SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
(202) 755-4846

THE COMMISSION AND THE BAR: FORTY GOOD YEARS

An Address By

A. A. Sommer, Jr., Commissioner

Securities and Exchange Commission

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A. A. Sommer, Jr. [*]
Commissioner
Securities and Exchange Commission

I feel very much at home with this audience. As indicated, my association with this Section has been long-standing, intimate and most satisfying. While I think it's unfortunate that we are denied the opportunity to hear the distinguished Chairman of the AEC -- I was looking forward to it -- I feel it is a great privilege and honor to address the annual luncheon of this Section that has meant so much to me. I have to warn you: I may not say very much that's very important. I'm supposed to talk later today about directors' liability and tomorrow about SEC injunctions. I remember only too well something that Ray Garrett said a few months ago. He said he found it very difficult to be profound more than once a month. I'm sure I'll find it difficult to be profound for more than 3 or 4 minutes in two days.

Be all that as it may, I think it is not inappropriate that a Commissioner address you on this occasion even though Chairmen of the Commission spoke at the last two annual luncheons.

Two years ago Bill Casey spoke at the annual luncheon in San Francisco. At that time he indicated that he had instructed the staff to prepare a rule that would deal with the problem of private placements. As you know, a couple of months ago, after a great deal of incubation, we finalized Rule 146. There are still divided opinions as to

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the merits of that rule. I am hopeful that sometime 6 to 8 months from now this Section and more particularly the Committee on Federal Regulation of Securities will tell us whether or not it's a good rule or a bad rule and whether we should change it.

A year ago, Ray Garrett -- I can't remember whether he became the Chairman in a few days or had been the Chairman for a few days -- addressed this annual luncheon. He spoke, I thought, very profoundly on the necessities of counsel responsibility.

I said it is not inappropriate that a Commissioner address you today. The Commission is celebrating this year its 40th Anniversary -- the first Commission meeting was held July 2, 1934, about a year after the 1933 Act had begun to be administered by the Federal Trade Commission -- and during the time the Section has been in existence, and the Commission has been in existence, there has always existed a very close bond and a very close relationship between this Section and its committees and the Commission. Perhaps that is now best indicated by the fact that Ray Garrett is a former Chairman of this Section and, as Hal Clark indicated, a year ago when I was appointed to the Commission, I was the Secretary elect of the Section. The committees of this Section include many who are former Chairmen, former Commissioners, former staff members. And there has been a constant and, I would say somewhat proudly, an increasingly active flow of conversation between the Commission and members of this Section and the committees of this Section.

I have hoped that the communication process had become steadily more effective. However, there is every evidence that there has been growing, for reasons that I am going to discuss, an estrangement, an interruption of this process, the

introduction of static on that line of communication between the Bar and the Commission, giving rise to such things as the headline in Business Week this week, "Angry Lawyers Blast the SEC."

As you know, when I was one of those lawyers on the outside looking in, I sought to give the Commission the benefits of input from the Section. As a result I am somewhat dismayed to realize now that the angry lawyers, who are for the most part friends of mine, are now blasting, among others, I suppose, me. And I wonder what has happened.

I am reminded of what I told Ray Garrett shortly after we had taken our offices: "Sometimes I am reminded of the famous Pogo line where he said, 'We have met the enemy -- and it is us.'" It also reminds me of a story that Professor Edmund Morgan used to tell about Felix Frankfurter. He said that very frequently after Frankfurter had gone to the Supreme Court and his opinions had begun to take a conservative cast, many people began to wonder what had happened to Felix. Felix the liberal, Felix the defender of the people, you know. Professor Morgan said it reminded him of the story of a hitchhiker who was picked up outside a small town in the South. As they entered the town the driver remarked on the fact that on the left-hand side of the road there was this perfectly magnificent ecclesiastical edifice and on the right side another one equally elegant though the town was hardly a wide place in the road. He asked the hitchhiker if he knew anything about this, why the town had two such magnificent churches. The hitchhiker said he did. The driver said, "What does it all mean?" The hitchhiker replied, "Well, the way I understand it, and I'm not much on theology, them folks on the left-hand side, they say the devil is a fallen angel. And those on the right-

hand side, they say he was an S.O.B. from the beginning." I think some people have that sort of a feeling about Ray Garrett and me. They can't quite decide whether we are fallen angels or whether we were simply S.O.B.'s from the beginning. My purpose here, I suppose, is to convince you that we are neither.

The estrangement, the static on the line of communication of which I speak, is a matter of great concern to us. As Ray Garrett emphasized a year ago at this luncheon, the work of the Commission cannot be done, it has not been able to be done in the past, without the close collaboration, the cooperation, the integrity and the confidence of the private Bar.

The private Bar has been since 1934, or going back a year before that to 1933, an integral part of the process and as he said, with our relatively meager staff, by federal standards at least, we cannot do the job unless we have the cooperation of the Bar. This recent upsurge of criticism is distressing to the Commission because it contradicts a long and a satisfying relationship. And perhaps most cutting is the fact that most of the criticisms come from very good friends whose opinions we respect very deeply.

Why is it that this situation appears to have developed? I think there are probably three principal reasons. One of them is the fact that within the last couple of years the Commission has filed landmark enforcement actions naming very distinguished lawyers and very distinguished law firms as violators of the federal securities law. This has had a jarring effect; it jarred me, very frankly, when it happened, since was then in practice, so much so that in response to this, as Chairman of the Federal Regulation of Securities Committee of this Section, I immediately

appointed a subcommittee to explore the implications of these actions. The second reason is, I think, a broad concern among members of the Bar that, in their eyes, the Commission has initiated unwarranted extensions of the liabilities and responsibilities of lawyers. The thought is that perhaps we are asking lawyers to take on responsibilities that should not properly belong to private attorneys. There are complaints of investigations that appear initially to be directed to the clients which suddenly extend to and point to the lawyer. There have been concerns that the Commission appears to be regarding lawyers as protectors of the public interest to the detriment of their clients and that this is interfering with the historic responsibility of the lawyer to his client and the historic confidential relationship that has been one of the crowns of the legal profession and one of its strengths. And there has been concern that as private lawsuits multiply, in some cases because of enforcement actions first brought by the Commission, insurance has become more difficult to secure and the economic welfare of the lawyers engaged in securities practice imperiled. A third reason for the present disquiet has been the charges that the procedures of the Commission are unfair and that the people who act on behalf of the Commission, the staff members, have been guilty of heavy-handed, unfair, uncivil practices with regard to the lawyers who practice in our building.

I think it is high time that we get the cards out on the table. There have been suggestions that there are "guerillas" who are making attacks upon the Commission. I have not met any of these guerillas (I emphasize, this is guerillas, not gorillas), and perhaps that is not surprising, since the connotation of "guerilla" is clandestine and

underground activity. I have not, for that matter, met anyone who has met a guerilla. I have begun to doubt, really, whether guerillas exist.

Nonetheless, I think it is time that we talk about all this, not in rancorous terms, not in defensive terms, but in very candid and forthright terms. I am happy to say that Ken Bialkin and I -- Ken is the Chairman of the Federal Regulation of Securities Committee of this Section -- met this morning and had what I thought was a very illuminating and very helpful discussion, trying to think through some of these problems.

I think that this guerilla warfare, if you want to call it that, this tension, to speak more moderately, has been exaggerated. The media would much sooner talk about guerillas and guerilla attacks upon the Commission than they would about the hundreds of lawyers who come into our building every day and deal in a very civilized and very friendly and very forthright fashion with our staff, leave that building, go home and report accomplishment to their clients. Those dealings, I think, should be emphasized a little bit more. But that's a common complaint of public servants -- that the press is not treating them well. Nonetheless, I think there has been a blowing out of proportion.

Now I'd like to talk very openly about these three sources of the problem that I mention. First of all, the lawsuits. I was not at the Commission when the most controversial lawsuits were filed. I cannot comment on them, not only for that reason, but because they are presently in litigation, and it would be most inappropriate for me to do so. However, I can assure you that the Commission is not going to sue lawyers because they make honest mistakes of judgment in good faith. That is not the practice or the policy of the Commission. I don't think you're going to see that happen. It

seems to me that it is important to remember, and I have frankly been heartened by the realization, that the Commission does exercise a very careful responsibility with regard to the initiation of any sort of enforcement action. Perhaps I shouldn't say this, because every action is entitled to the same sort of scrutiny by the Commission, but we are if anything somewhat more cautious when a staff recommendation includes an action against a professional because we realize the consequences that can flow from that. I repeat, we are not going to sue for honest mistakes of judgment; we have to see something more than that. In the actions that have been brought against professionals since I have been there, I can say to you we have believed that something more than a simple good faith mistake in judgment was present; and, in fact, we have refused to authorize actions when it appeared nothing more than poor judgment was involved.

One of the problems that we have is the limited nature of the remedies that the Commission has available through which to carry out its statutory mandate to enforce the securities laws. In many instances, because of these limitations, it appears that we are going after flies with a howitzer. This is disturbing to us, as it often is to you. We are seeking, and I've asked Ken Bialkin through the Federal Regulation of Securities Committee to help us seek, means that will be as effective in enforcing the laws, raising the levels of compliance and carrying out our responsibilities without some of the deleterious effects that follow from the traditional remedies that we utilize. We know full well that an injunctive action against a professional can have a profoundly adverse effect; as I have said on another occasion, very often this effect is far more profound and devastating than a similar action may be upon a businessman.

I would not have anything I say here, however, create a false sense of assurance that the Commission will not bring actions against professionals or any other class of people, for that matter, in the future. We are committed to enforce the securities laws of the United States. When we find anyone, be he or she a lawyer, accountant, financial analyst, broker-dealer, or simply citizen, who has been involved in the violation of these laws, we will be obliged to take appropriate action. I can assure you, however, that such action will not be taken lightly, or irresponsibly, or without due consideration of all the consequences.

In all candor, I think it should be recognized that the enforcement actions of the Commission against attorneys and others have had an important and salutary effect. These have compelled everyone to focus upon their public responsibilities, their responsibilities to investors and the market place. These actions have, as perhaps nothing else could have, caused a deep and thoughtful re-examination of the role of counsel in the investment process and I think the standards of responsibility prevalent among those lawyers who work in the securities field are being raised in response to these actions. This Section has organized a committee under the leadership of Don Evans to examine these questions. I am hopeful that these conclusions will be imbued, as I am sure they will be, with a deep sense of public interest.

The second source of concern to lawyers that I mentioned, and closely related to the first, is a belief which seems to be common among practitioners in the securities field that the Commission is unduly extending the concepts of professional responsibility and exposing lawyers to grave liabilities. I do not think there is any question that throughout the corporate world today there is occurring, not only under

the aegis of the Commission but under the initiative of others as well, a far-ranging re-examination of the roles of all those who participate in the corporate process, their respective responsibilities, and out of this there are unquestionably developing new notions with regard to the outer limits of liability. However, I can assure you that the Commission is not indifferent to the historic relationship which has existed between lawyers and clients and the necessity that that relationship, with all its confidentiality, candor and loyalty be preserved. There has been great concern over the statement in one enforcement action filed by the Commission that the attorneys involved in the matter, if the client had refused to take appropriate action to avoid an alleged fraud, should have come to the Commission and revealed the misconduct of the client. I cannot discuss, as I'm sure you realize, the particulars of the charge since it is in litigation. However, I would suggest that anyone who reads that complaint as enunciating a general rule that whenever a lawyer has knowledge of a client's fraud he is compelled to report it to the Securities and Exchange Commission at the risk of otherwise being considered an aider and abettor is totally misreading that complaint and the approach of the Commission. We are not about to turn securities lawyers into "squealers" on their clients. As has been recognized for a long time in the Canons of Ethics and now the Code of Professional Responsibility, there are circumstances in which a lawyer has an obligation to act to defeat a client's fraud. There may be such circumstances involving securities matters but again I reiterate it is totally unwarranted to read the National Student Marketing Corporation complaint as if it were enunciating a general rule.

As I have said, the Commission is concerned that there be a greater concern with, and recognition by attorneys of, their public responsibilities. In this respect I think it is extremely important to distinguish the role of attorneys when they are acting as advocates on behalf of clients who are defendants or respondents, or potential defendants or respondents, in proceedings initiated by the Commission, from the role of attorneys in the disclosure process. This bifurcation stems, in part, from the very make-up of the Commission. The Commission administers a complicated, sophisticated disclosure system; in addition to that it is an enforcement agency that is charged by statute with investigating misconduct under federal securities laws and taking appropriate enforcement action. In disclosure matters, including questions concerning the availability of exemptions, I think the attorney has a public responsibility, a responsibility to the investing public. He must act responsibly, cautiously and prudently in giving opinions that may unleash huge amounts of stock upon the public without appropriate disclosure. Similarly, in preparing registration statements and other disclosure documents he must be imbued with a high sense of responsibility to those who will rely upon them. However, when it comes to enforcement matters I would say to you that the Commission and counsel for potential or actual respondents or defendants are not partners in the enforcement process except in a most diluted sense. Very often it is desirable for counsel to cooperate with the staff in working out a controversy, but I would suggest that that cooperation should stem from a conviction that it is in the client's interest that such cooperation be extended and not because of any sense of broader obligation. In a litigation context the Commission is an adversary and you, representing your clients in such proceedings, are adversaries. In the best

traditions of the law adversaries are tough, hard-hitting and avail themselves of all legitimate means to protect the interests of their clients. We expect our lawyers to do that for us and we are not and should not be surprised when you do it. Obviously, counsel representing clients in Commission adversary proceedings must be bound by established principles of conduct: perjury must not be suborned, witnesses must not be misled, evidence must not be tampered with, and so on, but that is true always and everywhere, not just in Commission proceedings.

I would suggest to you that an examination of the cases which the Commission has brought against attorneys would hardly justify the conclusion that the Commission is seeking to impose unreasonable standards. Obviously, I cannot talk about those that are still pending, but I would suggest that you examine the facts of a recent case brought by the Commission, SEC v. Spectrum, Ltd. which is now concluded. Most of the discussion about that case has focused upon the dictum of the court that an attorney rendering an opinion concerning the availability of an exemption may be subject to an enforcement proceeding if he is simply negligent. In my estimation, far more important than that are the allegations in the case. An examination of these allegations indicates, that, if true, there was irresponsibility on the part of counsel that certainly justified action by the Commission. Instead of focusing upon such propositions as "Commission Sues Lawyer for Negligence," I would suggest instead we focus upon the allegations in the Spectrum case, realize how truly shocking they were, and recognize the merits of the Commission's proceeding.

There has been a frequent complaint that often in the course of an investigation the staff shifts the focus from the initial subject of the inquiry, an attorney's client, to

the attorney himself. I cannot deny that this happens. The staff cannot know at the commencement of an investigation where it is going to lead or who is going to be involved. Not infrequently, in the course of an investigation, it appears that additional persons, sometimes attorneys, have been actively involved in the violation. When that appears, I think you would agree we should pursue the investigation in the newly indicated directions. However, I would certainly agree that as soon as it appears that an attorney may be a subject of the inquiry himself, he should ordinarily be so informed, since then tough decisions must be made, such as whether he should continue to represent his client in view of his natural instinct, newly aroused, to protect his own interests.

The third source of uneasiness, I think, between the Commission and the Bar has been the suggestion, widely bruited, that the Commission's procedures are unfair and that in the administration of its enforcement program people on the staff act unfairly. First of all, I have throughout my adult life been dedicated to the proposition that people be treated fairly by their government, that they are entitled to the full protection of their rights, that they must be treated with civility and decency and restraint by those who represent the government. I deplore any departure from those standards, whether is occurs at the Commission or in some other government agency. Since I have been with the Commission I have been sensitive to charges that Commission employees have been guilty of such aberrations. I would like to share with you my reflections concerning these charges.

First of all, with regard to the procedures, I have examined carefully the recommendations of the Wells Committee. I find some of them have been

implemented in whole or in part. I find there are many instances where, because their importance is secondary, the failure to implement them has not, in my estimation, compromised the fairness or integrity of our processes. In some cases this has been because the Commission, after reflection and investigation, has in all honestly not felt it desirable to act. In other instances, I think there should perhaps be a reexamination, and I would hope that there will be at the Commission a continuing effort to carry out as fully as possible those proposals in the Wells Committee report which are meritorious.

With regard to people, I think it would be absurd to deny that in the Commission, as in any agency having as many people involved in the enforcement process as we have, there are not occasional excesses. Sometimes they arise out of the heat of battle, just as, on occasions, private practitioners are guilty of abusive and inappropriate conduct. I know from my own trial experience that it is very easy for tempers to flare, for righteousness to assert itself, for conviction in the rightness of a client's case to overrule prudence and restraint. This can happen on both sides of the table. Not infrequently, we must send into the fray young people, short on experience, long on desire, to take on some of the most skilled, shrewd, experienced practitioners in the field. And very often their only counterfoil to the skills of the adversary may be strong assertions of authority. The instances in which impropriety happens on either side of the fence are fortunately to my mind infrequent when consideration is given to the number of encounters.

In any event, I can say to you the staff and the Commission are sensitive to these problems and they try in every case that comes to their attention to deal

responsibly and fairly with the matter. In those few instances of reasonable complaints, senior staff and the Commission act quietly, but nonetheless effectively, to remedy the complaint. The Commission is not indifferent to the manner in which we carry out our responsibilities and I would say to you that the members of the staff who are involved in enforcement are not indifferent either.

In my estimation our own self-interest dictates restraint. We do not want an image of bureaucratic overreaching, arrogant assertions of power, insensitivity to concerns of decency and fairness.

I have dwelt upon the relationships between the Bar and the Commission because I feel that this is one of the most important problems we have as we move into our 41st year.

As the Commission looks back on the 40 years of its history, I think it and everyone who is or has been associated with it may take great pride in its achievements. During that period it has restructured an industry, the public utility holding company industry. It did this through an immense effort which is recorded proudly on thousands upon thousands of pages of Commission and judicial reports. Now, it may in the very near future receive from Congress a similar mandate to develop a National Market System. Already we have taken our first steps in this direction by beginning development of a consolidated tape. I would hope that we could bring into existence a National Market System in a shorter period of time, with the spilling of considerably less ink, than was entailed in developing a rational system of public utility holding companies.

During this period the Commission has engaged in imaginative and resourceful lawmaking. Pre-eminent has been Rule 10b-5, perhaps a spur-of-the-moment bit of lawmaking, but nonetheless one which has afforded the Commission the means of moving responsibility and effectively with the times. Out of that grew the Texas Gulf Sulphur case which translated into law what previously had been largely an ethical principle, namely, that insiders cannot take advantage of their position to the detriment of the markets and the everyday investors. The implications of this to the integrity of our market place are tremendous. I regard that particular victory of the Commission as one of the great landmarks in the development of corporate honesty. There are other countries, notably Great Britain, which have experienced the same horror which was experienced in this country over the misconduct of corporate officials and they are moving in the same direction that we have to put such conduct outside the legal pale.

The Commission has avoided the curse of many agencies, it has not become the captive of the industry that it was created to regulate. Indeed, if it is the captive of that industry, the industry is reacting mighty strangely. It is demanding, through responsible spokesmen, that some new agency be created which will be a friend of the industry -- hardly to be expected from the captor. It reminds one a bit of Mark Twain's, "The Ransom of the Red Chief."

I believe it was Justice Douglas who suggested that every administrative agency ought to be terminated after 10 years because by that time all of them had lost their initiative, their energy, and their imagination. It was, I believe, Thomas Jefferson who suggested that every 25 years or each generation there should be a revolution and a new constitution. I think we have learned recently, quite dramatically, that our venerable

Constitution is able to deal with new and unforeseen crises. I think the same may be said of the Commission. As it goes into its fifth decade of existence, I think there is every evidence that it has retained the energy, the imagination, and the mission which it has displayed so dramatically and well in the first and each ensuing decade of its existence.

During these 40 years there have been periods in the Commission of near hyper-activity, some of seeming torpor. During this time there have been, I believe, 19 Chairmen and a little over 50 Commissioners. All of these have had their strengths and their weaknesses, their times of greatness, their moments of clay-footedness. My view may be parochial, but I genuinely believe that the Commission now is supremely blessed with one of its greatest Chairmen, Ray Garrett, and that the other Commissioners, Phil Loomis, John Evans and Irv Pollack, are among the finest who ever sat at the Commission table. And I find it difficult to imagine there was ever a time -- even those halcyon days of the thirties -- when the staff was abler or more dedicated.

In 1934, Congress told the Commission to protect the investor and assure the integrity of the market place. Obviously, it has not done this to perfection. If it had, I think our enforcement calendars would be shorter. I think, though, that indeed investors have been protected and the market place protected, with energy and skill, and with demonstrable benefits to the entire nation.

Frankly, I am proud of the Commission upon which I serve and proud of its staff. I am proud of this Section and I am proud to have been for many years such an intimate part of it. I am proud of the very constructive collaboration that has existed

through the years between the Commission and the Section. I shall be even prouder if a year from now we have found our tensions reduced and our collaboration even more constructive.

Thank you.