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THE LIABILITY OF LAWYERS FOR FRAUD UNDER THE FEDERAL AND STATE SECURITIES LAWS

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I. INTRODUCTION

In the wake of the spectacular corporate collapses in 2002, considerable attention has been focused on the liability, if any, that can attach to lawyers whose clients are accused of violations of the federal and state securities laws. The purpose of this Article is to provide a practical and concise summary of the relevant law in the hope of clarifying an area that is claimed to be, but in fact is not, murky and subject to dispute.[1] With only a few exceptions, case

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1. The analysis in this Article is limited to the question of whether and in what circumstances liability attaches to lawyers under the anti-fraud provisions of the federal securities laws and similar provisions of the Blue Sky Laws enacted in the several states. *See, e.g.*, 17 C.F.R. § 240.10b-5 (2002) (listing the restrictions on the use of deceptive and manipulative devices); ALA. CODE § 8-6-19 (2002) (describing the civil liabilities of advisors, agents, and sellers of securities); GA. CODE ANN. § 10-5-14 (2002) (detailing the resulting civil liability

law reveals that courts considering securities fraud claims against lawyers have adhered to the traditional rule that lawyers owe duties of candor and disclosure only to their clients, not to the investing public at large. As a result, courts considering whether liability under the federal and state securities laws can attach to lawyers have generally held that:

1. The only parties against whom primary liability attaches under the securities laws are the speakers who directly make a representation (which lawyers usually are not);
2. In the absence of a statement by a lawyer relied on by the investor, characterizing lawyers as "participants" in alleged schemes to defraud is not sufficient to affix primary liability under the securities laws upon a lawyer or her law firm; and,
3. Providing legal advice to a client, without a communication to the potential investors that invites reliance on a lawyer's legal work, does not constitute aiding, abetting or "materially assisting" a securities violation under relevant state securities statutes.

This Article will also assess whether the recently enacted Sarbanes-Oxley amendments to the federal securities laws create any new cause of action against lawyers in favor of third-party investors.[2] Based upon the text of the statute, its legislative history, and the proposed regulations under consideration by the Securities and Exchange Commission (SEC) in response to the legislation, these amendments are unlikely to expand the scope of potential liabilities of lawyers under the federal securities laws.

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from violations of the sale of securities); 815 ILL. COMP. STAT. ANN. 5/13 (West 1999) (explaining the remedies available for securities violations). This Article also considers whether conspiracy to defraud claims survived in the aftermath of the Supreme Court's 1994 decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994). However, this Article does not consider the scope of liability under other provisions of the federal and state securities laws. *See, e.g.*, 15 U.S.C.A. §§ 77k, 77l (West 1997 & Supp. 2002) (governing the civil liability of officers, directors, underwriters, and issuers in connection with the issuance of registration statements and prospectuses); 15 U.S.C.A. §§ 77o, 78t (West 1997 & Supp. 2002) (governing the liability of controlling persons).

2. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (adding 15 U.S.C. §§ 7201-7266 and amending 15 U.S.C. §§ 77t, 78c, 78j, 78m, and 78u among others).

II. Background and Scope of the Liability Issue

The securities laws have traditionally been thought to regulate the purchase and sale of securities, not the practice of law.[3] The concern of the securities laws has been to ensure full and complete disclosure of material facts to investors, replacing caveat emptor with a policy of caveat venditor, so as to impose on sellers and issuers of securities a policy of full and complete disclosure of the material facts concerning an investment security.[4] Lawyers have historically played important roles in the disclosure process by advising clients concerning the securities laws, relevant regulations, and the scope of clients' potential liabilities for breach of their duties of disclosure.[5] The question has naturally arisen, therefore, whether lawyers should be made to bear all or a part of the responsibility when clients to whom they have given disclosure advice are accused of securities fraud.

What at first blush seems a simple issue becomes more complex when one considers the system of duties and responsibilities that exist between a lawyer and her client. The relationship between a lawyer and client is fiduciary in nature, requiring the lawyer to put the client's interest ahead of her own.[6] Inherent in that fiduciary relationship is the client's entitlement to the confidentiality of communications with her lawyer.[7] This confidentiality obligation, em-

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3. Although the recently enacted Sarbanes-Oxley Act imposes some requirements on lawyers under the federal securities laws, it does so in a manner consistent with the *existing duties* that lawyers owe to their own clients and the duty of candor lawyers always owed to tribunals. *Compare* Model Rules of Prof'l Conduct R. 3.3 (2002) (holding lawyers to an absolute duty of candor before a tribunal), *with* 15 U.S.C.A. § 7245 (West Supp. 2002) (requiring the Commission to issue rules of professional conduct related to candor for attorneys appearing before the Commission). *See also* Part IV *infra*.

4. *See* Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 151 (1972) (noting that the fundamental philosophy behind securities law is full disclosure).

5. *See* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71,670, 71,670 (Dec. 2, 2002) (to be codified at 17 C.F.R. pt. 205) (acknowledging the role attorneys play in the securities work that comes before the Commission).

6. *See, e.g.*, Model Rules of Prof'l Conduct R. 1.18 (2002) (listing the duties a lawyer owes her client from the beginning of the relationship).

7. *See, e.g.*, Model Rules of Prof'l Conduct R. 1.6 (2002) (detailing the duty of confidentiality in the attorney-client relationship). The Texas rules also state:

> Both the fiduciary relationship existing between lawyer and client and the proper functioning of the legal system require the preservation by the lawyer of confidential information of one who has employed . . . the lawyer. Free discussion should prevail between lawyer and client in order for the lawyer to be fully informed and for the client to obtain the full benefit of the legal system.

bodied in the attorney-client privilege, belongs to the client.[8] With certain exceptions that are beyond the scope of this Article,[9] it is generally the client's choice to preserve or waive the privilege when it desires to do so. When a client is accused of securities fraud, for example, it might invoke an "advice of counsel" defense to negate fraudulent intent.[10] In so doing, the client has made a voluntary, conscious decision to waive the attorney-client privilege in order to establish that the client actually sought to comply with its disclosure obligations by seeking legal advice.

What happens, however, when the lawyer is sued along with the client and the client does not wish to waive the privilege? How is the lawyer to defend herself against an allegation that she aided the client's fraud?[11] Before the advent of permissive disclosure modifications in rules of professional conduct, the lawyer might have been barred from adducing evidence, for example, that the client received and disregarded the lawyer's advice.[12] With permissive disclosure rules, however, a different problem is created. Now, the

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TEX. DISCIPLINARY R. PROF'L CONDUCT 1.05 cmt. 1, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G app. A (Vernon 1998) (TEX. STATE BAR R. art. X, § 9).

8. *See* MODEL RULES OF PROF'L CONDUCT R. 1.6(a) (2002) (providing that a lawyer may reveal the confidences or secrets of the client only if, after full disclosure, the client consents).

9. *Compare* MODEL RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2002) (permitting a lawyer to disclose a client's intention to commit a violent crime), *with* TEX. DISCIPLINARY R. PROF'L CONDUCT 1.05(e) (requiring lawyers to reveal privileged information when necessary to prevent a client from committing a criminal or fraudulent act that is likely to result in death or bodily harm), *and id.* at 1.05(f) (requiring a lawyer to reveal privileged information when directed to do so under the Texas Disciplinary Rules of Professional Conduct), *and id.* at 4.01(b) (requiring lawyers to disclose privileged information when necessary to prevent the lawyer from becoming "party to a criminal act or knowingly assisting a fraudulent act perpetrated by a client").

10. *See* 15 U.S.C.A. § 77k (West 1997 & Supp. 2002) (allowing a client to invoke an "expertised opinion" defense, which sometimes asserts reliance on disclosed counsel to rebut a claim that the client sold securities by means of a registration statement that contained false or misleading information).

11. *See* MODEL RULES OF PROF'L CONDUCT R. 1.6(b)(3) (2002) (stating that a lawyer may reveal the confidences or secrets of a client when necessary to defend herself against an accusation of wrongdoing). It is important to make clear that a lawyer is never free to counsel a client on how to successfully commit a fraud, and the cases rarely arise in that context. Rather, the cases more frequently arise when the lawyer has given the client advice on a difficult disclosure issue. Clients are entitled to obtain bona fide legal advice about those matters, and when they do, they expect the lawyer to maintain that advice in confidence.

12. *See* Bernstein v. Portland Sav. & Loan Ass'n, 850 S.W.2d 694, 701 (Tex. App.—Corpus Christi 1993, writ denied) (noting that "[t]he state bar rules indicate that the duty

lawyer may reveal confidential communications with the client over the client's objection "[t]o establish a defense to a . . . civil claim . . . against the lawyer or the lawyer's associates based upon conduct involving the client or the representation of the client."[13] These rules force upon the client the considerable peril that its privileged communications will be revealed over its objection simply because a third party has chosen to sue the client's lawyer.

The recognition of the significant burdens this imposes on clients, who face the involuntary disclosure of lawful legal advice, significantly influences the ways in which courts have approached the question of when, and in what circumstances, securities liability attaches to a lawyer who has advised a client alleged to have committed securities fraud. In most cases, courts hold that lawyers owe no general duty of disclosure to the investing public.[14] However, when the lawyer chooses to speak directly to the investing public, for example by providing an opinion to be included in an offering document, the lawyer is like any other speaker and must speak truthfully or risk liability under the securities laws when she does not.[15]

A judicial approach informed by respect for the traditional role of lawyers and the duties of confidentiality they owe to clients does

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runs to the client and to remain silent"), *overruled on other grounds by* Crown Life Ins. Co. v. Casteel, 22 S.W.3d 378 (Tex. 2000).

13. TEX. DISCIPLINARY R. PROF'L CONDUCT 1.05(c)(6); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.6(b)(3) (2002) (permitting a lawyer to reveal the confidences of a client when necessary for her own defense).

14. *See* Schatz v. Rosenberg, 943 F.2d 485, 490 (4th Cir. 1991) (holding that a lawyer is not liable for failing to disclose information "absent some fiduciary or other confidential relationship with the third party"); Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 497 (7th Cir. 1986) (determining that a law firm had no duty of disclosure to third-party purchasers or investors unless the firm had a fiduciary relationship with that third party).

15. *See* Abell v. Potomac Ins. Co., 858 F.2d 1104, 1126 (5th Cir. 1988) (noting that no claim would lie against underwriters' counsel, who provided no opinion for the benefit of investors, but that a claim could be made against bond counsel "who actually did sign a letter disclosing his own legal opinion regarding several aspects of the bond offering"), *vacated on other grounds by* 492 U.S. 914 (1989); SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1095 (2d Cir. 1972) (finding lawyer liable for violation of the securities laws when the lawyer stepped out of his professional role and actively solicited investments). Acting as a corporate director is also outside the role of attorney. *See In re* JDN Realty Corp. Sec. Litig., 182 F. Supp. 2d 1230, 1248 (N.D. Ga. 2002) (holding lawyer, who was also corporate director, liable for misleading disclosure documents); Blakely v. Lisac, 357 F. Supp. 255, 266-67 (D. Or. 1972) (ruling that lawyer who was also corporate director was liable for securities violations).

not mean lawyers are never (or can never be) held responsible for improvident securities advice. First, and most obviously, lawyers are directly liable to their clients for the damages suffered by the client as a result of negligent securities advice.[16] Second, applicable comparative fault schemes under the federal and state securities laws allow a client to join its lawyer as a potentially responsible party in order to shift to the lawyer the responsibility for all or part of the damages assessed against the client as a result of the allegedly negligent advice.[17] These client-based remedies ensure that negligence is not without consequence to the lawyer. Equally important, however, is that the interplay of these rules leaves the client—rather than its adversary or its lawyer—in control of the question of whether to disclose the client's privileged communications.[18] It is against this backdrop of careful allocation of rights and responsibilities that the securities cases concerning lawyer liability must be evaluated.

III. THE FEDERAL SECURITIES LAWS

The Supreme Court decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*,[19] eliminated aiding and abetting as a theory of liability under the federal securities laws.[20] In *Central Bank*, the Court held that neither section 10 of the Exchange Act[21] nor Rule 10b-5[22] supported the judicial creation of a

16. *See, e.g.*, DCD Programs, Ltd. v. Leighton, 833 F.2d 183, 190 (9th Cir. 1987) (finding that a fiduciary duty to a party gives rise to certain liabilities).

17. *See* 15 U.S.C.A. § 78u-4(f) (West Supp. 2002) (determining proportionate liability for damages in a private securities litigation).

18. In point of fact, a liability scheme exposing lawyers to liability for their clients' alleged fraud would invite opportunistic claims by plaintiffs, who might well choose to sue the lawyer solely to try to force the disclosure of privileged communications that would otherwise be undiscoverable in a suit solely against the client.

19. 511 U.S. 164 (1994).

20. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994) (basing the holding primarily on the fact that section 10(b) does not explicitly prohibit aiding and abetting).

21. 15 U.S.C.A. § 78j (West 1997 & Supp 2002). This section, referred to generally as section 10(b), makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." *Id.* § 78j(b) (West Supp. 2002).

22. 17 C.F.R. § 240.10b-5 (2002). This rule, promulgated by the SEC in response to section 10(b), provides that:

> It shall be unlawful for any person, directly or indirectly, . . .

cause of action for aiding and abetting a violation of the Exchange Act.[23] In a carefully reasoned opinion, the Court rejected the notion that the prohibition on "direct or indirect" violation of the securities laws extended liability under the statute to those who aid and abet others.[24] The Court reasoned that such an expansion would extend liability to "persons who do not engage in the proscribed activities at all, but who give a degree of aid to those who do."[25] As in the past, the Court specifically did not intend this result. "The proscription does not include giving aid to a person who commits a manipulative or deceptive act."[26] To allow recovery in these circumstances

> would impose 10b-5 aiding and abetting liability when at least one element critical for recovery under 10b-5 is absent: reliance. A plaintiff must show reliance on *the defendant's* misstatement or omission to recover under 10b-5. Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements or actions. Allowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases.[27]

Thus, the Court held, "a private plaintiff may not maintain an aiding and abetting suit under § 10b."[28] However, the Court did not stop there as it sought to make clear this holding.

> [The holding] does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, *who employs a manipulative device or makes a material misstatement (or*

> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.

23. *Cent. Bank*, 511 U.S. at 177, 180.
24. *Id.* at 176.
25. *Id.*
26. *Id.* at 177.
27. *Id.* at 180 (citing Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988) and Chiarella v. United States, 445 U.S. 222, 228 (1980)) (emphasis added).
28. *Cent. Bank*, 511 U.S. at 191.

> *omission) on which a purchaser or seller of securities relies* may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met.[29]

From this holding, a few principles are apparent. First, a lawyer who "makes a material misstatement (or omission)" may be held liable as a primary violator of the securities laws.[30] Second, a lawyer who employs a deceptive device may likewise be held liable.[31] Third, and most importantly, no liability will lie against anyone—including a lawyer—unless the requirements for Rule 10b-5 liability are met in full.[32] However, three important questions remain unanswered:

1. When does a lawyer make a misrepresentation?
2. What liability, if any, attaches to a lawyer who allegedly fails to disclose to investors material facts known to the lawyer?
3. When has a lawyer "employed" a scheme to defraud or "used" a manipulative device?

Each of these questions is examined, in turn, below.

A. *When Does a Lawyer Make a Misrepresentation?*

As was noted earlier, lawyers play a significant role in the preparation of client disclosure documents. Nearly a half century ago, the Second Circuit observed that "[a] lawyer has no privilege *to assist* in circulating a statement with regard to securities which he knows to be false. . . . [Moreover,] a lawyer, no more than others, can escape liability for fraud by closing his eyes to what he saw and could readily understand."[33] With the demise of aiding and abetting liability in the wake of *Central Bank*, the question of "assistance" became something of a dead letter. Instead, courts began to consider whether lawyers "made a misrepresentation" when a doc-

29. *Id.* at 191 (first emphasis added).

30. *Id.*

31. *Id.*

32. *Id.*

33. SEC v. Frank, 388 F.2d 486, 489 (2d Cir. 1968) (emphasis added). Of course, lawyers have never been free to counsel their clients on how to commit fraud. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.2(d) (2002) (stating that "[a] lawyer shall not counsel a client to engage . . . in conduct that the lawyer knows is criminal or fraudulent"); TEX. DISCIPLINARY R. PROF'L CONDUCT 1.02(c) (prohibiting a lawyer from counseling "a client to engage in conduct that the lawyer knows is criminal or fraudulent").

ument they drafted for a client was alleged to contain a misrepresentation concerning the client's business or securities offering.[34]

The theory that lawyers could be liable for documents they drafted was initially articulated in *Klein v. Boyd*.[35] In an opinion later vacated by the Third Circuit, the *Klein* panel asserted that a law firm could be primarily liable for a violation of the federal securities laws when it drafted allegedly misleading offering documents, even though the law firm's work on the documents was never known to investors. The panel concluded:

> [L]awyers and other secondary actors who significantly participate in the creation of their client's misrepresentations, to such a degree that they may fairly be deemed authors or co-authors of those misrepresentations, should be held accountable as primary violators under section 10(b) and Rule 10b-5 even when the lawyers or other secondary actors are not identified to the investor, assuming the other requirements of primary liability are met.[36]

The panel further stated that a lawyer who prepares a document knowing that it will be given to investors "has elected to speak to the investors, even though the document may not be facially attributed to the lawyer."[37] The *Klein* opinion, however, was vacated by the Third Circuit en banc a mere three weeks after it was issued.[38]

34. *See, e.g.*, Ziemba v. Cascade Int'l, Inc., 256 F.3d 1194, 1202 (11th Cir. 2001) (looking to misrepresentations amounting to inexcusable negligence); Dinsmore v. Squadron Ellenoff, Plesent, Sheinfeld & Sorkin, 135 F.3d 837, 841 (2d Cir. 1998) (applying the "material misrepresentation" focus of Rule 10b-5 to a conspiracy cause of action); Wright v. Ernst & Young LLP, 152 F.3d 169, 173 (2d Cir. 1998) (applying the *Central Bank* rationale by refusing to hold secondary actors primarily liable for a statement not attributable to that action at the time of its dissemination); Anixter v. Home-Stake Prod. Co., 77 F.3d 1215, 1225 (10th Cir. 1996) (listing a misrepresentation by the defendant that was relied upon by the plaintiff as the "critical element" separating primary liability from aiding and abetting violations). Some of these cases, understandably, arose in the context of claims against accounting firms, but the principles they articulate concerning when primary liability may attach to the draftsperson of a document apply with equal force to the question of whether, and under what circumstances a claim may be stated against a lawyer who drafts an allegedly misleading disclosure document.

35. Klein v. Boyd, [1998 Supp. Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 90,136, at 90,317 (3d Cir. Feb. 12, 1998), *vacated on reh'g en banc*, 1998 U.S. App. LEXIS 4121 (3d Cir. Mar. 9, 1998).

36. *Id.* at 90,324.

37. *Id.* at 90,325.

38. Klein v. Boyd, Nos. 97-1143 & 97-1261, 1998 U.S. App. LEXIS 4121 (3d Cir. Mar. 9, 1998). The case was later settled without a final decision en banc. The vacated panel decision, although illustrative of the theory of liability pursued, has no precedential effect, even in the Third Circuit.

The weight of authority since *Klein* has overwhelmingly rejected its thesis. With the exception of one circuit,[39] the circuit courts have uniformly held that lawyers are liable for making misrepresentations only when they are identified to investors as the speakers of the representation in question. For instance, in *Ziemba v. Cascade International, Inc.*,[40] the Eleventh Circuit held that "in light of *Central Bank*, in order for the defendant to be primarily liable under § 10b and Rule 10b-5, the alleged misstatement or omission upon which a plaintiff relied must have been publicly attributable to the defendant at the time that the plaintiff's investment decision was made."[41] In *Wright v. Ernst & Young LLP*,[42] the Second Circuit likewise held that "a secondary actor cannot incur primary liability under the [Securities] Act for a statement not attributed to that actor at the time of its dissemination."[43] In *Anixter v. Home-Stake Production Co.*,[44] the Tenth Circuit also rejected "a rule allowing liability to attach to an accountant or other outside professional who provided 'significant' or 'substantial' assistance to the representations of others."[45] Instead, to be liable as primary violators, the secondary actors "must themselves make a false or misleading statement (or omission) that they know or should know will reach potential investors."[46] The pre-*Central Bank* decision of the Fifth Circuit in *Abell v. Potomac Insurance Co.*[47] is similar in effect:

> In general, the law recognizes such suits only if the non-client plaintiff can prove that the attorney prepared specific legal documents that represent explicitly the legal opinion of the attorney preparing them, for the benefit of the plaintiff. In practice, this rule has meant that an attorney is rarely liable to any third party for his or her legal

39. *In re* Software Toolworks Inc., 50 F.3d 615, 628 n.3 (9th Cir. 1995).

40. 256 F.3d 1194 (11th Cir. 2001).

41. Ziemba v. Cascade Int'l, Inc., 256 F.3d 1194, 1205 (11th Cir. 2001).

42. 152 F.2d 169 (2d Cir. 1998).

43. Wright v. Ernst & Young LLP, 152 F.2d 169, 175 (2d Cir. 1998).

44. 77 F.3d 1215 (10th Cir. 1996).

45. Anixter v. Home-Stake Prod. Co., 77 F.3d 1215, 1227 (10th Cir. 1996).

46. *Id.* at 1226.

47. 858 F.2d 1104 (5th Cir. 1988), *vacated on other grounds by* 492 U.S. 914 (1989). Although its discussion of theories of liability under the Racketeer Influenced and Corrupt Organizations (RICO) statute was subsequently vacated, the Fifth Circuit has recognized that *Abell* "remains authoritative on the non-RICO issues," including its discussion of the scope of attorney liability under the federal securities laws. Abbott v. Equity Group, Inc., 2 F.3d 613, 621 n.23 (5th Cir. 1993).

work unless the attorney has prepared a signed "opinion" letter designed for the use of a third party.[48]

The decisions contrary to this view arise entirely in the Ninth Circuit.[49] First, the Ninth Circuit in *In re Software Toolworks Inc.*[50] suggested in a footnote that a secondary actor might incur primary liability if it had a "significant role" in drafting misleading disclosure or offering documents.[51] The Second, Tenth, and Eleventh Circuits have rejected this thesis as inconsistent with the Supreme Court's holding in *Central Bank*.[52]

A second Ninth Circuit case, *Cooper v. Pickett*,[53] held that "*Central Bank* [did] not preclude liability based on allegations that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme."[54] *Cooper*, however, applies a more rigorous analysis than this sweeping statement would indicate. In *Cooper*, the court did not bar a claim that the issuer "through false statements to analysts, and those analysts, by *issuing reports* based on statements they knew were false, together engaged in a scheme

48. Abell v. Potomac Ins. Co., 858 F.2d 1104, 1124-25 (5th Cir. 1988), *vacated on other grounds by* 492 U.S. 914 (1989) (citation omitted).

49. *But see* Carley Capital Group v. Deloitte & Touche, L.L.P., 27 F. Supp. 2d 1324, 1334 (N.D. Ga. 1998) (holding that "a secondary actor can be primarily liable when it, acting alone or with others, creates a misrepresentation even if the misrepresentation is not publicly attributed to it"). The Eleventh Circuit in *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001) rejected this view of secondary actor liability in favor of the view expressed in *Wright v. Ernst & Young LLP*, 152 F.3d 169 (2d Cir. 1998), giving the *Carley Capital Group* holding no precedential effect.

50. 50 F.3d 615 (9th Cir. 1995).

51. *See In re* Software Toolworks Inc., 50 F.3d 615, 628 n.3 (9th Cir. 1995) (noting that plaintiffs offered sufficient evidence to find a secondary actor primarily liable under these conditions).

52. *See Ziemba*, 256 F.3d at 1205 (noting the split in the federal courts following *Central Bank* but applying *Central Bank* principles); *Wright*, 152 F.3d at 176 (declining to adopt the substantial participation test); *Anixter*, 77 F.3d at 1226 n.10 (holding that "substantial assistance" cases allowing primary liability do not conform with *Central Bank*).

53. 137 F.3d 616 (9th Cir. 1998).

54. Cooper v. Pickett, 137 F.3d 616, 624 (9th Cir. 1998). As will be explained below, however, the term "manipulative or deceptive act" has repeatedly been held to apply to misleading sales practices such as washed sales, price manipulation, and the like—such that this theory is likely to have little application to lawyers. *See* Part III C, *infra*; *see also* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476-77 (1977) (considering a manipulative or deceptive act to "generally [refer] to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity").

to defraud the shareholders."[55] Thus, although the *Cooper* court made a sweeping statement that "*Central Bank* does not preclude liability . . . as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme,"[56] the conduct it found to constitute "the scheme" involved identifiable reports by identified defendants.[57] This theory of liability is entirely consistent with the more limited holdings of the Second, Fifth, Tenth, and Eleventh Circuits.[58] In fact, since the decision in *Klein* was vacated, no circuit court has sustained a claim against a lawyer who drafted disclosure documents but made no identifiable public statement to an investor.

B. *Lawyer's Liability for Omissions*

Putting aside the opinion letter cases where liability attaches because the lawyer has made a public statement for the benefit of investors,[59] many of the claims advanced against lawyers arise from their alleged failure to disclose material facts known to them about

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55. *Cooper*, 137 F.3d at 625 (emphasis added). Claims against the accounting firms and underwriters were sustained, similarly, on the theory that they too had made public statements that materially misled investors. *See id.* at 628 (permitting the claim against the underwriters because the plaintiffs had specified the content of the false statement, the condition in which it was given, and the relationship that allowed for the access to inside information); *id.* at 629 (permitting the claim against the accounting firm because an issue of fact existed regarding whether the firm "knowingly certified financial statements" of the underwriter's larger customers).

56. *Id.* at 624.

57. *See id.* at 628 (acknowledging the specificity of the charge).

58. *But see Cooper*, 137 F.3d at 628 n.2 (showing *Cooper* to be of doubtful precedential value because it was decided prior to the enactment of the Private Securities Litigation Reform Act (PSLRA)). The PSLRA now requires a greater degree of particularity in pleading than was permitted at the time *Cooper* was decided. *See* 15 U.S.C.A. § 78u-4(b)(2) (West 1997) (requiring pleadings to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind"). Subsequent cases have recognized this important limitation on *Cooper's* precedential value. *See In re* Sec. Litig. BMC Software, Inc., 183 F. Supp. 2d 860, 908 n.4 (S.D. Tex. 2001) (noting *Cooper* "is a pre-PSLRA case"); *see also* Pegasus Holdings v. Veterinary Ctrs. of Am., Inc., 38 F. Supp. 2d 1158, 1166 (C.D. Cal. 1998) (holding that "[s]ince it is well settled that allegations must identify the individual defendants responsible for the fraudulent representations, this Court finds the converse to also be true: namely, that *allegations must identify the fraudulent misrepresentations made by individual defendants*").

59. *See* Abell v. Potomac Ins. Co., 858 F.2d 1104, 1125 (5th Cir. 1988) (citing SEC v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973) to support its holding that "an attorney is rarely liable to any third party for his or her legal work unless the attorney has prepared a signed 'opinion' letter designed for the use of a third party"), *vacated on other grounds by* 492 U.S. 914 (1989); *see also* Morgan v. Prudential Group, Inc., 527 F. Supp. 957, 961

their clients or the securities their clients are seeking to sell. Before examining this theory, it is important to recall that liability for omissions arises under the federal securities laws only when a party has a pre-existing duty to disclose material facts.[60] "Silence, absent a duty to disclose, is not misleading under Rule 10b-5."[61]

No duty to disclose has traditionally existed between a lawyer and a potential investor who is not his client:

> Traditionally, lawyers are accountable only to their clients for the sufficiency of their legal opinions. It is well understood in the legal community that any significant increase in attorney liability to third parties could have a dramatic effect upon our entire system of legal ethics. An attorney required by law to disclose "material facts" to third parties might thus breach his or her duty, required by good ethical standards, to keep attorney-client confidences. Similarly, an attorney required to declare publicly his or her legal opinion of a client's actions and statements may find it impossible to remain as loyal to the client as legal ethics properly require.[62]

Therefore, in *Abell* the Fifth Circuit dismissed a claim against underwriters' counsel who had made no public statement to investors, but noted that a claim could have been made against bond counsel, "who actually did sign a letter disclosing his own legal opinion regarding several aspects of the bond offering."[63]

The Fourth Circuit has echoed this sentiment, noting that "[a]n omnipresent duty of disclosure would not only be unfair to law firms; it would destroy incentives for clients to be forthcoming with their attorneys and would artificially inflate the cost of involving legal counsel in commercial ventures."[64] The Seventh Circuit

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(S.D.N.Y. 1981) (holding that a fact issue exists as to whether an attorney who prepares a tax opinion for a prospectus has a fiduciary relationship to prospective investors).

60. *See Abell*, 858 F.2d at 1119 n.14 (maintaining that claims of misrepresentation and omission must be based on a pre-existing duty); *see also* Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 177 (1994) (concluding that section 10(b) only prohibits committing a manipulative act or making a material misrepresentation).

61. Basic Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988); *see also* Chiarella v. United States, 445 U.S. 222, 226, 230 (1980) (analyzing the language and history of section 10(b) as well as case law to determine the duty to disclose arises between parties based on the trust and confidence in their relationship).

62. *Abell*, 858 F.2d at 1124 (citations omitted).

63. *Id.* at 1126.

64. Fortson v. Winstead, McGuire, Sechrest & Minick, 961 F.2d 469, 475 (4th Cir. 1992).

reached a similar conclusion in *Barker v. Henderson, Franklin, Starnes & Holt*[65] and refused to impose upon a law firm a duty to disclose to investors facts it knew concerning its client's unstable financial condition.[66] "Neither lawyers nor accountants are required to tattle on their clients in the absence of some duty to disclose. To the contrary, attorneys have privileges not to disclose."[67] Likewise, *Ziemba* rejected the argument that lawyers have a duty to disclose facts to investors or to the public at large.[68]

The handful of cases that appear on the surface to have recognized a duty of disclosure on the part of lawyers who provide securities advice to clients are, in fact, cases that either: (1) arose when lawyers actually made statements to investors that were attributed to them, or (2) predate *Central Bank's* elimination of aiding and abetting liability. For example, in *In re Flight Transportation Corp. Securities Litigation*,[69] the court sustained a complaint alleging generally that the law firm

> knowingly or in reckless disregard of the facts, directly and indirectly, and aiding and abetting the other Principal Actors, engaged in an unlawful combination, conspiracy, and course of conduct pursuant to which [the law firm] and the other Principal Actors made various untrue statements of material fact and omitted to state other material facts necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading to plaintiffs and members of the Class.[70]

As many as three theories of liability appear to be sustained in this complaint. First, to the extent the plaintiffs alleged that the law firm had actually made attributed misstatements, those claims would survive even under the modern cases. Second, to the extent the plaintiffs relied—as the court indicates they did—on allegations that the lawyers aided and abetted the other principal actors, those claims have been abolished by *Central Bank*. Finally, to the

65. 797 F.2d 490 (7th Cir. 1986).

66. *See* Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 497 (7th Cir. 1986) (stating that "[l]iability depends on an *existing* duty to disclose").

67. *Id.* (citations omitted).

68. Ziemba v. Cascade Int'l, Inc., 256 F.3d 1194, 1203 (11th Cir. 2001) (agreeing in part with the lawyers' position that because they did not issue a public statement, they did not owe a duty to disclose to investors).

69. 593 F. Supp. 612 (D. Minn. 1984).

70. *In re* Flight Transp. Corp. Sec. Litig., 593 F. Supp. 612, 617 (D. Minn. 1984).

extent the court premised its holding on the argument that the law firm "undertook the preparation of allegedly fraudulent and misleading Prospectuses,"[71] it would appear to rest upon an alleged duty to disclose that has since been rejected by the majority of courts.[72]

In sum, no case except the vacated decision in *Klein* has imposed upon lawyers, who owe duties of care and confidentiality to their clients, a separate, independent—and arguably inconsistent—duty to disclose facts to the investing public.[73] In the absence of such a duty, an omissions claim against an attorney cannot be sustained.

C. *Manipulative and Deceptive Devices: Liability for Schemes to Defraud*

Any assessment of whether an independent claim can be made against a lawyer for an alleged scheme to defraud, or for the em-

71. *Id.* at 618.

72. *See* Erickson v. Horing, No. 99-1468 JRT/FLN, 2001 WL 1640142, at *12 & n.12 (D. Minn. Sept. 21, 2001) (illustrating the hazard of relying on pre-*Central Bank* case law for insight into the scope of lawyers' duties to investors under the securities laws). The Minnesota District Court in *Erickson* observed that "[c]ourts since *Central Bank* have found that allegations of conspiracy or a common scheme do not create liability under section 10(b)." *Id.* at *12 n.12. Other cases sustaining claims against lawyers for alleged non-disclosure more typically include allegations that the lawyer undertook additional duties. *See* Abell v. Potomac Ins. Co., 858 F.2d 1104, 1126 (5th Cir. 1988) (holding that a claim could be made against a lawyer who signed an opinion letter), *vacated on other grounds by* 492 U.S. 914 (1989); SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1095 (2d Cir. 1972) (finding lawyer who actively solicited investors himself liable for violation of securities laws); *In re* JDN Realty Corp. Sec. Litig., 182 F. Supp. 2d 1230, 1248 (N.D. Ga. 2002) (deciding that a lawyer simultaneously serving as a corporate officer had a duty to disclose based on his status as an officer); Blakely v. Lisac, 357 F. Supp. 255, 266-67 (D. Or. 1972) (ruling that a lawyer serving as corporate director was liable for securities violations).

73. *But see In re* Enron Corp. Sec., Derivative & ERISA Litig., No. H-01-3624, 2002 WL 31854963, at *117 (S.D. Tex. Dec. 19, 2002) (denying the motion to dismiss because lead plaintiff had sufficiently stated a claim for relief under section 10(b) against the law firm of Vinson & Elkins). Judge Harmon distinguished the claims against the law firm of Kirkland & Ellis, which she dismissed, from those against Vinson & Elkins because the complaint asserted that Vinson & Elkins had allegedly co-authored documents for public consumption that the plaintiffs contended were central to Enron's alleged securities fraud. *See id.* at *116 (equating the co-authoring of documents with making a statement directly to the public). In reaching this decision, Judge Harmon acknowledged that she was addressing an unsettled area of the law, explaining "[i]ndeed division among the courts is so substantial that either a ruling by the Supreme Court or action by Congress appears necessary to resolve the differences." Order at 6 (Jan. 27, 2003), *In re* Enron Corp. Sec., Derivative & ERISA Litig., 2002 WL 31854963, at *1 (S.D. Tex. Dec. 19, 2002) (No. H-01-3624).

ployment of a manipulative device, must begin with the text of the statute. First, section 10 states that "[i]t shall be unlawful for any person . . . *[t]o use or employ* . . . any manipulative or deceptive device or contrivance" in connection with the sale of securities.[74] Second, Rule 10b-5 makes it unlawful for any person "*[t]o employ any device, scheme, or artifice to defraud*."[75] Two questions arise: (1) Do these provisions support the continued survival of conspiracy liability in the wake of *Central Bank*; and, (2) Do these provisions retain some liability, however limited, for "non-speaking" lawyers who participate in alleged schemes to defraud?

The answer to the first question is simple: "[E]very court to have addressed the viability of a conspiracy cause of action under § 10(b) and Rule 10b-5 in the wake of *Central Bank* has agreed that *Central Bank* precludes such a cause of action."[76] No matter how characterized, "Allegations of 'assisting,' 'participating in,' 'complicity in' and similar synonyms used throughout the complaint all fall within the prohibitive bar of *Central Bank*."[77]

The answer to the second question turns on what is meant by the statutory phrases "use or employ" and "manipulative or deceptive device." In general and as a matter of common sense, it is difficult to conceive of a case in which a lawyer, as distinct from her client, would "use or employ" a deceptive device in a securities offering. The client, whether an issuer or an underwriter, is generally the party "using" the disclosure document to sell securities; it is the client who "employs" it in the selling process. Although there is a paucity of law on this point under the securities statutes,[78] case law interpreting "use or employ" provisions in other statutes makes

74. 15 U.S.C.A. § 78j(b) (West Supp 2002) (emphasis added).

75. 17 C.F.R. § 240.10b-5(a) (2002) (emphasis added).

76. Dinsmore v. Squadron, Ellenoff, Plesent, Sheinfeld & Sorkin, 135 F.3d 837, 841 (2d Cir. 1998) (listing nine holdings in support). *But see* Wenneman v. Brown, 49 F. Supp. 2d 1283, 1286 (D. Utah 1999) (declining to dismiss a 10b-5 conspiracy case against a law firm where the plaintiff alleged it was "undisputed" that the firm had held meetings with principals, conducted legal research, written opinion letters, and given advice on structuring a business). The complaint adequately alleged an active role played by the law firm in the scheme to defraud. *Id.* at 1289.

77. Shapiro v. Cantor, 123 F.3d 717, 720 (2d Cir. 1997).

78. *But see In re* Enron Corp. Sec., Derivative & ERISA Litig., No. H-01-3624, 2002 WL 318554963, at *116 (S.D. Tex. Dec. 19, 2002) (allowing a claim for violation of section 10(b) where the complaint alleged that the law firm was so materially involved with the client's fraud that the firm allegedly "'effected the very' deceptive devices and contrivances that were the heart of the alleged Ponzi scheme").

clear that the conduct in question is not prohibited unless the proscribed object is used for one's own *personal* benefit. For example, in *Bailey v. United States*,[79] the Supreme Court held that the crime of using a gun in drug-trafficking required a defendant's "active employment of the firearm."[80] Given that lawyers generally do not "actively employ" disclosure documents in the selling process, it is not a surprise that no court has yet accepted the theory that a lawyer "employs" a deceptive device when she provides legal advice to her client in connection with a securities offering.[81]

The term "manipulative or deceptive device" has been in the text of Rule 10b-5 since it was promulgated by the SEC in 1942. However, this ostensibly broad term has been narrowed to a virtual "'term of art when used in connection with the securities markets' . . . [and] refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activit[ies]."[82] Manipulative devices are those "that have the effect of misinforming investors by creating the false impression that certain market activity is occurring when in fact such activity is unrelated to supply and demand."[83] Moreover, this stringent limitation arises from a "concern with limiting the scope of the securities laws so as not to intrude on the province of the states."[84] Given this policy and the

79. 516 U.S. 137 (1995).

80. Bailey v. United States, 516 U.S. 137, 144 (1995). "The word 'use' in the statute must be given its 'ordinary or natural' meaning, a meaning variously defined as '[t]o convert to one's service,' 'to employ,' 'to avail oneself of,' and 'to carry out a purpose or action by means of.'" *Id.* at 145; *see also* Jones v. United States, 529 U.S. 848, 855 (2000) (recognizing that "use" frequently means "active employment" in both conversation and legislation).

81. *See* Anixter v. Home-Stake Prod. Co., 77 F.3d 1215, 1226 (10th Cir. 1996) (indicating that "use" of a deception for purposes of liability under the securities laws does not attach unless the parties *themselves* "make a false or misleading statement"); *see also* Part III A, *supra*.

82. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476 (1977) (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976)).

83. *In re* Commonwealth Oil/Tesoro Petroleum Sec. Litig., 484 F. Supp. 253, 267 (W.D. Tex. 1979); *see also* Schreiber v. Burlington N., Inc., 568 F. Supp. 197, 202 (D. Del. 1983) (asserting that manipulative conduct is established by artificial acts of trading designed to mislead investors), *aff'd*, 731 F.2d 163 (3d Cir. 1984), *aff'd*, 472 U.S. 1 (1985); Hundahl v. United Benefit Life Ins. Co., 465 F. Supp. 1349, 1359 (N.D. Tex. 1979) (recognizing that the Supreme Court's definition of manipulation does not encompass "acts occurring outside the marketplace").

84. *Hundahl*, 465 F. Supp. at 1362.

Supreme Court's clear intention to limit the prohibition on "manipulative devices" to conduct constituting "market manipulation,"[85] it is unlikely that there will be significant development toward recognizing a generalized cause of action against lawyers alleged to have used or employed manipulative or deceptive devices in connection with securities offerings by their clients.

IV. *ZANDFORD* AND SARBANES-OXLEY: WHAT IS THE CURRENT STATE OF FEDERAL LAW?

A recent Supreme Court case and section 307 of the Sarbanes-Oxley Act of 2002, a newly enacted statute, are also relevant to an assessment of when a lawyer may be held liable for fraud under the federal securities laws.[86]

In *SEC v. Zandford*,[87] the Supreme Court considered whether a broker who had misrepresented the nature of investing activity being pursued for a customer but did not make specific representations about the value of any particular security, could be liable for a violation of the securities laws.[88] The Court asserted: "[N]either the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of [§ 10b]."[89] *Zandford* did not eliminate the requirement that the defendant actually have made "a misrepresentation"; rather, it solely held that the misrepresentation need not be one that pertains to "the value of a particular security" to violate sec-

85. *See* United States v. O'Hagan, 521 U.S. 642, 655 (1997) (declining to create an expansive new interpretation of a lawyer's potential liability under the "deceptive device" provisions of the securities laws). In *O'Hagan*, a partner in a law firm traded on inside information that one of the firm's clients was planning a tender offer for another company. *Id.* at 647. The Court upheld the lawyer's conviction for insider trading on a theory that the lawyer had misappropriated confidential information belonging to the client. *Id.* at 676. Importantly, the Court noted the misappropriation theory that insider trading as a deceptive device was "designed to 'protec[t] the integrity of the securities markets against abuses by "outsiders" to a corporation who have access to confidential information *that will affect th[e] corporation's security price when revealed*, but who owe no fiduciary or other duty to that corporation's shareholders.'" *Id.* at 653 (emphasis added).

86. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 307, 116 Stat. 745, 784 (2002) (codified at 15 U.S.C. §§ 7201-7266).

87. 535 U.S. ___, 122 S. Ct. 1899 (2002).

88. SEC v. Zandford, 535 U.S. ___, 122 S. Ct. 1899, 1903-04 (2002) (weighing the SEC's claim that the fraud was in the making of the sales against the broker's claim that any fraudulent activity occurred subsequent to lawful sales).

89. *Id.* at 1903.

tion 10(b).[90] The broker in *Zandford* had in fact made repeated misrepresentations to his elderly customers, including assurances that he was acting conservatively and in their best interests when, in reality, he was stealing from their accounts.[91] Because the broker in *Zandford* made repeated and material misrepresentations, the case does not alter the statutory requirement that a defendant must be shown, individually, to have made a misrepresentation in order for liability to attach under section 10.

Section 307 of the Sarbanes-Oxley Act charges the SEC with the responsibility to establish a new standard of professional conduct for lawyers who practice before the Commission.[92] Specifically, section 307 requires the SEC to issue rules

> 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 . . ., 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.[93]

As of the writing of this Article, the Commission has requested public comment on proposed regulations pursuant to section 307 that purport to extend this "up the ladder" disclosure to include a requirement that a lawyer inform the Commission if the issuer fails to adequately respond to notifications of violations within the or-

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90. *Id.*

91. *See id.* at 1904 (describing how the customers were duped into believing conservative and safe investments were being made on their behalf).

92. *See* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71,670, 71,670 (Dec. 2, 2002) (to be codified at 17 C.F.R. pt. 205) (denoting the purpose of the rule proposal).

93. *Id.*

ganization.[94] Regardless of the extent of this disclosure (its precise scope remains uncertain), the following question is sure to arise: Will either section 307, or its implementing regulations, give rise to a new federal securities claim against lawyers? The language of the statute, its legislative history, and the proposed commission regulations all indicate that no private right of action under this section was intended to, or should, exist.

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94. *See generally id.* at 71,681-71,691 (explaining in detail the regulatory proposals for "up the ladder" disclosure by an attorney).

> Where an attorney who has reported evidence of a material violation [within the organization as required by this rule] does not receive an appropriate response, or has not received a response in a reasonable time, to his or her report, and the attorney reasonably believes that a material violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interest or property of the issuer or of investors: (i) An attorney retained by the issuer shall: (A) Withdraw forthwith from representing the issuer, indicating that the withdrawal is based on professional considerations; (B) Within one business day of withdrawing, give written notice to the Commission of the attorney's withdrawal, indicating that the withdrawal was based on professional considerations; and (C) Promptly disaffirm to the Commission any opinion, document, affirmation, representation, characterization, or the like in a document filed with or submitted to the Commission, or incorporated into such a document, that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading.

Id. at 71,688. It is unclear whether it was the intent of the Congress to have the Commission adopt a "noisy withdrawal" requirement such as this under the rules promulgated pursuant to Sarbanes-Oxley. *See* 148 CONG. REC. S6555 (daily ed. July 10, 2002) (statement of Sen. Enzi) (distinguishing that "[t]he amendment [he] support[ed] would not require the attorneys to report violations to the SEC, only to corporate legal counsel or the CEO, and ultimately, to the board of directors"). This proposed rule has engendered significant professional debate and its final version has yet to be announced. *See* Implementation of Standards of Professional Conduct for Attorneys, Exchange Act Release Nos. 33-8185, 34-47276, IC-25929 (Jan. 29, 2003) (to be codified at 17 C.F.R. pt. 205), *available at* 2003 SEC LEXIS 256 (2003) (providing the final rule adopted by the SEC with the exception of the "noisy withdrawal" provision); *Commission Adopts Sarbanes-Oxley Rulemaking Measures*, 2063 Fed. Sec. L. Rep. (CCH) No. 2060, at 3 (Jan. 29, 2003) (explaining that the SEC removed the "noisy withdrawal" proposal from the release of their final standards for attorney conduct and reissued that proposal separately for additional comment); Implementation of Standards of Professional Conduct for Attorneys, Exchange Act Release Nos. 33-8186, 34-47282, IC-25920 (Jan. 29, 2003) (to be codified at 17 C.F.R. pts. 205, 240, 249), *available at* 2003 SEC LEXIS 266 (2003) (providing further discussion of the "noisy withdrawal" provision and soliciting comments on it and an alternative proposal). The relative merit of this "noisy withdrawal" provision is beyond the scope of this Article. *See* Geoffrey C. Hazard, Jr., *Rectification of Client Fraud: Death and Revival of a Professional Norm*, 33 EMORY L.J. 271, 301-07 (1984) (providing an excellent discussion of the history of the "noisy withdrawal" concept); *see also* ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 92-366 (1992) (noting that the ABA Model Rules concerning "noisy withdrawal" apply only to a client fraud that is ongoing or intended, not one that is in the past and is complete).

In *Cort v. Ash*,[95] the Supreme Court adopted a four-part test to be applied to determine whether an implied right of action existed under a statute:

> In determining whether a private remedy is implicit in a statute not expressly providing one, several factors are relevant. First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted,"–that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?[96]

The Court has since made clear, however, that the analysis must begin—and may in fact end—with the text of the statute itself.[97] "It is inconsistent with settled methodology in § 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text."[98] Furthermore, "We cannot amend the statute to create liability for acts that are not themselves manipulative or deceptive within the meaning of the statute."[99] It is clear under both *Central Bank* and *Cort* that no implied right of action exists under section 307.

First, the text of the statute itself purports to govern the conduct of lawyers practicing before the SEC. It contains no right of action in favor of any party; indeed, it provides only that the Commission may adopt "standards of professional conduct for attorneys ap-

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95. 422 U.S. 66 (1975).

96. Cort v. Ash, 422 U.S. 66, 78 (1975). *But see* Thompson v. Thompson, 484 U.S. 174, 189 (1988) (Scalia, J., concurring) (asserting that the Court has subsequently made congressional intent the definitive issue of the four factors).

97. *See* Touche Ross & Co. v. Redington, 442 U.S. 560, 575 (1979) (explaining that the four factors in *Cort* are not of equal weight); Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 23-24 (1979) (emphasizing congressional language as the most important of the factors in determining congressional intent); Park Nat'l Bank of Chicago v. Michael Oil Co., 702 F. Supp. 703, 704 (N.D. Ill. 1989) (acknowledging that Justice Scalia's concurring opinion in *Thompson v. Thompson* noted "that the Supreme Court effectively overruled the *Cort v. Ash* analysis in *Touche Ross & Co. v. Redington* and *Transamerica Mortgage Advisors, Inc. v. Lewis*").

98. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 177 (1994).

99. *Id.* at 177-78.

pearing and practicing before the Commission."[100] Under *Central Bank*, the absence of a private right of action is dispositive; its omission fails the first element in *Cort* as well.

Legislative intent is also clear: "Nothing in this bill gives anybody a right to file a private lawsuit against anybody. The only people who can enforce this amendment are the people at the SEC."[101] "This amendment creates a duty of professional conduct and does not create a right of action by third parties."[102] In its recently promulgated proposed rules, the SEC has emphasized the lack of any intent to create a private right of action under these amendments:

> The Commission notes that nothing in Section 307 creates a private right of action against an attorney. Indeed, statements by the sponsors of the provision unequivocally demonstrate that there was never an intention to create a right of action by third parties for violation of the rule. Similarly, the Commission does not intend that the provisions of [this regulation] create any private right of action against an attorney based on his or her compliance or non-compliance with its provisions.[103]

In short, the language of section 307 provides no express right of action in favor of third parties against a lawyer who fails to conform to the Commission's soon-to-be-adopted standards of professional conduct. The legislative history likewise makes clear that Congress did not intend to create any such cause of action in favor of third parties. Accordingly, it would be extraordinary if a court were to imply any private right of action against a lawyer under section 307 of the Sarbanes-Oxley Act.

V. Aiding and Abetting Claims Under State Securities Statutes

Unlike the federal securities statutes, the state securities statutes frequently contain express provisions imposing liability on a seller's agents or on those who substantially assist or materially aid and abet persons who commit primary violations of the relevant

100. 15 U.S.C.A. § 7245 (West Supp. 2002).

101. 148 Cong. Rec. S6552 (daily ed. July 10, 2002) (statement of Sen. Edwards).

102. 148 Cong. Rec. S6555 (daily ed. July 10, 2002) (statement of Sen. Enzi).

103. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71,670, 71,697 (Dec. 2, 2002) (to be codified at 17 C.F.R. pt. 205).

state statute.[104] Although the statutes are somewhat of a patchwork quilt,[105] and though little attention has been given in state case law to the need to define what is meant by "substantial assistance," the cases tend to break down liabilities into categories generally consonant with the liabilities that traditionally have and have not been imposed on lawyers under the federal securities laws. For example, lawyers who provide opinion letters in securities offerings are liable to investors if the investors saw and relied upon those opinion letters.[106] Lawyers are also liable as agents or "aiders" if they actively participate in the process of selling the securities.[107]

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104. *See, e.g.*, CAL. CORP. CODE § 25504.1 (Deering 1997) (specifying that "[a]ny person who materially assists in any violation . . . with intent to deceive or defraud, is jointly and severally liable with any other person liable under this chapter for such violation"); IDAHO CODE § 30-1442(4) (Michie 1999) (extending liability for sanctions to all who violate as well as all who aid and abet others in violation); IND. CODE ANN. § 23-2-1-19(d) (Michie 1999) (imposing liability on the "person who materially aids in the conduct creating the liability"); MD. CODE ANN., CORPS. & ASS'NS § 11-703(c) (1999) (providing for joint and several liability among primary violators and "every . . . agent who materially aids in such conduct"); OR. REV. STAT. § 59.115(3) (2001) (declaring that "every person who participates or materially aids in the [misleading] sale is also liable jointly and severally with and to the same extent as the seller"); TEX. REV. CIV. STAT. ANN. art. 581-33, § F(2) (Vernon Supp. 2003) (making a person who even indirectly aids a deceptive seller, buyer or issuer liable "to the same extent as if he were the seller, buyer, or issuer").

105. Concern about the lack of uniformity among the various state securities laws led Congress to enact some standard rules. *See* National Securities Markets Improvements Act of 1996, Pub. L. 104-290, 110 Stat. 3416 (1997) ("amend[ing] the Federal securities laws in order to promote efficiency and capital formation in the financial markets"). Although this statute preempted many state registration requirements, the anti-fraud provisions of the state securities statutes remain intact. *See* H.R. REP. No. 104-622, at 4 (1996) (amending section 18(d)(1) of the Securities Act of 1933 (15 U.S.C. 77r) to preserve the states' jurisdiction over investigations and enforcement actions dealing with securities fraud or deceit); *see also* A.S. Goldmen & Co. v. N.J. Bureau of Sec., 163 F.3d 780, 782 (3d Cir. 1999) (noting that even after NSMIA, "[F]ederal and state regulations each continue to play a vital role in eliminating securities fraud and abuse").

106. *See, e.g.*, Bitter v. Borton, Petrini & Conron, Nos. H022431, H022032, 2002 WL 557844, at *5 (Cal. Ct. App. Apr. 15, 2002) (finding no liability for aiding and abetting attached to author of an opinion letter that "plaintiffs never saw or read"); State v. Tenney, 858 P.2d 782, 789 (Idaho Ct. App. 1993) (holding lawyer liable as aider and abettor when he helped prepare offering materials, which included his opinion letters).

107. *See* Pinter v. Dahl, 486 U.S. 622, 647 (1988) (holding that liability under section 12(1) of the Securities Act extended not only to the person who passed title but also "to the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner"). Subsequent state cases have looked to *Pinter* as an important sign of where the limits of liability under the state securities statutes should be drawn.

In *Johnson v. Colip*,[108] the Indiana Supreme Court explained that the liability line for violating securities laws was to be drawn in this fashion:

> The definition of "agent" in [the Indiana statute] does not include attorneys who merely provide legal services, draft documents for use in the purchase or sale of securities, or engage in their profession's traditional advisory functions. To rise to the level of "effecting" the purchase or sale of securities, the attorney must actively assist in offering securities for sale, solicit offers to buy, or actually perform the sale.
>
> We . . . hold that an attorney is an agent [and thus violates the securities laws] if his or her affirmative conduct or failure to act when reasonably expected to do so at a meeting of prospective investors made it more likely than not that the investors would purchase the securities than they would have been without such conduct or failure to act.[109]

The Maryland Court of Special Appeals conducted a significant survey of the law of aiding and abetting under the state securities statutes and concluded that although states' definitions of when a person has become an agent who materially assists in a violation "vary to differing degrees . . ., they each have one thing in common: they do not impose liability upon an attorney who merely provides legal services or prepares documents for his or her client. To impose liability, the attorney must do something more than act as legal counsel."[110]

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108. 658 N.E.2d 575 (Ind. 1995).

109. Johnson v. Colip, 658 N.E.2d 575, 578 (Ind. 1995) (citation omitted).

110. Baker, Watts & Co. v. Miles & Stockbridge, 620 A.2d 356, 368 (Md. Ct. Spec. App. 1993); *see also* CFT Seaside Inv. Ltd. P'ship v. Hammet, 868 F. Supp. 836, 844 (D. S.C. 1994) (noting "[t]he definition of 'agent' . . . does not include attorneys who merely render legal advice or draft documents for use in securities transactions. . . . It is not intended to cover professionals such as attorneys engaging in their traditional advisory functions"); Rendler v. Markos, 453 N.W.2d 202, 206 (Wis. Ct. App. 1990). *But see* Excalibur Oil Inc. v. Sullivan, 616 F. Supp. 458, 467 (N.D. Ill. 1985) (holding that the purchaser stated a valid claim against a lawyer when the attorney's direct role included "face-to-face and direct telephonic representations" to the purchaser of the securities); *In re* N. Am. Acceptance Corp. Sec. Cases, 513 F. Supp. 608, 623 (N.D. Ga. 1981) (maintaining that "[t]o hold an individual to be an *agent* who has participated or aided in *making sales* of securities, the Court must find that the individual was so entangled in the actual sale of the security that his activities were at least a substantial factor in the purchaser's decision to buy"). The Oregon Supreme Court drew a line between the two. Thus:

> [W]hen an attorney prepares, attends to the execution of, and personally delivers and files documents required for the registration of a security . . ., such conduct goes be-

The Texas courts have similarly limited liability for aiding and abetting to only those parties who had an independent duty to make disclosure to the plaintiff investor. Although no reported decisions have considered the potential aiding and abetting liability of lawyers under the Texas Securities Act, two recent Texas cases indicate that ordinary legal work and traditional securities advice are unlikely to give rise to a claim in favor of a third-party investor. For example, in *Insurance Co. of North America v. Morris*,[111] a jury found a surety company liable for aiding and abetting violations of the Texas Securities Act based upon evidence that the surety (with knowledge of a promoter's prior violations of the securities laws) had nonetheless issued surety bonds to investors who purchased shares in the promoter's private placement.[112] The Texas Supreme Court reversed the holding that aiding and abetting liability would not lie because the surety "owed no duty of disclosure under the Texas Securities Act."[113] In *Frank v. Bear, Stearns & Co.*,[114] a Texas appellate court extended *Morris* and found that its rule insulated underwriters as well.[115] "[I]f the surety in *Morris* did not have a duty to disclose known prior securit[ies] violations to investors, we will not imply a duty by the underwriters to communicate the riskiness of this investment to investors in our case."[116]

The principles articulated in *Morris* and *Frank* make it unlikely that a Texas court would attach aiding and abetting liability to the actions of a lawyer. Under Texas law, an attorney owes a duty of disclosure only to her client.[117] A lawyer generally owes no duty to

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yond what plaintiff describes as "the preparation of documents and other services normally performed by a lawyer for a client" so as to constitute "participat[ion]" or "materially aid[ing]" in the sale of such a security.

Adams v. Am. W. Sec., Inc., 510 P.2d 838, 844 (Or. 1973) (in banc).

111. 981 S.W.2d 667 (Tex. 1998).

112. *See* Ins. Co. of N. Am. v. Morris, 981 S.W.2d 667, 675 (Tex. 1998) (finding liability under TEX. REV. CIV. STAT. ANN. art. 581-33, § F(2)).

113. *Id.* at 671.

114. 11 S.W.3d 380 (Tex. App.—Houston [14th Dist.] 2000, pet. denied).

115. Frank v. Bear, Stearns & Co., 11 S.W.3d 380, 385 (Tex. App.—Houston [14th Dist.] 2000, pet. denied).

116. *Id.*

117. *See, e.g.*, Bernstein v. Portland Sav. & Loan Ass'n, 850 S.W.2d 694, 704 (Tex. App.—Corpus Christi 1993, writ denied) (holding "that the law does not require an attorney to reveal information about a client to a third party when that client is perpetrating a non-violent, purely financial fraud through silence"), *overruled on other grounds by* Crown Life Ins. Co. v. Casteel, 22 S.W.3d 378 (Tex. 2000).

one who is not her client.[118] Thus, unless a lawyer undertakes to speak directly to a third party and for their benefit,[119] it is unlikely that a Texas court would impose aiding and abetting liability upon an attorney who performs the traditional functions of providing securities advice to, or drafting disclosure documents for, her client.

VI. Conclusion

As this review of the law has made clear, the potential liability of lawyers under the federal and state securities laws derives from a series of clear principles. First, if lawyers speak directly to investors, they, like anyone else, are required to tell the entire truth about what they know. A lawyer who undertakes to speak and fails to tell the whole truth is exposed to primary liability for violations of both the federal and state securities laws. Second, as a corollary to the first rule, when a lawyer issues an opinion letter for the benefit of investors, the lawyer is liable for misrepresentations and omissions contained within that opinion letter and relevant to the letter itself.

Absent these circumstances, however, both the federal and state securities laws continue to recognize that lawyers do not owe duties of disclosure to investors who are not their clients. Thus, regardless of how cast, courts generally will not sustain a claim by an investor who asserts that a lawyer is primarily liable for violations of the federal or state securities laws when the lawyer has performed only the traditional functions of the disclosure process: namely, advising the client and drafting disclosure documents. If, however, the lawyer negligently performs such services or renders incompetent disclosure advice, the lawyer may be liable for the damages that result—but only to her own client and to no one else.

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118. *See* Barcelo v. Elliott, 923 S.W.2d 575, 577 (Tex. 1996) (maintaining the privity barrier, which limits the attorney's liability to her client).

119. *See* McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d 787, 791-92 (Tex. 1999) (upholding the privity bar in general, but acknowledging a difference "when the attorney invites a nonclient's reliance").