there is a range of conduct that an attorney can engage in without being “unreasonable.” *See* Implementation of Standards of Professional Conduct for Attorneys, Exchange Act Release No. 47,276, 2003 WL 193527 (Jan. 29, 2003) (codified at 17 C.F.R. Part 205).

   (c) According to the adopting release, the “circumstances” under which evidence of a material violation should be reported take into account, inter alia, an attorney’s background and skills, time constraints, previous experience with the client and consultation with other lawyers. *Id.*

   (d) The SEC explained, “an attorney is not required (or expected) to report ‘gossip, hearsay, [or] innuendo.’” *Id.* On the other hand, the Commission stated in the adopting release that the up-the-ladder reporting duty “is not triggered only when an attorney ‘knows’” of a material violation, or concludes that no reasonable fact finder could conclude otherwise. *Id.* “To be ‘reasonably likely’ a material violation must be more than a mere possibility, but it need not be ‘more likely than not.’” *Id.*

   (e) Upon receiving a report of evidence of a material violation, the CLO “shall cause such inquiry into the evidence of a material violation as he or she reasonably believes is appropriate to determine whether the material violation described in the report has occurred, is ongoing, or is about to occur.” 17 C.F.R. § 205.3(b)(2).

   (f) The CLO shall “notify the reporting attorney” in the event he determines no violation is present, but unless the CLO “reasonably believes that no material violation has occurred, is ongoing, or is about to occur, he shall take all reasonable steps to cause the issuer to adopt an appropriate response” and “advise the reporting attorney.” *Id.*

   (g) A reporting attorney must report further up the ladder to the audit committee, a committee of solely independent directors, or the full board, unless he reasonably believes the CLO or CEO has made an appropriate response. Rule 205.3(b)(3). If an attorney who becomes aware of evidence of a material violation reasonably believes reporting to the CLO and CEO would be futile, such an attorney may take this step without first reporting to the CLO or CEO. Rule 205.3(b)(4).

G. An "appropriate response" is defined not in terms of what the CLO actually does, but in terms of what the reporting attorney reasonably believes was done. It means a response that causes the reporting attorney to reasonably believe: (a) no material violation occurred, is ongoing or is about to occur; (b) the issuer has adopted appropriate measures to stop, prevent and/or remedy material violations; or (c) the issuer, with the consent of the board, a committee of solely independent directors or the QLCC, has retained or directed an attorney to review the evidence and either substantially implemented any remedial recommendations made by that attorney after a reasonable investigation, or has been advised that such attorney may assert a colorable defense in any investigation or judicial or administrative proceeding relating to the reported evidence of a material violation. Rule 205.2(b).

1. With respect to the last category of "appropriate response"—a direction by the CLO to defense counsel to assert a "colorable defense"—the SEC noted in the adopting release that this category of appropriate response is limited to defenses that can be asserted consistent with defense counsel's professional obligations, including the duty of candor to the tribunal. *See* Implementation of Standards of Professional Conduct for Attorneys, Exchange Act Release No. 47,276, 2003 WL 193527 (Jan. 29, 2003) (codified at 17 C.F.R. Part 205).

H. Alternative: reporting to the "qualified legal compliance committee" ("QLCC").

1. As an alternative to reporting to the CLO (or the CLO or CEO), a lawyer with awareness of evidence of a material violation can report it to a QLCC, if one exists. Reporting to a QLCC exhausts the reporting attorney's duties. He need not follow up on the response to the report. Rule 205.3(c)(1).

2. Likewise, upon receipt of a report of evidence of a material violation from a reporting attorney, in lieu of causing an inquiry, a CLO may refer the evidence to the QLCC, which shall be responsible for responding. Rule 205.3(c)(2).

3. A QLCC is a committee of the issuer consisting of at least one member of the audit committee and two or more independent directors, which has adopted written procedures for the confidential receipt, retention and consideration of evidence of a material violation, which has been duly established by the board of directors and has the authority and responsibility to take various steps, including, inter alia, reporting to the CLO and the CEO, determining whether to conduct and initiating an investigation by the CLO or outside counsel, notifying the audit committee and the full board of directors, making recommendations, and taking

other appropriate action, including the authority to notify the Commission in the event that the issuer fails to implement the recommendations. Rule 205.2(k).

4. A "subordinate attorney" can satisfy his reporting obligation by reporting to his "supervising attorney." Rule 205.5(c). Thereafter, if he "reasonably believes" the supervising attorney has not complied with his reporting obligation, the subordinate attorney "may" himself report to the CLO (or the CLO and CEO), or to the QLCC. Rule 205.5(d).

I. The SEC's rules may not align perfectly with obligations under state law.

1. ABA Model Rule of Professional Conduct 1.13(b) provides, "[i]f a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law."

2. One major difference is the level of knowledge—a lawyer must know of a violation. "Credible evidence" is not enough.

3. Even when a lawyer knows of a violation, a lawyer has flexibility under the model rules to refrain from reporting it up the chain if he reasonably believes it is not necessarily in the best interest of the organization.

J. "Noisy withdrawal" and reporting out—

1. As discussed, as far back as *National Student Marketing* (1972), the SEC has suggested that lawyers should, in some circumstances, report clients' violations to the SEC. To the extent any such obligation ever existed, its parameters were murky.

2. As proposed, the SEC's rules of lawyer conduct implementing § 307 of Sarbanes-Oxley would have required outside attorneys who have reported evidence of a material violation to the CLO, and who do not receive an appropriate response, or do not receive such a response within a reasonable time, and who reasonably believe that a material violation is ongoing or is about to occur and will likely result in substantial injury to the financial interest or property of the issuer or of investors, to:

(a) Withdraw from the representation;

(b) Inform the SEC of the withdrawal within one day and indicate that it was for professional reasons; and

(c) Promptly disaffirm to the SEC any opinion, filed document, representation, etc., that was previously filed or submitted with the SEC that the outside attorney had prepared or assisted in preparing and that the attorney reasonably believes may be false or materially misleading. Proposed Rule 205.3(d)(1)(i).

3. The proposed rules contained a similar provision for in-house counsel, Proposed Rule 205.3(d)(1)(ii), and a permissive noisy withdrawal rule for inappropriate responses to past violations. Proposed Rule 205.3(d)(2).

4. The SEC separately proposed mandatory "quiet withdrawal" rules. Implementation of Standards of Professional Conduct for Attorneys, Exchange Act Release No. 48,282, 2003 WL 203262 (Jan. 29, 2003).

(a) Under the alternative proposed quiet withdrawal rules, an outside lawyer who reports evidence of a material violation to the CLO, but who does not receive an appropriate response within a reasonable time, and reasonably concludes that there is substantial evidence of a material violation that is ongoing or about to occur and is likely to cause substantial injury to the financial interest or property of the issuer or of investors, would be required to withdraw and notify the issuer of the reason. Proposed Rule 205.3(d)(1)(iii)(A).

(b) A similar rule would require in-house counsel to halt participation in the relevant matter and notify the issuer of the lack of an appropriate response. Proposed Rule 205.3(d)(1)(iii)(B).

(c) The issuer would be required to report the withdrawal (or cessation of participation in the matter) on Form 8-K or its equivalent within two business days. Proposed Rule 205.3(e).

(d) The lawyer would be permitted to notify the SEC that he has given notice to the issuer if the issuer does not make a report. Proposed Rule 205.3(f).

(e) The withdrawal requirement would not apply if the attorney would be prohibited from doing so by order of any court, administrative body or other authority with jurisdiction over the attorney, after having sought leave to withdraw from representation or to cease participation or assistance in a matter. An attorney shall give notice to the issuer that, but for such prohibition, he would have withdrawn from representation. Proposed Rule 205.3(d)(2).

5. The mandatory noisy and quiet withdrawal rule proposals were met with fierce opposition from the bar. The SEC never implemented them. However, the SEC did include in the final rules an extremely controversial permissive reporting-out provision.

   (a) An attorney appearing or practicing before the Commission on behalf of an issuer may reveal to the SEC, without the issuer's consent, confidential information related to the representation, if the attorney believes it reasonably necessary:

      (i) To prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;

      (ii) To prevent the issuer, in an SEC investigation or administrative proceeding, from committing perjury, suborning perjury or making false statements to the SEC that are likely to perpetrate a fraud on the SEC; or

      (iii) To rectify the consequences of a material violation that caused or may cause substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used. Rule 205.3(d)(2).

K. Comparing Part 205 state rules governing withdrawal and reporting out.

1. Withdrawal

   (a) As discussed, as adopted, Part 205 is silent regarding a lawyer's withdrawal from representation.

   (b) State law, however, may permit or require withdrawal under certain circumstances.

   (c) ABA Model Rule 1.16(a) states that "a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if . . . the representation will result in violation of the rules of professional conduct or other law," among other circumstances.

   (d) ABA Model Rule 1.16(b) states that "a lawyer may withdraw from representing a client if," among other things, "the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent," or "the client has used the lawyer's services to perpetrate a crime or fraud."

2. Reporting out

(a) As discussed, Rule 205.3(d) *permits* the disclosure of client confidences in certain circumstances.

(b) Applicable state rules may be more or less restrictive.

(c) ABA Model Rule of Professional Conduct 1.6 permits disclosure of client confidences: (1) to prevent death or substantial bodily harm; (2) to prevent a crime or fraud that is reasonably certain to result in substantial financial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services; (3) to prevent or rectify financial injury from a client's crime or fraud in furtherance of which the client has used the attorney's services; (4) to obtain advice about the lawyer's own compliance with the rules of professional responsibility; (5) to defend himself against a claim relating to the representation; and (6) to comply with the law or a court order.

(d) ABA Model Rule of Professional Conduct 1.13(c) provides, "if . . . despite the lawyer's efforts [at reporting up] in accordance with [Rule 1.13(b)] the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action, or a refusal to act, that is clearly a violation of law, and . . . the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization, then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization."

(e) There are some distinctions between the ABA Model Rules and the SEC rules. For example, if relying on Rule 1.6, a lawyer may only report a crime or fraud, and the lawyer's services must have been used in furtherance of the action. Rule 1.13(c) allows reporting out in certain additional circumstances, though only after reporting up.

(f) In other jurisdictions, there are more pronounced differences.

(i) For example, New York's Rule of Conduct 1.6 permits an attorney to disclose client confidences, inter alia, to "prevent a client from committing a crime," and "to withdraw [an] . . . opinion or representation previously given by the lawyer and reasonably believed by the lawyer still to be relied upon by a third person, where the lawyer has discovered that the opinion or representation was based on materially inaccurate information or is being used to further a crime or fraud." Note that not all "material violations" under Part 205 are necessarily "crimes."

(ii) New Jersey Rule of Professional Conduct 1.6 requires disclosure of client confidences "to the proper authorities, as soon as, and to the extent the lawyer reasonably believes necessary, to prevent the client or another person . . . from committing a criminal, illegal or fraudulent act that the lawyer reasonably believes is likely to result in death or substantial bodily harm or substantial injury to the financial interest or property of another . . . ."

(iii) California Business & Professions Code § 6068(e)(1) states that "[i]t is the duty of an attorney to . . . maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client." California Business & Professions Code § 6068(e)(2) and California Rule of Professional Conduct 3-100 contain an exception that permits (but does not require) disclosure of client confidences only "to the extent that the member reasonably believes the disclosure is necessary to prevent a criminal act that the member reasonably believes is likely to result in death of, or substantial bodily harm to, an individual." A disclosure in accordance with Rule 205.3(d)(2) would violate California law.

XI. The SEC Whistleblower Program: A Further Strain on the Traditional Attorney-Client Relationship

A. Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 added § 21F to the Exchange Act.

1. That provision requires the SEC to establish a whistleblower office and where the SEC brings a successful enforcement action on the basis of information provided by a whistleblower and collects at least $1,000,000, pay a bounty of 10-30% to the whistleblower.

2. Previously, the SEC had only very limited—and little used—authority to pay whistleblowers in insider trading cases.

B. On May 25, 2011, the SEC finalized Regulation 21F, which became effective on August 12, 2011, and which contains rules implementing the requirements of § 21F.

1. Under the rules, a whistleblower may be eligible for an award if:

(a) Information is original (i.e., the information is not known to the SEC, it is not derived from certain sources, and it meets certain other eligibility criteria);

(b) Information is provided voluntarily (i.e., before the SEC or certain other regulatory or law enforcement direct a request to the whistleblower for the information);

(c) The information leads to a successful enforcement action (i.e., it causes the SEC to open or broaden an investigation, or significantly contributes to the success of an enforcement action with respect to conduct already under investigation); and

(d) The SEC prevails and collects more than $1 million.

2. The SEC paid its first whistleblower award on August 21, 2012.

(a) An anonymous whistleblower received nearly $50,000 for "provid[ing] documents and other significant information that allowed the SEC's investigation to move at an accelerated pace and prevent the fraud from ensnaring additional victims."

(b) The payment represents the maximum payout on $150,000 in sanctions collected by the SEC. The SEC was awarded $1 million in all, and the court is considering additional sanctions against other individuals. Any increase in the amount collected will result in a concomitant increase to the whistleblower's bounty.

(c) SEC Press Release No. 2012-162, U.S. Sec. & Exch. Comm'n, SEC Issues First Whistleblower Program Award (Aug. 21, 2012).

C. Can an attorney get paid to be a whistleblower under the SEC's program?

1. Several provisions contained within Regulation 21F bear on the ability of a lawyer to blow the whistle on his client:

(a) Information generally is not "original" if it is obtained: (1) through an attorney-client privileged communication; (2) in connection with the legal representation of a client; (3) by an officer, director, trustee or partner of an entity, if such person learned the information from another person or in connection with the entity's processes for identifying, reporting and addressing possible violations of the law; or (4) by an employee whose "principal duties involve compliance or internal audit responsibilities," or an employee of a firm retained to perform compliance, internal audit or internal investigation functions. *See* Rule 21F-4(b)(4).

(i) These broad exclusions cover most (if not all) information obtained by an attorney in the course of representing a client.

(ii) Therefore, the rules will usually operate to prevent an attorney from profiting by disclosing client confidences to the SEC.

(b) Information that was obtained through an attorney-client privileged communication or in connection with the legal representation of a client may not qualify as "original information," unless disclosure of such information is permitted under 17 C.F.R. § 205.3(d) (the permissive reporting-out provision adopted by the SEC pursuant to Sarbanes-Oxley), applicable state attorney conduct rules, or otherwise. Rule 21F-4(b).

(c) In other words, the Dodd-Frank whistleblower rules do not change the landscape in terms of whether or not it is acceptable for a lawyer to blow the whistle on their client. The permissibility of such reports remains murky, at least in certain jurisdictions.

(d) However, Dodd-Frank adds a powerful profit motive in cases where a lawyer believes that a client has committed or is about to commit a "material violation."

2. Are other ethical rules relevant?

(a) Consider the ABA's Model Rule 1.7, which provides that "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest," and states that "[a] concurrent conflict of interest exists if . . . there is a significant risk that the representation of one or more clients will be materially limited . . . by a personal interest of the lawyer."

(b) The New York County Lawyers' Association Committee on Professional Ethics concluded that an attorney's disclosure of confidential client information to collect a payment under the SEC's whistleblower bounty program is in most instances ethically unjustifiable, stating: "It is the Committee's opinion that New York lawyers who are acting as attorneys on behalf of clients presumptively may not ethically serve as whistleblowers for a bounty against their clients under the Dodd-Frank Wall Street Reform and Consumer Protection Act, because doing so generally gives rise to a conflict between the lawyers' interests and those of their clients." *See* NYCLA Opinion New York County Lawyers' Association Committee on Professional Ethics Formal Opinion 746 (Oct. 7, 2013).

D. The whistleblower rules undermine privileged relationships in other ways.

1. A controversial provision of the SEC's rules implementing the new whistleblower program provides that, if a whistleblower is "a director, officer, member, agent, or employee of an entity that has counsel, and you have initiated communication with the Commission relating to a possible securities law violation, the staff is authorized to communicate directly with you regarding the possible securities law violation without seeking the consent of the entity's counsel." Rule 21F-17.

2. ABA Model Rule 4.2 provides, "[i]n representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order."

3. In its adopting release, the SEC asserted that SEC personnel may communicate directly with agents of represented companies, because Rule 21F-17 satisfies the "authorized by law" exception. The SEC explained that the rule "is a necessary and appropriate means to implement Section 21F's purposes of facilitating the disclosure of information to the Commission relating to possible securities law violations and preserving the confidentiality of those who do so. As a result, our rulemaking authority under [Exchange Act] Section 21F(j) permits us to authorize our staff to communicate directly with directors, officers, members, agents, or employees of an entity that has counsel where the individual first initiates communication with the Commission as a whistleblower." Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Exchange Act Release No. 64,545 (May 25, 2011).

E. Dodd-Frank prohibits employers from retaliating against whistleblowers. 17 C.F.R. § 240.21F-2.

1. In December 2016, the SEC submitted an amicus brief in support of Sandford Wadler, an in-house attorney who styled himself a whistleblower, noting that it has a "strong interest in ensuring that public companies do not retaliate against attorney-whistleblowers who, upon becoming aware of potential material violations, report them to management." Brief for the SEC as Amicus Curiae, *Wadler v. Bio-Rad Laboratories, Inc.*, No. 15-cv-02356 (N.D. Ca. Dec. 13, 2016).

2. That case began in 2015, when former General Counsel and Executive Vice-President for Bio-Rad, Sanford Wadler, filed a lawsuit against Bio-Rad alleging that he was fired due to his efforts to uncover wrongdoing at the company. The complaint stated that Wadler reported the potential violations "up the ladder," but shortly before Bio-Rad was scheduled to present to the SEC and DOJ, the company fired Wadler, "precisely because he refused to be complicit in its wrongdoing." *Wadler v. Bio-Rad Laboratories, Inc.*, No. 15-cv-02356 (N.D. Ca. May 17, 2015).

3. Bio-Rad alleged that much of the evidence presented by Wadler was privileged. In response, the SEC filed its amicus brief in December 2016, arguing that Wadler could use what would otherwise be privileged information at trial. The SEC explained that, "[i]f attorney-whistleblowers cannot use their reports to management of potential violations as evidence in anti-retaliation litigation . . . the congressional scheme of requiring lawyers for public companies to report potential violations, while protecting them from reprisals. . . would be seriously undermined." The SEC also cited *Van Asdale v. International Gaming Technology*, which held that two whistleblowers' claims should not be dismissed over confidentiality concerns, as the court could use sealing orders and other protective measures. 77 F.3d 989 (9th Cir. 2009). The SEC said the court could take the same precautions in this matter.

4. The fate of Wadler's suit was largely determined in December when U.S. Magistrate Judge Joseph C. Spero ruled that the Sarbanes-Oxley Act's whistleblower protections preempt attorney-client privilege, thus allowing Wadler to use otherwise privileged information as evidence. The decision indicated that the SEC's reporting rules reflect an "an unambiguous intent to preempt state ethical rules that prevent attorneys from disclosing privileged information necessary to comply with Sarbanes-Oxley." Order, *Wadler v. Bio-Rad Laboratories, Inc*., 15-cv-02356 (N.D. Ca. Dec. 20, 2016).

5. On February 6, 2017, a jury found that Bio-Rad violated whistleblower protections under the Sarbanes-Oxley Act when it fired Wadler for reporting FCPA violations, awarding Wadler $2.96 million in back wages and $5 million in punitive damages. The jury found that Wadler had reasonably thought the company's Chinese sales team had violated the FCPA based on beliefs that its distribution contracts did not include anti-corruption language, that it had failed to keep necessary sales records, and that some items were given away for free, suggesting possible bribery. Wadler's attorney attributed the punitive damages to a falsified negative review of Wadler's 2012 performance created by the CEO. The document was dated April 2013, but computer metadata had proved Schwartz had not created the file until a month after Wadler was fired in June 2013. Cara Bayles, *Jury Awards Bio-Rad's Ex-GC $8M For Retaliatory Firing*, LAW360 (Feb. 6, 2017). On July 7, 2017, counsel for Bio-Rad filed a notice of appeal to the Ninth Circuit. *Wadler v. Bio-Rad Laboratories, Inc*., No. 3:15-cv-02356-JCS (N.D. Ca. July 7, 2017) (appealing the court's final judgment, orders for attorney fees, and denial of defendant's motion for a new trial).

6. In its opening brief to the Ninth Circuit, Bio-Rad claimed that the jury was wrongly instructed that reporting on an FCPA violation is protected activity under Sarbanes-Oxley, when the act only covers reports of fraud and violations of the SEC rules and regulations. *Wadler v. Bio-Rad Laboratories, Inc*., No. 17-16193, 37 (9th Cir. Oct. 16, 2017). Bio-Rad also preserved its argument that Wadler's failure to report out to the SEC (in addition to his internal reporting)

precluded his retaliation claim under Dodd-Frank because Dodd-Frank's retaliation provision applies only to whistleblowers who report to the SEC. *Id.* at 56-57. The issues of privilege and pre-emption that were litigated in pretrial motions in the District Court were not raised in Bio-Rad's opening brief.

7. On March 5, 2018, after briefing had been completed, Bio-Rad filed a letter of supplemental authorities in light of the Supreme Court's decision in *Digital Realty Trust, Inc. v. Somers*, 138 S. Ct. 767 (2018). In that case, the Supreme Court held that the anti-retaliation provision of Dodd-Frank does not extend to individuals who have not reported securities violations to the SEC. *Digital Realty Trust, Inc.*, 138 S. Ct. at 772. Bio-Rad argued that the Ninth Circuit should reverse the district court's ruling on the retaliation claim, "including the $2.96 million in damages attributable solely to that claim." Letter of Supp. Auths., *Wadler*, No. 17-16193.

8. The Ninth Circuit heard oral arguments in November 2018 and in February 2019, the court sided with the company when it ruled that certain provisions of the FCPA do not constitute "rules and regulations" of the SEC, and thus complaints of violations of those provisions do not constitute protected activity under Sarbanes-Oxley. *Wadler v. Bio-Rad Laboratories, Inc.,* No. 17-cv-16193 (9th Cir. Feb. 26, 2019). Further, the Ninth Circuit remanded the case to the district court for a determination of whether a new trial on the Sarbanes-Oxley claim was warranted. The Ninth Circuit also held that under California law, it is unlawful to terminate an employee for reasons that go against public policy and that the erroneous jury instructions on the Sarbanes-Oxley claim did not prevent Wadler's right to $2.96 million in back wages and $5 million in punitive damages. It found that the $2.96 million in back pay could not be doubled given the decision in *Digital Realty Trust v. Somers*, which held that Dodd-Frank does not protect purely internal complaints. *Id.*

9. In March 2019, Bio-Rad asked the Ninth Circuit for a rehearing on the decision to affirm the $8 million award in back wages and punitive damages. Petition for Panel Rehearing or Rehearing En Banc, *Wadler v. Bio-Rad Laboratories, Inc.,* No. 17-cv-16193 (9th Cir. March 12, 2019). In the case remanded to the Northern District of California, the parties filed a notice to voluntarily dismiss the remaining claims with prejudice and an order dismissing the case was entered in September. Order, *Wadler v. Bio-Rad Laboratories, Inc.*, No. 15-cv-02356 (N.D. Cal, Sept. 25, 2019).

XII. The SEC's Increased Focus on the Conduct of Defense Counsel

A. The SEC staff has signaled that the number of cases brought against attorneys will continue to climb and that there is an increasing focus on attorney misconduct. In November 2013, Associate General Counsel Richard M. Humes described concerns, expressed by the Enforcement Division, of attorneys obstructing an investigation.

According to Humes, the Enforcement Division is interested in having the Office of General Counsel bring more Rule 102(e) cases and is focused on areas, including obstructive or dilatory conduct with respect to document production, improper coaching of witnesses, and conflicts of interest. Stephen Joyce, Official: SEC Enforcement Unit Concerned Defense Lawyers May Be Obstructing Probes, 45 Sec. Reg. & L. Rep. (BNA) 2114 (Nov. 18, 2013).

B. Previously, in a 2011 speech, former SEC Enforcement Director Khuzami identified two areas of concern regarding attorney conduct: (1) conflicts of interest; and (2) obstructive conduct by counsel during investigations.

C. Conflicts of Interest

1. The former Enforcement Director decried multiple representations of witnesses who appear to have adverse interests, or where witnesses represented by the same counsel "all adopt the same implausible explanation of events." Robert Khuzami, Sec. & Exch. Comm'n, Speech by SEC Staff: Remarks to Criminal Law Group of the UJA-Federation of New York (June 1, 2011).

2. According to the former Enforcement Director, "there is no problem presented by multiple representations . . . when one lawyer or one firm represents employees who are purely witnesses with no conflicting interests or material risk of legal exposure." *Id.*

3. However, he said problems arise in an investigation in which defense counsel represents: (a) "both the company and [multiple] employees . . . where there [is] a real potential that some of those persons faced material legal exposure"; (b) "multiple individuals with seemingly divergent interests"; (c) "both the supervisor and the person he supervised in a 'failure to supervise' case"; or (d) "himself, the alleged wrongdoer and the principal investor." *Id.*

4. The former Enforcement Director also asserted that the SEC's (as of early 2010) cooperation initiative could exacerbate conflicts of interest among jointly represented clients, because it increases the chances that one client could benefit at the expense of another by cooperating. *Id.* Due to this concern, the former Enforcement Director stated that the Staff is taking a harder look at multiple representations and is more likely to express concern than in the past. *Id.*

D. In a May 2015 address, Andrew Ceresney, Director of the SEC's Division of Enforcement, highlighted the potential impact the SEC's Cooperation Program may have on lawyers representing multiple clients in an investigation, stating: "let me point out that the cooperation program also may have important implications not only for potential cooperators, but also for their attorneys. The defense bar would benefit from heightened attention to the fact that our use of our cooperation tools has changed the calculus for individuals whose conduct is under investigation. Among other things, counsel need to take seriously the challenges posed by representing multiple clients when one client is in a position to obtain significant benefits by cooperating. This is especially true when one client's cooperation might threaten another of a lawyer's clients." Andrew Ceresney, Dir., Div. of Enforcement, The SEC's Cooperation Program: Reflections of Five Years of Experience (May 13, 2015).

E. In September 15, 2015, Deputy Attorney General Sally Yates issued a memorandum (the "Yates Memo"), encouraging DOJ prosecutors who identify corporate wrongdoing to shift the emphasis, at least in part, to the individuals who commit violations, rather than focusing only on the entity. Memorandum from Sally Quillian Yates, Deputy Attorney Gen., U.S. Dep't of Justice, on Individual Accountability for Corporate Wrongdoing to Assistant Attorney Gen., Antitrust Div., et al., (Sept. 9, 2015). Outlined in the memorandum were six key steps to strengthening the DOJ's pursuit of individual corporate wrongdoing. Included was the requirement that companies must first provide the DOJ with all relevant facts relating to any individuals involved in the misconduct, regardless of that individual's position, status, or seniority, to receive any cooperation credit. For attorneys defending entities and individuals in parallel investigations before the DOJ and SEC, counsel must be more sensitive even earlier in an investigation to actual or potential conflicts of interest when representing either an entity or its management.

F. Pursuant to the Yates Memo's directive, the U.S. Attorneys' Manual ("USAM") was revised on November 16, 2015, to reflect the increased focus on individuals. Among other things, the revisions updated the "Filip factors" concerning criminal prosecution of organizations and encouraged an early focus on individual culpability and possible prosecution in corporate criminal investigations. The revisions further made clear that to receive any credit at all for cooperation, corporations must identify culpable individuals and disclose non-privileged information concerning individual misconduct.

G. In a November 2018 speech, DAG Rod Rosenstein announced the DOJ's current position on the Yates Memo. *See* Deputy Attorney General Rod J. Rosenstein Delivers Remarks at the American Conference Institute's 35th International Conference on the Foreign Corrupt Practices Act, Office of Public Affairs, US Dep't of Justice (Nov. 29, 2018). Although Rosenstein reaffirmed the memo's central thrust—the prosecution of individual wrongdoers in corporate investigations—he also announced a revised policy that differs for civil and criminal investigations.

H. Rosenstein explained that in criminal cases, companies seeking cooperation credit under the revised policy must identify all individuals who "are substantially involved in or responsible for the criminal conduct." *Id.* There is a particular focus on individuals who "play significant roles in setting a company on a course of criminal conduct." *Id.* In place of the previous requirement to share information on every employee with any role in misconduct, regardless of culpability, the revised policy requires companies to share specific information about individuals who authorized misconduct and what knowledge these individuals had.

I. In civil cases, the DOJ will no longer employ an "all or nothing" approach that requires companies to provide the DOJ with evidence of the civil liability of any individual employees in order for it to receive full cooperation credit. Instead, the DOJ will apply a "sliding scale"-type approach, varying the credit awarded based on the extent of the company's cooperation. In order to receive "any credit," a company must identify "all wrongdoing by senior officials, including members of senior management or the board of directors." In order to receive "maximum credit," a company "must identify every individual person who was substantially involved in or responsible for the misconduct." *Id.*

J. Disqualifying Counsel for Conflicts of Interest – *In re Sands Brothers Asset Management, LLC.*

1. On April 7, 2014, an ALJ disqualified the law firm Gusrae Kaplan Nusbaum, PLLC and attorney Martin H. Kaplan (collectively, "Kaplan") from representing the company Sands Brothers Asset Management, LLC ("SBAM") in an administrative proceeding brought by the SEC against SBAM, Steven and Martin Sands (together, the "Sands"), and Christopher Kelly, SBAM's chief compliance officer, alleging that respondents failed to distribute audited financial statements to investors in violation of custody requirements under the Investment Advisers Act of 1940. *In re Sands Bros. Asset Mgmt. LLC., et al*., Inv. Advisor Act. Release No. 2503 (Apr. 7, 2015). The ALJ found that because Kaplan had a conflict of interest, which had not been waived by Kelly, their former client, Kaplan was to be disqualified as their continued appearance in the administrative proceeding on behalf of SBAM undercut the integrity and fairness of the proceeding. The ALJ explained that while an individual generally has the right to counsel of their choice, "respondents in Commission proceedings do not enjoy an absolute right to counsel of their original choosing when, for example, a conflict of interest with that attorney threatens the integrity of Commission proceedings." *Id.* at 3.

2. During the SEC's investigation, Kaplan jointly represented SBAM and the individual respondents. *Id.* at 2. Prior to the SEC filing an Order Instituting Proceedings ("OIP") on October 29, 2014, the SEC Staff alerted Kaplan of their concerns that a conflict of interest could preclude Kaplan from representing all, and perhaps any, of the parties in the investigation. SEC Staff believed that Kelly could have interests divergent from, and potentially adverse to, those of SBAM and the Sands. *Id.* The SEC noted that Kaplan had told the SEC in August 2013 during a telephone call (the "August 2013 Call") that SBAM ascribed the late distribution of the audited financials to the fact that Kelly did not understand the custody rule and that the Sands had relied on Kelly with regard to the audit requirements under that rule. *Id.* at 5. Kelly had previously testified during the investigation that he was not responsible for the late audits. *Id.* Subsequent to the SEC Staff expressing their concern, Kaplan terminated their representation of Kelly.

3. During a prehearing conference in December 2014, the SEC raised its concerns about Kaplan's potential conflict of interest in representing SBAM and the Sands to the ALJ, explaining that because Kaplan had represented all respondents during the investigation, there could be "issues of conflict that may permeate these proceedings, particularly if Mr. Kelly were to be called as a witness." *Id.* Subsequently, Kaplan terminated their representation of the Sands, and in February 2015, the ALJ ordered Kaplan to show cause why it should not be disqualified as SBAM's counsel.

4. The ALJ found that there was clear evidence that Kaplan, in representing SBAM, had an interest directly and materially adverse to their former client Kelly. The ALJ relied on the fact that SBAM had argued in its opposition to the SEC's motion for summary judgment on the alleged counts that Kelly was at fault for the custody rule violations. *Id.*

5. Kaplan argued they should not be disqualified because Kelly had expressly waived the right to seek to disqualify Kaplan from continued representation of any other respondent when signing the engagement letter with Kaplan in February 2014. *Id.* The ALJ found that Kaplan had failed to provide the information required for Kelly to give informed consent, rendering any waiver invalid. *Id.* Specifically, relying on the August 2013 Call, the ALJ found that there was "concrete evidence" demonstrating that Kaplan had "already colluded with the Sands to formulate a defense that would pin the blame on Kelly" prior to Kelly executing the engagement letter but failed to ever inform Kelly of Kaplan's strategy to assign fault to him prior to signing the letter. *Id.* The ALJ found that because Kelly was not aware of Kaplan's strategy, he could not have provided informed consent to any conflict waiver. *Id.* Accordingly, Kaplan's conflict with its former client persisted and under such circumstances, Kaplan's continued appearance undermined the integrity and fairness of the proceeding.

6. The ALJ noted that even had Kelly waived the conflict, it had great doubts about the integrity of this proceeding with Kaplan's continued appearance. *Id.* at 4.

7. Kaplan further argued that they did not obtain any confidential information from Kelly as there was limited contact. *Id.* at 6. The ALJ dismissed this argument, finding that Kaplan not only owed Kelly a duty of confidentiality but also a duty of loyalty, and that by taking a position in the proceeding that is in direct conflict with their former client, Kaplan's continued appearance undermined the integrity and fairness of the proceeding. *Id.*

8. The ALJ further dismissed Kaplan's argument that it would be unduly burdensome for SBAM to be required to retain new counsel in consideration of Kaplan's knowledge and expertise. *Id.* at 6-7. The ALJ explained that counsel's "longstanding relationship with a client" does not, in and of itself, demonstrate sufficient hardship to outweigh the concerns about the integrity of the proceeding

and that it was common in administrative proceedings for a respondent to retain different counsel after an investigation. *Id.*

9. SBAM filed a petition with the Commission for interlocutory review of the ALJ's order, which was denied in May 2015. *In re Sands Brothers Asset Mgmt. LLC., et al.*, Inv. Advisers Act. Release No. 4083 (May 13, 2015). SBAM's new counsel filed a notice of appearance in June 2015, and the ALJ granted SBAM leave to move for summary disposition and directed SBAM's new counsel to assess its position on statements and arguments made by former counsel. *In re Sands Brothers Asset Mgmt. LLC., et al*., Admin. Proceedings Ruling Release No. 2960 (July 22, 2015). The ALJ later granted a motion for summary disposition and denied SBAM's petition for interlocutory review. *In re Sands Brothers Asset Mgmt. LLC., et al.*, Exchange Act Release No. 76,119 (Oct. 8, 2015).

10. In November 2015, the respondents consented to the entry of an order imposing remedial sanctions and a cease-and-desist order pursuant to §§ 203(e), 203(f) and 203(k) of the Investment Advisers Act. I*n re Sands Brothers Asset Mgmt. LLC., et al.*, Advisers Act. Release No. 4273 (Nov. 19, 2015). The Sands agreed to pay a $1 million penalty and were suspended for a year from raising money from new or existing investors. Kelly agreed to pay a $60,000 penalty and was suspended for one year from acting as a chief compliance officer or appearing or practicing before the SEC as an attorney. Kelly neither admitted nor denied the charges but consented to an SEC order finding that he caused and willfully aided and abetted the firm's custody violations. *In re Christopher R. Kelly*, Exchange Act Release No. 76,477 (Nov. 19, 2015).

K. In light of former and current Enforcement Directors' remarks and actions against attorneys, defense counsel should focus renewed attention on their ethical obligations in connection with multiple representations.

1. ABA Model Rule 1.7 provides, "a lawyer shall not represent a client if . . . the representation of one client will be directly adverse to another client . . . or there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer," except that "a lawyer may represent a client if," among other things, he "reasonably believes that [he] will be able to provide competent and diligent representation to each affected client," and "each affected client gives informed consent, confirmed in writing."

2. It is a given that counsel must comport itself in accordance with applicable ethical rules.

3. However, the SEC Staff's focus on this issue means that the Staff's *perception* of compliance with applicable rules is equally important in the context of an SEC investigation.

L. Obstructive Conduct

1. In his 2011 speech, former Enforcement Director Khuzami criticized witnesses who implausibly answer "I don't recall" dozens of times or more in the course of testimony, including with respect to "facts documented in their own writings."

   (a) The former Enforcement Director acknowledged that asserting a lack of recollection is appropriate where a witness would otherwise be forced to guess or speculate. However, he said witnesses sometimes profess to lack recollection of "nearly everything of any substance, including even the most basic facts," and "the failure of recollection lacks credibility." In such cases, the former Enforcement Director said "[i]t is not unreasonable to draw the most negative inferences from the evidence . . . ." Robert Khuzami, Sec. & Exch. Comm'n, Speech by SEC Staff: Remarks to Criminal Law Group of the UJA-Federation of New York (June 1, 2011).

   (b) The former Enforcement Director also said the SEC Staff is skeptical when "no amount of contemporaneous documents can refresh a witness's absence of recollection on seemingly inculpatory points, but that same witness offers specific, detailed and consistent memories on most every point potentially helpful to his defenses," and where a witness fails "to acknowledge what is clear from the plain language of documents, the significance of the events under scrutiny, or the uniqueness of the circumstances under which the event occurred." *Id.*

   (c) The former Enforcement Director questioned whether, in some cases, witnesses were instructed to profess a lack of recollection with respect to anything they do not remember "with near certainty." *Id.*

2. The former Enforcement Director also criticized defense counsel signaling to and/or coaching witnesses during testimony.

   (a) The former Enforcement Director said that "inappropriate conduct by counsel" might be present where a witness "backtracks on a previous answer after her counsel's long speaking objection, or who returns to the testimony room after a break and repudiates her earlier testimony on an important point . . . ." *Id.*

   (b) The former Enforcement Director gave an extreme example of coaching. Allegedly, during unrelated testimonies by two Fortune 100 executives, two separate well-known defense attorneys employed a strategy of tapping the witnesses' feet when certain questions were asked, at which point the witnesses would profess a lack of recollection. *See id*.

3. The former Enforcement Director further criticized "[q]uestionable tactics in document productions and internal investigations." *Id.*

   (a) The former Enforcement Director acknowledged the cost and burden associated with responding to document requests by the SEC. However, he expressed concern regarding "productions that are not made until the eve of the witness's testimony, thus making full preparation for the testimony extremely difficult." *Id.*

   (b) The former Enforcement Director also decried "an increasing phenomenon where lower-level associates or contract document reviewers are setting aside as potentially privileged an extremely large and over-inclusive group of documents, including anything that is sensitive, for review by senior reviewers. Those senior reviewers then apparently fail to review them in a timely fashion or defer producing them for a long time as they search for some slender basis for claiming privilege—resulting in a last-minute supplemental production long after many witnesses have already testified." *Id.*

   (c) The former Enforcement Director said the SEC Staff has "similar concerns about extended delays in the production of a privilege log, which thwarts our ability to assess the validity of privilege claims in a timely fashion, as well as long delays in sending preservation notices, such that relevant documents and back-up tapes are destroyed in the interim." *Id.*

   (d) With respect to internal investigations, the former Enforcement Director asserted that some defense counsel "engage in questionable investigative tactics, including interviewing multiple witnesses at once, aggressively promoting exculpatory evidence while dismissing clear and identifiable red flags, scapegoating lower-level employees and/or protecting senior management who have longstanding relationships with the counsel in question, and failing to acknowledge constraints placed on the scope of their inquiry." *Id.*

   (e) Thus far, the SEC cases involving document productions have focused on egregious conduct.

      (i) For example, in January 2011, the SEC initiated an administrative proceeding against David Tamman, former Nixon Peabody partner, for engaging in improper professional conduct during an SEC examination. According to the initial order, Tamman altered private placement memoranda to add disclosure language that his client had not included at the time the memoranda were provided to investors and removed metadata requested by the SEC's staff before producing those documents. *In re David M. Tamman*, Exchange Act Release No. 63,785 (Jan. 27, 2011).

(ii) On November 12, 2012, Tamman was criminally convicted on charges that included conspiring to obstruct justice and five counts of altering documents in a production to the SEC and sentenced to seven years in prison. Following Tamman's criminal conviction, an ALJ barred him from appearing or practicing before the SEC. In re David M. Tamman, Exchange Act Release No. 69746 (June 12, 2013).

M. Conduct by defense counsel that results in or assists witnesses in giving false testimony implicates the rules of conduct that govern the legal profession.

1. For example, ABA Model Rule 3.4(b) states that a lawyer shall not "falsify evidence, counsel or assist a witness to testify falsely."

2. However, counsel must strike a fine balance by zealously representing their clients—including by discouraging guessing and speculation—and refraining from leading or coaching their clients' testimony.

3. Defense counsel must act carefully and take heed that, in cases where it feels the SEC Staff seeks inappropriate speculation, the SEC Staff may believe it is merely asking for a witness's best recollection. Similarly, the Staff and defense counsel may differ regarding the appropriateness of counsel's efforts to clarify or correct inaccurate testimony.

N. Remedies Available to the SEC

1. In his 2011 speech, the former Enforcement Director, Robert Khuzami, said that the Staff would take action against what it views as obstructive conduct by defense counsel. The SEC has a number of informal and formal weapons in its arsenal.

2. Informal sanctions

(a) "Where we view multiple representations of adverse witnesses as creating an incurable conflict, and counsel does not take these concerns seriously, we can and will request that witnesses specifically confirm that they have been informed of the counsel's potential conflict of interest, and have willingly chosen to proceed with the engagement." Robert

Khuzami, Sec. & Exch. Comm'n, Speech by SEC Staff: Remarks to Criminal Law Group of the UJA-Federation of New York (June 1, 2011).

(b) "Where conflicts we raised later come to pass, we can and will decline to extend courtesies—for example, if counsel chooses to wait until the Wells notice to secure independent counsel for a client whose interests diverged from those of other clients, requests for extensions of time to respond may be cut back or denied." *Id.*

(c) "We can and will do more to get senior supervisors involved when obstructive practices in testimony cannot be resolved by counsel and the examining SEC staff attorney." *Id.*

(d) The former Enforcement Director further explained that the credibility of defense counsel is a "prism" through which the Staff views the evidence in a case. *Id.*

(e) Finally, the former Enforcement Director asserted that obstructing an SEC investigation is not likely to result in a lasting "win," because the SEC's whistleblower program and the cooperation initiative make it likely that a knowledgeable person will eventually come forward and provide the Staff with the information it requires. *See id*.

3. Formal sanctions

(a) Rule 7(e) Referrals and Rule 102(e) Suspension and Disbarment

(i) In his 2011 speech, the former Enforcement Director explained that the SEC Staff "can and will increase the number of referrals under Rule 7(e) of the SEC Rules Relating to Investigations (17 CFR Sect. 203.7(e)) where appropriate. That section authorizes the Enforcement staff to report dilatory, obstructionist or contumacious conduct to the Commission, which in practice means a referral to the SEC's Office of General Counsel, who conducts an investigation. If the Commission finds unethical or improper professional conduct . . . counsel may be suspended or barred from practice before the Commission, excluded from participation in the particular investigation, or censured." *Id.*

(ii) Since the former Enforcement Director's speech, senior SEC Staff have continued to warn defense counsel about what they view as obstructive conduct, and reports indicate that Rule 7(e) referrals have increased. Jean Eaglesham, Legal Eagles in Cross Hairs, Wall St. J., April 30, 2012.

4. A Rule 102(e) action, *Steven Altman*, illustrates the risk run by obstructive counsel.

5. In January 2008, the Office of the General Counsel ("OGC") of the SEC instituted a Rule 102(e) proceeding against Steven Altman. Altman represented a witness in an SEC enforcement investigation. In several recorded telephone conversations, Altman allegedly offered to procure the non-cooperation and/or forgetfulness of his client in exchange for benefits to her, including a severance payment and removal of her name from certain automobile leases. The SEC charged Altman with violating Rule 102(e) and § 4C of the Exchange Act (a provision enacted pursuant to Sarbanes-Oxley, which essentially codifies Rule 102(e)) by engaging in improper professional misconduct in violation of the New York State Bar Association Lawyer's Code of Professional Responsibility. *Steven Altman*, Initial Decision Release No. 367, 2009 WL 88063 (Jan. 14, 2009).

6. Notably, the OGC did not charge Altman with any direct or aiding and abetting violations of the securities laws, nor had the New York State Bar Association found that Altman had violated the Code of Professional Responsibility. *See id*. The *Steven Altman* action was regarded as an aggressive departure from past practice for the SEC, which had not historically used 102(e) proceedings as a forum for making de novo determinations regarding the professional responsibilities of lawyers.

7. An ALJ found that Altman did violate relevant state bar rules, and that he therefore violated Rule 102(e) and § 4C. The ALJ suspended Altman from practicing before the Commission for nine months. *Id.*

8. The OGC appealed the ALJ's order to the Commission, and the Commission permanently barred Altman from appearing or practicing before the Commission. *Steven Altman*, Exchange Act Release No. 63,306, 2010 WL 5092725 (Nov. 10, 2010); *see also Steven Altman*, Exchange Act Release No. 63,665, 2011 WL 52087 (Jan. 6, 2011) (denying motion for reconsideration).

9. The U.S. Court of Appeals for the District of Columbia Circuit denied Altman's petition to review the Commission's order. *Altman v. SEC*, 666 F.3d 1322 (D.C. Cir. 2011). In 2014, the New York disciplinary committee petitioned for further suspension from practicing in New York, and in January 2016, the Appellate Division of the New York Supreme Court agreed that a suspension of eighteen months was warranted. *In re Altman*, 22 N.Y.S.3d 868 (Jan. 26, 2016).

10. The *Altman* matter is remarkable because, as discussed, the SEC has for nearly three decades been reluctant to use Rule 102(e) proceedings as a forum for enforcing rules of professional conduct. Lawyers who violate ethical rules can

now expect to face disciplinary action by the SEC, even if relevant state bar authorities do not act.

(a) Perceived obstruction and dilatory conduct during an investigation may also result in increased fines and penalties for the client.

(i) The SEC fined Banc of America Securities, LLC $10 million for securities law violations and failure to produce documents. SEC Press Release No. 2004-29, U.S. Sec. & Exch. Comm'n, SEC Brings Enforcement Action Against Banc of America Securities for Repeated Document Production Failures During a Pending Investigation (Mar. 10, 2004).

(ii) Lucent Technologies, Inc. agreed to pay the SEC a $25 million penalty for its lack of cooperation as part of a settlement agreement. SEC Press Release No. 2004-67, U.S. Sec. & Exch. Comm'n, Lucent Settles SEC Enforcement Action Charging the Company with $1.1 Billion Accounting Fraud (May 17, 2004).

(b) Finally, in his 2011 speech, the former Enforcement Director noted that the SEC Staff "can and will increase referrals to the Department of Justice for witnesses who engage in obstruction and perjury, including false claims of a lack of recollection. We can and will also increase referrals to state bar associations, and to the Department of Justice where appropriate, of attorneys who participate or assist in such misconduct." Robert Khuzami, Sec. & Exch. Comm'n, Speech by SEC Staff: Remarks to Criminal Law Group of the UJA-Federation of New York (June 1, 2011).

O. Consideration: Potential Chilling Effect

1. The former Enforcement Director's speech and recent enforcement actions against attorneys appear to have signaled a new era of prosecutorial zeal against counsel who appear before the SEC in the context of investigations; this is a new, different and potentially alarming development.

2. Historically, the SEC has recognized that a lawyer's duty to be a zealous advocate on behalf of his client is most pronounced in the context of an investigation or adversarial proceeding.

3. For that reason, there is a pronounced risk that a reign of SEC disciplinary actions against defense counsel will have a chilling effect. *See*, *e.g*., Edward F. Greene, Gen. Counsel, U.S. Sec. & Exch. Comm'n, Remarks to the New York County Lawyers' Association (Jan. 13, 1982) ("[B]ecause the threat of institution of Rule 2(e) proceedings in situations where the lawyer appears as an advocate

could have a serious chilling effect on zealous representation and be a harbinger of prosecutorial abuse, I would generally not recommend Commission disciplinary proceedings against attorneys appearing as advocates. Where conduct is egregious, such as the subornation of perjury, I believe that Commission referrals to the Justice Department or to state and local disciplinary authorities are perhaps the more appropriate way to proceed.").

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