July 12, 1979

Howard K. Phillips, Esq.
469 United States Courthouse
Denver, Colorado 80294

Re: Securities and Exchange Commission v. Andrew J. Haswell, (No. 78-1048)

Dear Mr. Phillips:

In response to the invitation of the Court, dated June 20, 1979, that the parties to this appeal advise the Court as to relevant cases decided after the briefs were filed in this matter, enclosed are the original and nine copies of the Supplemental Memorandum of the Securities and Exchange Commission Regarding Recently Decided Cases. I certify that copies of the Commission's Memorandum were served by mail on counsel for the appellee.

Sincerely,

James H. Schropp
Assistant General Counsel

Enclosures: As Stated

cc: Robert C. Bailey, Esq.
600 Hightower Building
Oklahoma City, Oklahoma 73102

Thomas J. Kenan, Esq.
1000 Fidelity Plaza
Oklahoma City, Oklahoma 73102

JS-DC XII

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

---

No. 78-1048

---

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellant,

v.

ANDREW J. HASWELL, JR.,

Defendant-Appellee.

---

Appeal from the United States District Court
for the Western District of Oklahoma

---

# SUPPLEMENTAL MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION REGARDING RECENTLY DECIDED CASES

---

PAUL GONSON
Principal Associate
General Counsel

JAMES H. SCHROPP
Assistant General Counsel

PAUL D. GLENN
Attorney

MITCHELL D. DEMBIN
Attorney

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In response to this Court's invitation, the Securities and Exchange Commission ("Commission"), appellant, wishes to bring to the attention of the Court the cases discussed herein, each of which was decided after the briefs were filed in this appeal.

A. RECENT DECISIONS OF THIS COURT AND OTHER COURTS MAKE IT CLEAR THAT THE DISTRICT COURT ERRED IN HOLDING THAT SCIENTER IS A NECESSARY ELEMENT OF A COMMISSION ACTION FOR EQUITABLE RELIEF

Recent court decisions have confirmed that, as the Commission stated in its briefs filed in this appeal, the court below erred in holding that the Commission had to show scienter in order to demonstrate its entitlement to injunctive relief. Based on these recent decisions, and the authority cited in our prior briefs, we submit that this Court should reverse and remand the case with directions to enter appropriate injunctive relief. 1/

---

1/ The Commission and Haswell are agreed that the essential facts of this case are not in dispute (Comm. Br. 10; Haswell Br. 8), and that what is in dispute is the inferences to be drawn from the established facts and the proper legal standard to be applied to the facts. Accordingly, a remand for further fact-finding proceedings is not required, and this Court should direct the entry of an injunction, as the Court of Appeals for the Fourth Circuit did in Securities and Exchange Commission v. American Realty Trust, 586 F.2d 1001, 1007 (1978).

1. On January 24, 1979, this Court decided Edward J. Mawod & Co. v. Securities and Exchange Commission, 591 F.2d 588 (10th Cir. 1979), affirming the Commission's imposition of remedial sanctions in an administrative proceeding against a securities broker-dealer. The Commission submits that this Court's decision in Mawod compels a reversal of the decision of the court below in this case.

In Mawod, the petitioners 2/ were held, inter alia, to have aided and abetted violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5 thereunder, and Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a). The violations of these statutes were based upon Mawod's acquiescence in permitting individuals who were manipulating the stock of a corporation to use the trading floor of Mawod & Co.

This Court, noting that Mawod "was not a novice as far as the securities business was concerned," 591 F.2d at 590, held that he "knew or had reason to know that such trading [i.e., trading on an extensive scale in the stock of an obscure over-the-counter company] was economically irrational". 591 F.2d at 595. "The inference to be drawn

---

2/ Edward J. Mawod & Co., a broker-dealer, and its principal, Edward J. Mawod.

is that the partner participated in the manipulation and thus aided and abetted the manipulators' violations of [Section 17(a) of the Securities Act; Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder]." Id.

Similarly, in the instant case, defendant Andrew J. Haswell, Jr. ("Haswell") is an experienced securities attorney who has specialized in municipal securities (A. 49, 52). Yet, in two of the three bond issues involved in this appeal, the Western State Plastics, Inc. ("WSP") issue 3/ and the Lee and Hodges, Inc. ("L&H") issue, 4/ Haswell prepared tax opinions, to his knowledge a critical step in the marketing of these issues, without ever having seen a final disclosure document, even though he was aware of and, indeed, had commented on deficiencies and irregularities in the preliminary documents. Under these circumstances, Haswell either "knew or had reason to know," Mawod, supra, 591 F.2d at 595, that a fraud was about to be perpetrated upon investors. The only correct inference to be drawn is that Haswell participated in the fraud and aided and abetted the violations of the securities laws. Cf. Mawod, supra, 591 F.2d at 595.

---

3/ See Comm. Br. at 12-16.

4/ See Comm. Br. at 16-20.

Despite the fact that it did not have to decide the scienter issue in Mawod, in view of its finding that scienter was involved in that case, this Court indicated that it would likely reject Mawod's argument that scienter was required. Thus, this Court stated, with respect to Section 10(b) of the Securities Exchange Act:

> "It is argued, however, that Hochfelder requires something more that what was shown. We must disagree. Hochfelder does not require that there be premeditated malice. It is recognized that the carrying on of a manipulative or deceptive device or contrivance was itself evidence that knowledge existed." 591 F.2d at 596.

Similarly, with respect to Section 17(a) of the Securities Act, this Court noted that "[a] strong argument can be made for the proposition that the scienter element is not essential to proving a case under Section 17(a)(2) of the 1933 Act." 591 F.2d at 596.

Finally, in deciding whether there was sufficient evidence to show that Mawod had "willfully" violated the law, this Court emphasized its own prior holding in Quinn & Co. v. Securities and Exchange Commission, 452 F.2d 943, 947 (10th Cir. 1971), that "where brokers are obligated to investigate, the failure to do so subjects them to a holding that they acted willfully." 591 F.2d at 596. Similarly, in

Stead v. Securities and Exchange Commission, 444 F.2d 713, 716 (10th Cir. 1971), cert. denied, 404 U.S. 1059 (1972), this Court held that "where one was aware or should have been aware of the improper goings-on in an investment firm, he was subject to a finding that he willfully violated the recordkeeping provisions of the 1934 Act." 591 F.2d at 596.

The evidence in the court below demonstrates that Haswell acted with indifference to his obligations as an attorney in connection with his review or preparation of admittedly deficient disclosure documents for the three offerings in issue, and his issuance of tax opinions when he knew that the companies in question could not possibly meet the statutory requirements for a tax exemption. As the only attorney involved in these offerings, Haswell had a duty to investigate the many warnings he had that something was wrong, and he should have been aware of the "improper goings-on" in connection with these bond issues. The facts that were known to Haswell, and those which he should have known, were more than enough to "bring the matter home" to him. 5/

---

5/ This Court found that Mawod's awareness of the stock manipulators in the firm's trading room, as well as his necessary awareness of the ups and downs of the stock in question, "were enough to bring the matter home to Mr. Mawod." Mawod, supra, 591 F.2d at 596.

2. The Court of Appeals for the Second Circuit, in Securities and Exchange Commission v. E. L. Aaron & Co., Inc., [Current] CCH Fed.Sec.L.Rep. ¶96,800 (March 12, 1979), squarely decided the scienter issue, holding that it is not necessary for the Commission to prove scienter in order to show a need for injunctive relief to prevent further violations of either Section 10(b) of the Securities Exchange Act and Rule 10b-5, or Section 17(a) of the Securities Act. 6/ The Court so held after a careful review of the Hochfelder decision, subsequent cases and commentary, and the legislative histories of both Acts. 7/

---

6/ Haswell attempted, in his brief in this Court, to distinguish the district court decision in Aaron on the ground that while the court stated that "negligence is all that is required under Sections 10(b) and 17(a), [it] significantly made a specific finding of scienter on the part of the defendant." Haswell Br. 31. This is not true with respect to the decision of the Court of Appeals, however, which stated:

> ". . .we find it unnecessary to reach the question whether Aaron's conduct would support a finding of scienter, since we hold that the scienter requirement enunciated in Hochfelder is not applicable to government enforcement actions brought under Section 10(b). . .of the 1934 Act."

CCH Fed.Sec.L.Rep. at 95,128.

7/ The Second Circuit surveyed the cases discussing the scienter issue at 95,128 n. 10, and various commentary on this issue at 95,129 n. 11.

Regarding Section 10(b) and Rule 10b-5, the Court held:

> "[W]e are satisfied that rejection of a scienter requirement for SEC injunction actions is consistent with the overall enforcement scheme of the securities acts. The Hochfelder holding reflected the Court's concern that the absence of a scienter requirement for private damage actions under Section 10(b) would render superfluous the statutory scheme of 'express civil remedies' and would 'significantly broaden the class of plaintiffs who may seek to impose liability upon accountants and other experts who perform services or express opinions.' 425 U.S. at 214 n. 33. Such concerns strike us as not applicable to SEC enforcement actions. An examination of the statutory scheme indicates that there are no comparable provisions which would be nullified by permitting SEC enforcement actions to be predicated on a showing of negligence. Indeed, to sanction Section 10(b) injunctive relief on proof of negligence would be to harmonize the requirements of that section with the standards governing similar prophylactic provisions of the 1933 Act." CCH Fed.Sec.L. Rep. at 95,131. 8/

---

8/ The court in Aaron pointed out the differences between Commission actions and private actions for damages, observing that while the courts, in connection with the latter, have looked for guidance to the common law of misrepresentation or deceit, in defining the requirements for Commission actions, they have looked directly to the statutory provisions which authorize such actions. CCH Fed.Sec.L.Rep. at 95,130. Citing the legislative history of Section 21(d) of the Securities Exchange Act -- the same history cited in the Commission's opening brief at page 51, note 65 -- the Second Circuit held that "[i]t would be difficult to find a clearer indication, at the time of the enactment of Section 21(d), that Congress intended to exempt SEC injunctive actions from the scienter requirement applicable to private actions." CCH Fed.Sec.L.Rep. at 95,131.

The Court in Aaron also reaffirmed the Second Circuit's prior holding in Securities and Exchange Commission v. Coven, 581 F.2d 1020, 1026-1028 (2d Cir. 1978), that proof of scienter is "unequivocally . . . not required" in Commission actions based on violations of Section 17(a) of the Securities Act. CCH Fed.Sec.L.Rep. at 95,132 (emphasis in original).

* * *

As we pointed out in our reply brief (pp. 1-3), Haswell has admitted, in his brief filed in this Court, that the performance of his legal duties was seriously deficient in several respects. While Haswell characterizes these deficiences as the result of "poor judgment" (Br. 18, 23), or, "perhaps", the product of "negligence" (Br. 16), it seems plain that more than mere negligence is involved in the three separate issues involved in this case. Even if Haswell's characterizations were correct, however, the decisions of this Court and other courts have made it clear that, contrary to the legal standard applied by the district court, negligent conduct of the sort involved here does warrant the entry of injunctive relief in an action brought by the Commission.

B. CERTAIN RECENT DECISIONS HAVE CLARIFIED THE NATURE OF THE DUTIES IMPOSED UPON AN ATTORNEY IN HASWELL'S POSITION

Finally, the Commission wishes to bring to the Court's attention two recent district court decisions which have, more successfully than the court below, articulated the nature of the duties and responsibilities imposed by the securities laws upon an attorney in a position similar to Haswell's. These cases, as well as the cases cited in the Commission's prior briefs, make it clear that the decision of the court below is wrong as a matter of law.

1. Baron v. Commerical & Industrial Bank of Memphis, [Current] CCH Fed.Sec.L.Rep. ¶96,826 (S.D.N.Y. April 11, 1979), was a private action under the securities laws against, inter alia, a bond attorney who rendered an opinion in connection with bonds claimed to be exempt from the securities registration provisions of the Securities Act as tax-exempt industrial development bonds. The plaintiff alleged that these bonds did not qualify as tax-exempt bonds and therefore were subject to the registration provisions of the Securities Act. 9/

---

9/ The Court held that the bonds could not be held to be exempt from registration, either as bonds issued by a "political subdivision" or as tax-exempt industrial bonds, on the basis of the record before it.

The Court held that the attorney's "bond opinion, printed on every bond certificate mailed to purchasers after the sale was completed, constitutes a 'prospectus' within the meaning of Section 12(2)" of the Securities Act. 10/ Accordingly, bond counsel must comply with the registration requirements of the Securities Act in issuing bond opinions, unless an exemption is available; and, in any event, the antifraud provisions of both the Securities Act and the Securities Exchange Act apply. CCH Fed.Sec.L.Rep. at 95,308.

Thus, in the instant case, Haswell should be held accountable for the false statements he permitted to be made to the public, both in the disclosure documents which he prepared or reviewed, and in the bond opinions which falsely represented that the bonds in question were tax-exempt. Haswell is also responsible for the failure of the bond issuers to comply with the securities registration provisions of Section 5 of the Securities Act.

It is also worthy of note that the court in Baron, in considering the legal issues involving the tax laws, gave appropriate weight to a letter from the Commissioner of the Internal Revenue Service to the Chairman of the Securities

---

10/ CCH Fed.Sec.L.Rep. at 95,308. See, the definition of the term "prospectus" in Section 2(10) of the Securities Act, 15 U.S.C. §77b(10).

and Exchange Commission, dated July 27, 1976, which was cited to the court by the plaintiff in support of the plaintiff's legal argument. In holding that "only bona fide and reasonable costs of acquisition of land or depreciable property qualify" as proper uses of proceeds of an offering under Section 26 U.S.C. 103(c)(6)(A), the court noted that:

> "The Commissioner stated: 'Thus, an industrial development bond, which otherwise qualifies, will be tax-exempt if at least 90 percent of the bond proceeds is allocable to the bona fide and reasonable costs of acquisition, construction, reconstruction, or improvement of land or depreciable property (qualifying costs), and no more than 10 percent of the bond proceeds is allocable to other costs (nonqualifying costs)'. . . ." CCH Fed.Sec.L.Rep. at 95,307 n. 14.

The letter cited by the court in Baron is the same letter which the Commission, in the court below, attached to its post-trial brief, not as evidence, but solely for its value in explicating the relevant legal issues. As we have pointed out in our opening brief (p. 6), it was apparently this entirely proper use of the letter that resulted in the district judge's citing five Commission attorneys for contempt of court, and concluding its consideration of the case with the Commission's attorneys under the cloud of potential contempt proceedings. As the court's decision in

Baron indicates, the Commission's use of the letter was appropriate, and the reaction of the district judge, as well as his other acts of unexplained hostility to the Commission, warrants a remand to a different district judge, should the court determine that a remand for further proceedings is necessary.

2. In Felts v. National Account Systems Associations, Inc., [Current] CCH Fed.Sec.L.Rep. ¶96,860 (N.D. Miss., November 30, 1978), appeal pending, 5th Cir., the court held that a lawyer representing an issuer of securities violated and aided and abetted violations of the registration and antifraud provisions of the Securities Act and the Securities Exchange Act by failing to make the inquiries required of him. Haswell's role in the instant case is indistinguishable.

The court held that the "lawyer for the issuer plays a unique and pivotal role in the effective implementation of the securities laws," which requires the imposition of "special duties" on the lawyer. CCH Fed.Sec.L.Rep. at 95,519. The court continued:

> "The duty of the lawyer includes the obligation to exercise due diligence, including a reasonable inquiry, in connection with responsibilties he has voluntarily undertaken. A lawyer has no privilege

> to assist the issuer circulate statements which he knows or should know to be false simply because they were furnished to him by his client * * *. He must make a reasonable, independent investigation to detect and correct false or misleading materials." Id. at 95,520 (citations omitted).

In Felts, the court concluded that "without the active, affirmative assistance of * * *[the] lawyer for the issuer * * * the sale would not have been accomplished." Id. In the instant case, the marketing of the bonds would not have been possible without Haswell's active, affirmative assistance as counsel for the co-issuer of these bonds. The court in Felts held that the attorney involved in that case materially and substantially aided and abetted the issuer's registration violations, and further held that in violating the antifraud provisions he had acted with scienter. "The preparation and assisstance[sic] with the materially false and misleading statements and the course of conduct of [the lawyer] clearly imposes aiding and abetting liability on him as a matter of law." CCH Fed.Sec.L.Rep. at 95,520. 11/

---

11/ In Felts, the attorney was liable for damages despite the fact that he "had little corporate experience and no experience with or knowledge of securities law." Id. at 95,513. In this case, Haswell is an experienced securities law practitioner.

As the Felts decision makes clear, a lawyer in Haswell's position owes a duty not only to the issuer but to the purchasers of securities. 12/ Here, as in Felts, the purchasers

> "were foreseeable and intended third-party beneficiaries of [the attorney's] legal services and skill. It was foreseeable * * * that all purchasers of these securities would rely on him * * *. The law and public policy require that the attorney exercise his position of trust and superior knowledge responsibly so as not to adversely affect persons whose rights and interests are certain and foreseeable." CCH Fed.Sed.L.Rep. at 95,520.

And here, as in Felts, an attorney who so abused his trust should similarly be found to have violated and aided and abetted violations of the federal securities laws.

---

12/ As the court pointed out, the lawyer "must make a reasonable, independent investigation to detect and correct false or misleading materials." CCH Fed. Sec.L.Rep. at 95,520. That duty must be contrasted with Haswell's total failure, in this case, to check the figures furnished to him by the company for inclusion in the offering materials for accuracy and reasonableness because, as he testified, "[n]obody ever asked me to" (A. 199). In Felts, however, the lawyer was liable because he accepted as true the "promotional material furnished to him" without making a reasonable inquiry to ascertain the truth or falsity of the representations when these statements could have been readily verified by a lawyer." CCH Fed.Sec.L.Rep. at 95,520.

## CONCLUSION

For the reasons indicated herein, as well as those set forth in our prior briefs, the judgment of the district court should be reversed, and the case should be remanded to the district court with instructions to grant the relief requested by the Commission.

Respectfully submitted,

PAUL GONSON
Principal Associate
General Counsel

JAMES H. SCHROPP
Assistant General Counsel

PAUL D. GLENN
Attorney

MITCHELL D. DEMBIN
Attorney

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

July 12, 1979