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THE ATTORNEY AS GATEKEEPER: AN AGENDA FOR THE SEC

John C. Coffee, Jr.*

Section 307 of the Sarbanes-Oxley Act authorizes the SEC to prescribe “minimum standards of professional conduct” for attorneys “appearing or practicing” before it. Although the initial debate has focused on issues of confidentiality, this terse statutory provision frames and seemingly federalizes a much larger question: What is the role of the corporate attorney in public securities transactions? Is the attorney’s role that of (a) an advocate, (b) a transaction cost engineer, or, more broadly, (c) a gatekeeper—that is, a reputational intermediary with some responsibility to monitor the accuracy of corporate disclosures? Skeptics of any gatekeeper role for attorneys have long argued that (a) such a role conflicts with the traditional obligations of loyalty that attorneys owe their clients, and (b) imposing gatekeeping obligations on attorneys will chill attorney-client communications and thereby reduce law compliance. This Essay examines these arguments that attorneys make inferior gatekeepers and replies that securities attorneys can and do perform a limited “gatekeeping” function and that imposing such obligations on attorneys should neither chill socially desirable client communications nor reduce the attorney’s influence over the client (and probably will increase that leverage). Finally, this Essay proposes specific standards and obligations that the SEC might adopt to enhance the securities attorney’s role as a gatekeeper. Going beyond the current “noisy withdrawal” issue, it proposes both limited certification and independence standards.

INTRODUCTION

The spotlight is now focused on lawyers. In the post-Enron, post-Sarbanes-Oxley debate over the United States’s seemingly dysfunctional system of corporate governance, Congress, the SEC, and the public at large all suspect that, when sophisticated financial chicanery occurs, lawyers are typically present “at the scene of the crime.”¹ So too does Professor Susan Koniak, whose contribution to this Symposium drives home the

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1. This was said in very blunt terms by two of the principal Senatorial draftsmen of section 307 (“Rules of Professional Responsibility for Attorneys”) of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.A. (West Supp. 2003)). Reviewing the recent scandals and explaining his support for section 307, Senator Michael Enzi (R-Wyo.) commented: “[O]ne of the thoughts that occurred to me was that probably in almost every transaction there was a lawyer who drew up the documents involved in that procedure.” 148 Cong. Rec. S6554 (daily ed. July 10, 2002) (statement of Sen. Enzi). His statement was quickly followed by that of co-sponsor Senator Jon Corzine (D-N.J.), the former chief executive of Goldman Sachs, who said:

In fact, in our corporate world today—and I can verify this by my own experiences—executives and accountants work day to day with lawyers. They give them advice on almost each and every transaction. That means when executives

point, with the unrelenting persistence of a jackhammer, that lawyers have behaved badly.² In response both to the enactment of the Sarbanes-Oxley Act last year and to the SEC's promulgation this year of rules under section 307 of that Act designed to force "up-the-ladder" reporting of material violations of law,³ the bar associations themselves still seem locked in denial. Reacting with the same shocked alacrity of a patient in the dental chair when the drill hits an exposed nerve, they have answered: "You don't understand; lawyers can't undertake the obligations that you are proposing because they conflict with our duties to our clients."⁴ Evan Davis's contribution to this Symposium is representative. A distinguished litigator, Mr. Davis asserts that the role of the attorney is to serve as "a bulwark between individuals or organizations and the political branches of government."⁵ This view of the lawyer as the client's shield against an oppressive state is no doubt right with respect to the role of the litigator, but the question remains whether his description of the attorney's role applies as well—or at all—to the securities attorney. As a result, the debate has had the character of two ships passing in the night—with neither

and accountants have been engaged in wrongdoing, there have been some other folks at the scene of the crime—and generally they are lawyers.

Id. at S6556 (statement of Sen. Corzine).

This Essay focuses on how to change the behavior of lawyers in this position.

2. See generally Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle With the SEC*, 103 Colum. L. Rev. 1236 (2003). I agree with many of Professor Koniak's comments about the deficiencies in the SEC's rules under section 307, but I am not convinced that the bar has been as corrupted as she feels it has. In any event, the relevant question is how to structure the relationship between lawyer and client in this field to enhance the independence, integrity, and influence of the attorney. Here I attempt to take a wider-angled examination than she does of what the SEC could do under section 307.

3. On November 21, 2002, the SEC proposed rules under section 307 of the Sarbanes-Oxley Act to mandate "up-the-ladder" reporting. See *Implementation of Standards of Professional Conduct for Attorneys*, Securities Act Release No. 33-8150, 67 Fed. Reg. 71,670 (Dec. 2, 2002). On January 23, 2003, the Committee voted to approve an up-the-ladder reporting system under which attorneys must report evidence of material violations of certain laws to the corporation's chief legal officer and, when that attorney fails to respond appropriately, to the corporation's audit committee. See *Implementation of Standards of Professional Conduct for Attorneys*, Securities Act Release No. 33-8185, 68 Fed. Reg. 6296 (Feb. 6, 2003) (to be codified at 17 C.F.R. pt. 205). However, the Commission delayed for further review its original proposal that mandated attorney resignation and a report to the SEC when the corporate client refused to correct or rectify an ongoing material violation of law that threatened serious injury to the corporation or its security holders. See *Implementation of Standards of Professional Conduct for Attorneys*, Securities Act Release No. 33-8186, 68 Fed. Reg. 6324 (proposed Feb. 6, 2003).

4. In a December 18, 2002 letter from American Bar Association President Alfred P. Carlton, Jr. to the Securities and Exchange Commission, the ABA expressed its view that the SEC's proposed rules would "adversely affect issuers' ability to obtain sound legal advice." *Comments of American Bar Association on Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys* (Dec. 18, 2002), at <http://www.sec.gov/rules/proposed/s74502/apcarlton1.htm> (on file with the *Columbia Law Review*).

5. See Evan A. Davis, *The Meaning of Professional Independence*, 103 Colum. L. Rev. 1281, 1281 (2003).

side truly engaging the claims of the other. Both sides are shocked—in the one case about attorney misconduct, in the other about regulatory intrusions into the quiet world of the professions—but neither side has focused fully on the scope of the transformation of the legal profession that the SEC could effect under section 307.

The SEC has also contributed to the nonconceptual character of the current debate. Understandably eager to minimize controversy, it has presented its up-the-ladder reporting rules under section 307 as intended to protect only the attorney's client, the corporation. Yet, particularly in the case of the SEC's proposals for a "noisy withdrawal" obligation, this is disingenuous. The real issue is: *To what degree can or should the securities attorney serve as a gatekeeper with guardian-like responsibilities to investors who rely upon the disclosures that the securities attorney typically prepares or at least reviews.* Because the bar associations simply deny that attorneys have (or should have) any mandatory gatekeeper obligations,⁶ and because the SEC finds it impolitic to assert that they do (even as they indirectly impose them), this debate has not yet fully been joined. Yet this debate

6. The American Bar Association has historically favored the "hired gun" model of the attorney under which even the securities attorney generally has no duty or right to make disclosure, absent the client's consent. See American Bar Association, Statement of Policy Adopted by the American Bar Association Regarding Responsibilities and Liabilities of Lawyers in Advising with Respect to the Compliance by Clients with Laws Administered by the Securities and Exchange Commission, 31 Bus. Law. 543, 545 (1975) [hereinafter ABA Statement of Policy] ("[T]he lawyer has neither the obligation nor the right to make disclosure when any reasonable doubt exists concerning the client's obligation of disclosure.").

Even the American Bar Association's Task Force on Corporate Responsibility, which earlier this year recommended some loosening of lawyer confidentiality rules, has shied away from endorsing any gatekeeping role for lawyers. In its 2003 Final Report, it stated: "The Task Force acknowledges that lawyers for the corporation—whether employed by the corporation or specially retained—are not 'gatekeepers' of corporate responsibility in the same fashion as public accounting firms." See Report of the American Bar Association Task Force on Corporate Responsibility at 22 (March 31, 2003), available at http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf (on file with the *Columbia Law Review*) [hereinafter ABA Task Force on Corporate Responsibility]. This is of course a nuanced statement that does not necessarily deny that lawyers could have some gatekeeping responsibilities, although not the same as auditors. The rationale for this view is expressed later in the same paragraph of this report:

Except in clearly defined circumstances in which other considerations take precedence, an alternative view of the lawyer as an enforcer of law may tend to create an atmosphere of adversity, or at least arm's length dealing, between the lawyer and the corporate client's senior executive officers that is inimical to the lawyer's essential role as a counselor promoting the corporation's compliance with law.

Id. at 23. As discussed later, this assertion seems overboard—both in its implicit claim that any gatekeeping responsibility will lead to an "atmosphere of adversity" and, even more so, in its assumption that imposing such a responsibility on lawyers will be "inimical to promoting the corporation's compliance with law." For a contrary view, see text and notes infra at notes 41–50.

must ultimately focus on how much the role of the attorney should change, at least in the case of the securities lawyer.

Clearly, nontrivial arguments can be advanced that securities attorneys will not make good gatekeepers. Chiefly, skeptics object either that (1) the responsibilities of a gatekeeper conflict with the traditional obligations of loyalty that attorneys owe to their clients, or (2) imposing gatekeeping obligations on attorneys will chill attorney-client communications that also serve to promote law compliance. In response, this brief Essay will reply that: (1) securities attorneys have long recognized gatekeeper-like obligations (and thus differ from their litigator colleagues in a profession that is considerably more heterogenous than is generally recognized); (2) the differences between attorneys and auditors are less fundamental and more marginal than opponents of the SEC's proposed noisy withdrawal standard have recognized; (3) in some respects, it may be easier to impose gatekeeper obligations on attorneys than on auditors; and (4) imposing gatekeeper obligations on attorneys is likely neither to chill socially desirable client communications nor to reduce attorneys' influence over their clients, but may actually increase attorneys' leverage over their most intransigent clients. Finally, this Essay will examine the critical question that the SEC has not yet begun to consider: Now that the SEC has the power to promulgate "minimum standards of professional conduct" for securities attorneys under section 307, what standards make sense if we believe it necessary that the legal profession assume some responsibility as a guardian of the market's integrity? It will propose some other obligations that could overshadow and prove more beneficial to investors than a duty of noisy withdrawal.

1. WHAT IS A GATEKEEPER?

The term "gatekeeper" has frequently been used to describe the independent professionals who serve investors by preparing, verifying, or assessing the disclosures that they receive.⁷ Examples of gatekeepers include: (1) the auditor who provides its certification that the issuer's financial statements comply with generally accepted accounting principles; (2) the debt rating agency that evaluates the issuer's creditworthiness; (3) the securities analyst who communicates an assessment of the corporation's technology, competitiveness, or earnings prospects; (4) the investment banker who furnishes its "fairness opinion" as to the pricing of a merger; and (5) the securities attorney for the issuer who delivers an opinion to the underwriters that all material information of which the

7. The SEC regularly uses the term "gatekeeper." See, e.g., Revision of the Commission's Auditor Independence Requirements, Securities Act Release No. 33-7870, 65 Fed. Reg. 43,148, 43,150 (July 12, 2000) (noting that "the federal securities laws . . . make independent auditors 'gatekeepers' to the public securities markets"); Securities Act Concepts and Their Effects on Capital Formation, Securities Act Release No. 33-7314, 61 Fed. Reg. 40,044, 40,048-49 (July 25, 1996) (discussing the role of gatekeepers in maintaining the quality of disclosure).

attorney is aware concerning the issuer has been disclosed properly. The underwriter in an initial public offering also performs a gatekeeping function, in the sense that its reputation is implicitly pledged and it is expected to perform due diligence services.

Structurally, gatekeepers are independent professionals who are so positioned that, if they withhold their consent, approval, or rating, the corporation may be unable to effect some transaction or to maintain some desired status.⁸ For example, institutional investors may be able to purchase the corporation's bonds only if an independent debt-rating agency rates them as being of investment grade.⁹ Similarly, a "clean" opinion from an auditor may be required by stock exchanges and the SEC if the corporation is to remain publicly traded. From a law compliance perspective, the existence of the gatekeeper offers an effective strategy for deterrence. Because the gatekeeper will receive little, if anything, from corporate involvement in crime or misconduct, it can be deterred more easily than can the corporation or its managers, who may profit handsomely from crime or who may be tempted to engage in criminal activities to achieve goals or thresholds that allow them to remain in office.

The gatekeeper's relative credibility derives in part from its lesser incentive to lie or dissemble, but even more so from the fact that the gatekeeper in effect pledges reputational capital that it has built up over many years and many clients to secure its representations about the particular client or transaction.¹⁰ At least in theory, a gatekeeper would not rationally sacrifice this reputational capital for a single client who ac-

8. Professor Reinier Kraakman originally defined "gatekeepers" as private parties who were able to prevent corporate misconduct by withholding their cooperation from wrongdoers. Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 *J.L. Econ. & Org.* 53, 54 (1986); see also Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 *Yale L.J.* 857, 888-96 (1984) (evaluating gatekeeper liability).

9. A debt rating agency must be recognized by the SEC as a "nationally recognized statistical rating organization" (NRSRO) before its ratings carry meaningful consequences. Thus, the SEC has de facto licensing control over this form of gatekeeper. See Rule 15c3-1(c)(2)(vi)(E), (F), & (H) under the Securities Exchange Act of 1934. 17 C.F.R. § 240.15(c)(3)-1 (2001) (requiring certain debt securities to carry an investment grade rating from an NRSRO if securities are to be assigned value in computing broker-dealer's net capital). The term "investment grade" was originally used by a variety of regulatory bodies in the United States to describe debt obligations that they deemed eligible for investment by institutions such as banks, insurance companies, and savings and loan institutions. See Steven L. Schwarcz, *Private Ordering of Public Markets: The Rating Agency Paradox*, 2002 *U. Ill. L. Rev.* 1, 6-8 (describing process by which determination of investment grade status came to be delegated to private bodies).

10. The idea that a gatekeeper is an "informational intermediary" whose presence or certification makes the issuer's representations credible was probably first articulated by Professors Ronald Gilson and Reinier Kraakman with respect to underwriters. See Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 *Va. L. Rev.* 549, 618-21 (1984).

counts for only a small portion of its revenues.¹¹ Attorneys resemble gatekeepers in that they usually have reputational capital and are often in a position to block or delay transactions or governmental approvals that are vital to their corporate clients. This is truest in the case of securities attorneys, who could potentially block the effectiveness of a registration statement or the consummation of a merger simply by signaling their displeasure to the SEC. In the past, the SEC has suggested strongly that the attorney who is aware of a disclosure violation has a duty to seek to block or delay the consummation of any transaction, at least until properly-informed shareholder approval is obtained.¹² At times (although inconsistently), the SEC has even said that the attorney has an affirmative obligation to cause the client to comply with the federal securities laws.¹³

Historically, bar associations have resisted these SEC pronouncements, insisting that attorneys owe no mandatory obligations to public investors.¹⁴ The securities bar has, however, been far more equivocal.¹⁵ Although litigators have often asserted (as Evan Davis does in this Symposium) that lawyers owe a duty only to their clients and cannot assume other responsibilities, prominent securities attorneys have long endorsed the idea that they owe a duty to the investor who relies on their work—

11. For a strong (and probably overstrong) statement of this view that gatekeepers will not acquiesce in fraud, see *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990) (Easterbrook, J.) (“It would have been irrational for any of them [the auditors] to have joined cause with [the client].”). For a critique of this view, see Robert A. Prentice, *The Case of the Irrational Auditor: A Behavioral Insight into Securities Fraud Litigation*, 95 *Nw. U. L. Rev.* 133, 218–19 (2000).

12. This was the SEC’s central claim in *National Student Marketing*. See *SEC v. Nat’l Student Mktg. Corp.*, 457 F. Supp. 682, 700–01 (D.D.C. 1978) (upholding SEC’s claim that attorney who failed to act in this fashion aided and abetted client’s fraud).

13. The high water mark in the Commission’s statements about the obligations of an attorney to cause a corporate client to comply with the securities laws was probably its decision in *In re Carter & Johnson*, [1981 Transfer Binder] *Fed. Sec. L. Rep. (CCH)* ¶ 82,847, at 84,170 (Mar. 25, 1981) (finding a lawyer “must make all efforts within reason to persuade his client to avoid or terminate proposed illegal action”). The Commission quickly retreated from this position. See *infra* note 30.

14. See ABA Statement of Policy, *supra* note 6, at 544; ABA Section of Corp., Banking and Bus. Law, SEC Standard of Conduct for Lawyers: Comments on the SEC Rule Proposal, 37 *Bus. Law.* 915, 922–23 (1982) (criticizing SEC decision in *In re Carter* that attorney owed duty to take prompt action to cause corporate client to comply with securities laws). Both statements were approved by the ABA’s Board of Governors. The ABA Task Force on Corporate Responsibility, which reported earlier this year, also skirted around endorsing any gatekeeper role for attorneys. See *supra* note 6 and accompanying text.

15. A considerable body of literature has discussed the conceptions that corporate lawyers have of themselves. See, e.g., Robert W. Gordon, *Corporate Law Practice as a Public Calling*, 49 *Md. L. Rev.* 255, 258 (1990); see also Ronald J. Gilson, *The Devolution of the Legal Profession: A Demand Side Perspective*, 49 *Md. L. Rev.* 869, 884 (1990) (“The lawyer functions ‘as a kind of buffer between the illegitimate desires of his client and the social interest.’”). One commentator has noted that the bar has long divided between two competing visions of the attorney: (1) the “hired gun” or “total commitment” model; and (2) the gatekeeper model. Paul G. Haskell, *Why Lawyers Behave as They Do* 85–86 (1998).

one that requires them to be skeptical of, and independent from, their client. A classic expression of this view was stated in 1974 by A.A. Sommer, Jr., a long-time leader of the securities bar and at the time an SEC Commissioner. In a speech entitled, "The Emerging Responsibilities of the Securities Lawyer," he succinctly summarized the key elements of this duty:

I would suggest that in securities matters (other than those where advocacy is clearly proper) the attorney will have to function in a manner more akin to that of auditor than to that of the attorney. This means several things. It means that he will have to exercise a measure of independence that is perhaps uncomfortable if he is also the close counselor of management in other matters, often including business decisions. It means he will have to be acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about were it not for his professional presence. It means that he will have to adopt the healthy skepticism toward the representation of management which a good auditor must adopt. It means that he will have to do the same thing the auditor does when confronted with an intransigent client—resign.¹⁶

In overview, Sommer's definition of the securities attorney's ethical responsibilities stresses precisely the elements that define a gatekeeper: (1) independence from the client; (2) professional skepticism of the client's representations;¹⁷ (3) a duty to the public investor; and (4) a duty to resign when the attorney's integrity would otherwise be compromised.

Of course, other securities attorneys might well disagree with Commissioner Sommer, and his commanding presence in the field does not prove that his policy analysis is inherently correct. But even an ambivalence on the part of securities attorneys about their gatekeeper role contrasts sharply with the unqualified assertions of litigators that attorneys are essentially advocates. The litigators' certainty seems attributable to a "center-of-the-universe" fallacy under which litigators assume that their experience and their typical relationships with clients also necessarily characterize the experiences of other branches of the bar.

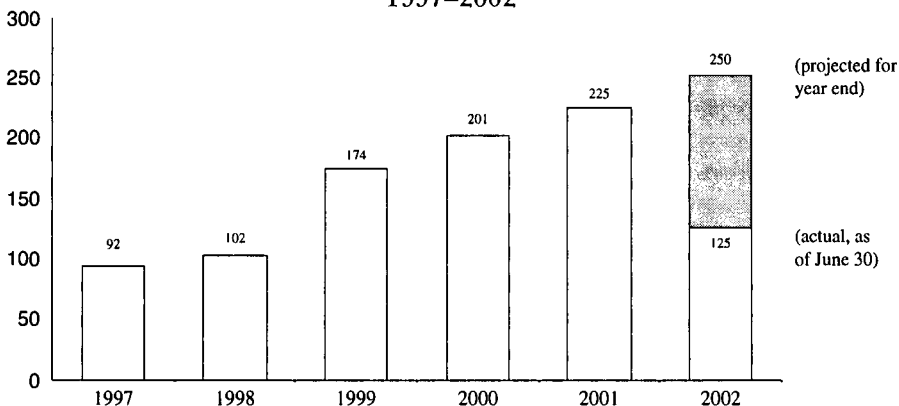
16. A.A. Sommer, Jr., *The Emerging Responsibilities of the Securities Lawyer*, Address to the Banking, Corporation & Business Law Section, N.Y. State Bar Ass'n (Jan. 24, 1974), in Larry D. Soderquist & Theresa Gabaldon, *Securities Regulation* 617-19 (4th ed. 1999). For another analysis of the corporate lawyer's "public" obligations, see also Simon M. Lorne, *The Corporate and Securities Adviser, the Public Interest, and Professional Ethics*, 76 Mich. L. Rev. 423, 468-96 (1978).

17. The late Harvard Law School Professor Louis Loss, the unquestioned dean of securities law academics before his death, similarly took the position that the securities lawyer's job inherently involved asking "searching questions" of the client about its proposed disclosures. See Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation* 1384 (4th ed. 2001).

II. WHAT HAPPENED TO GATEKEEPERS DURING THE 1990S

A 2002 study by the General Accounting Office (GAO) found that approximately ten percent of all publicly listed U.S. companies restated their financial statements at least once between 1997 and June 2002.¹⁸ The GAO study also shows that the annual rate of financial restatements soared between 1997 and 2002.¹⁹

FIGURE 1: TOTAL NUMBER OF RESTATEMENT ANNOUNCEMENTS IDENTIFIED, 1997–2002



This sudden spike in financial restatements strongly suggests that auditors became compromised during the 1990s and acquiesced in risky and questionable accounting policies favored by corporate managements.²⁰ But auditors were neither the only profession that dealt with financial disclosures nor the only profession that seemed to have become compromised during the 1990s. Securities analysts present an even clearer case in which conflicts of interest caused once cautious and objective analysts to behave more like cheerleaders than neutral umpires, at least when the corporation under review was an underwriting client of the investment banking firm that employed them.²¹ Both quantitative

18. See U.S. Gen. Accounting Office, *Financial Statement Restatements: Trends, Market Impacts, Regulatory Responses, and Remaining Challenges* 4–5, GAO-03-138 (Oct. 2002) (report to the Chairman of the Committee on Banking, Housing and Urban Affairs). Specifically, the GAO study finds that there were 919 announced restatements over the period from 1997 to June 2002, involving some 845 different companies, which constitutes ten percent of all those listed.

19. *Id.* at 15.

20. This author has elsewhere made the case in more detail that during the 1990s auditors became compromised by a combination of reduced legal risks for acquiescing in financial irregularities and heightened benefits that corporate managements could bestow on acquiescent auditors in the form of highly lucrative consulting work. See John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid"*, 57 *Bus. Law.* 1403, 1409–16 (2002).

21. For a general overview of this scandal, which was largely brought to the public's attention by New York Attorney General Eliot Spitzer, see Gretchen Morgenson, *Requiem*

and qualitative data suggest that the behavior and incentives of securities analysts changed during the 1990s.²²

Responding to these problems with both auditors and analysts, Sarbanes-Oxley sought to restore the independence of both gatekeepers by different strategies. In the case of auditors, Congress decreed a divorce, separating the consultant role from the auditing role in order to preclude the possibility that management could bribe auditors into acquiescence with lucrative consulting contracts.²³ In the case of analysts, it authorized the SEC to engage in broad rulemaking designed to “address conflicts of interest that can arise when securities analysts recommend equity securities . . . in order to improve the objectivity of research.”²⁴

This leaves the attorney as the lone remaining agent with responsibilities for the disclosure process who has not yet been subjected to prophylactic rules affecting its professional structure or independence. To be sure, Sarbanes-Oxley did not ignore attorneys, but it was less certain about how to treat them. Section 307 authorizes the SEC to promulgate “minimum standards of professional conduct” for attorneys appearing or practicing before the SEC. In their statements in the Congressional Record, the Senate co-sponsors of section 307 clearly expressed their view that attorneys were at least as implicated as auditors and investment bankers in the financial and accounting irregularities that produced the collapses of Enron, WorldCom, et al.²⁵ Although the only specific reform mandated by section 307 was up-the-ladder reporting, the breadth of the

for an Honorable Profession, *N.Y. Times*, May 5, 2002, § 3, at 1 (concluding that major changes in the profession date from around 1996).

22. Professors Hong and Kubik find that optimism was more important than accuracy during the 1990s in predicting a security analyst’s advancement within the industry. Harrison Hong & Jeffrey D. Kubik, *Analyzing the Analysts: Career Concerns and Biased Earnings Forecasts*, 58 *J. Fin.* 313, 345–46 (2003); see also Roni Michaely & Kent L. Womack, *Conflict of Interest and the Credibility of Underwriter Analyst Recommendations*, 12 *Rev. Fin. Stud.* 653, 680 (1999) (finding that analysts employed by underwriting firms behaved differently—and less accurately—than independent analysts).

Another source of evidence is the marked shift in the ratio of buy to sell recommendations made by analysts; a study by Thompson Financial First Call found this ratio rose from 6:1 in 1990 to 100:1 in 2000. The same study further found that less than one percent of the 28,000 stock recommendations issued by brokerage firm analysts during late 1999 and most of 2000 were sell recommendations. See *Hearing on Analyzing the Analysts: Are Investors Getting Unbiased Research from Wall Street?: Hearing Before the House Subcomm. on Capital Mkts., Ins., and Gov’t-Sponsored Enters.*, 107th Cong. 1 (2001) (opening statement of Rep. Paul E. Kanjorski, Ranking Democratic Member) (discussing this study).

23. Section 201 of the Sarbanes-Oxley Act prohibits accounting firms from providing a variety of non-audit services to an audit client that is a publicly held company. This section of the Act has been codified as Section 10A(g) of the Securities Exchange Act of 1934. 15 U.S.C.A. 78j-1(g) (West Supp. 2003). The conflict of interest that arises when accounting firms offer both consulting and auditing services is discussed further *infra* at notes 31–32 and accompanying text.

24. See Sarbanes-Oxley Act § 501, which has been codified as a new section 15D to the Securities Exchange Act of 1934. 15 U.S.C. § 78o-6.

25. See *supra* note 1 and accompanying text.

phrase “minimum standards of professional conduct” sweeps far more broadly and easily could encompass other, potentially more extensive gatekeeping duties, at least to the extent that any such duty can be fairly characterized as a “minimum standard of professional conduct.”

The issue then is whether law is a sufficiently distinctive profession that attorneys should be treated differently from auditors and analysts, whose objectivity and independence Sarbanes-Oxley expressly sought to upgrade. Plausible arguments can, of course, always be made that every profession is different. Balanced against these attempts to distinguish the legal profession, however, is a countervailing consideration: Can investor confidence in our equity markets be restored without imposing on attorneys, the professionals typically having the principal role in the drafting of disclosure documents, some greater responsibility for protecting the integrity of the disclosure process? If not, the social cost of exempting attorneys from gatekeeping responsibilities would include a higher cost of equity capital for corporate issuers, more reliance upon debt and resulting higher corporate leverage, and reduced economic growth; all these potential costs are impossible to measure with any precision, but nonetheless their macroeconomic impact would be real and adverse.

III. CAN ATTORNEYS BE GATEKEEPERS?

How are attorneys different from more classic gatekeepers, such as auditors? Two differences are usually identified.

First, attorneys are not predominantly gatekeepers, as are, in theory, auditors and analysts. Rather, they play multiple roles with respect to the corporate client: (1) advocate; (2) transaction engineer; and (3) disclosure supervisor—or gatekeeper. Critics of the SEC’s proposed rules have been quick to assert that imposing gatekeeper-like duties on the attorney would compromise the attorney’s loyalty to the client, thereby subordinating the attorney’s primary role to the secondary role of gatekeeper.²⁶

Second, public policy has uniquely favored free and open communications between the attorney and the client, deeming them to be legally privileged in order to maximize the incentive for the client to communicate freely with the attorney. Once again, critics assert that such communications will “dry up” under the SEC’s proposed rules on noisy withdrawal, with the result that the end goal of law compliance could actually be impeded because of reduced communications.

A third and countervailing consideration must also be noted: The other principal gatekeepers are each regulated today by a public body that at least in theory seeks to protect the interests of the public. For example, after Sarbanes-Oxley, auditors are regulated by the Public Com-

26. For a good statement of this position, see Jill E. Fisch & Kenneth M. Rosen, *Is There a Role for Lawyers in Preventing Future Enrons?*, 48 *Vill. L. Rev.* (forthcoming 2003), available at http://papers.ssrn.com/sol3/delivery.cfm/SSRN_ID367661_code030213500.pdf?abstractid=367661 (on file with the *Columbia Law Review*).

pany Accounting Oversight Board (PCAOB), which is charged expressly with setting ethical standards for auditors,²⁷ while securities analysts are subject to regulation by the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE), as self-regulatory bodies monitored by the SEC, and by the SEC itself. Only attorneys stand apart, regulated by private state bar associations. Such guild-like regulation has little incentive to be aggressive, to fund enforcement, or to place the interests of the public above those of its members (as the SEC has complained).²⁸

A. *The Multiple Roles of Attorneys*

For the sake of argument, let us assume that business lawyers are primarily transaction engineers, who only secondarily oversee the disclosure process. How real is the conflict between these two roles? Unsurprisingly, it has long been the law that an attorney who knowingly files a false disclosure document with the SEC can be held liable by that agency as an “aider and abetter” of the primary violation by the corporate client.²⁹ Thus, some obligation to play a gatekeeper role already exists. The major difference between current law and a noisy withdrawal obligation is that today an attorney arguably could stand aside and not object when the issuer made a disclosure violation of which the attorney was aware but did not actively assist.³⁰ If a noisy withdrawal were mandated,

27. Section 101(a) of the Sarbanes-Oxley Act empowers the PCAOB “to oversee the audit of public companies that are subject to the securities laws . . . in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports.” 15 U.S.C.A. § 7211(a) (West Supp. 2003).

28. In his 2002 speech before the American Bar Association, then SEC Chairman Harvey Pitt expressed frustration over “the generally low level of effective responses we receive from state bar committees when we refer possible disciplinary proceedings to them.” Harvey L. Pitt, Remarks Before the Annual Meeting of the American Bar Association’s Business Law Section (Aug. 12, 2002), at <http://www.sec.gov/news/speech/spch579.htm> (on file with the *Columbia Law Review*). Criticism of state bar enforcement of ethical rules is not new. See, e.g., Geoffrey C. Hazard, Jr. & Deborah L. Rhode, *The Legal Profession: Responsibility and Regulation* 484–87 (2d ed. 1988) (“Disciplinary action is practically nonexistent in many jurisdictions . . .”).

29. See, e.g., *SEC v. Fehn*, 97 F.3d 1276 (9th Cir. 1996) (upholding SEC “aiding and abetting” action against an attorney).

30. In *In re Carter & Johnson*, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, 84,145 (Mar. 25, 1981), the SEC announced that a lawyer who is aware of serious and continuing violations of law by a corporate client has an obligation to “take[] prompt steps to end the cl[i]ent’s noncompliance.” However, the SEC retreated one year later from this aggressive stance when its general counsel indicated that in the future the Commission would exercise greater prosecutorial restraint in bringing administrative proceedings under SEC Rule 102(e) and would bring such proceedings generally only when a court had previously determined that the lawyer had violated the federal securities laws. See Edward F. Greene, *Lawyer Disciplinary Proceedings Before the Securities and Exchange Commission*, Remarks to the New York County Lawyers’ Association (Jan. 13, 1982), in 14 *Sec. Reg. & L. Rep.* 168 (1982). This position was later adopted by the Commission itself in *Disciplinary Proceedings Involving Professionals Appearing or Practicing Before the Commission*, Exchange Act Release No. 34-25893, 53 *Fed. Reg.*

however, at least some instances would arise in which the attorney could not remain passive without violating this rule. Thus, the conflict already exists, but, in fairness, it would be exacerbated by subjecting the attorney to gatekeeper duties.

Still, other professions also perform multiple roles—or at least did until recently. Immediately prior to the enactment of Sarbanes-Oxley, one survey found that the “Big Five” auditing firms received, on average, more than three times as much in consulting income from their audit clients as they received from them in audit fees.³¹ Obviously, this imbalance reduces the incentive of the auditor to detect or report violations of law if such conduct could cause the audit firm to forfeit even more lucrative consulting revenues.³² Economically then, the auditor had at least as much disincentive to blow the whistle on a major client.

Similarly, the securities analyst is an employee within a larger investment banking firm, whose compensation and advancement within the firm appears to correlate closely with publishing highly favorable and optimistic research about underwriting clients of the firm.³³ Again, the investment banking firm has multiple relationships with the corporate client that compromise the objectivity of its analysts’ recommendations.

Of course, Sarbanes-Oxley has restricted such conflicts in the case of the auditor and the analyst. Yet, precisely for this reason, reformers could logically propose a corresponding structural reform for the attorney: To prevent conflicts that compromise the attorney, a corporation might be required to use different counsel for “transaction engineering” tasks than it used for “gatekeeping responsibilities.” That is, the corporation could use one law firm to plan and structure a merger and another to handle all disclosure responsibilities pertaining to the merger.³⁴ To be

26,427 (July 13, 1988) (to be codified at 17 C.F.R. pt. 2a). The Commission’s retreat effectively ended SEC disciplinary actions against lawyers. See Robert W. Emerson, Rule 2(e) Revisited: SEC Disciplining of Attorneys Since *In Re Carter*, 29 Am. Bus. L.J. 156, 213 (1991) (noting that virtually all subsequent Rule 102(e) proceedings against lawyers were preceded by a federal court finding of a securities law violation).

31. See Janet Kidd Stewart & Andrew Countryman, Local Audit Conflicts Add Up: Consulting Deals, Hiring Practices in Question, Chi. Trib., Feb. 24, 2002, at C1 (surveying the one hundred largest corporations in the Chicago area in terms of how they compensated their auditors and the breakdown between audit and consulting fees). Probably, the focus should not be on the average ratio, but on the extreme cases. This study found one large corporate issuer (Motorola) that had more than a 16:1 ratio between the consulting fees and the audit fees it paid to its auditor. *Id.*

32. Even more importantly, the client could silently cancel or revoke consulting relationships and revenues if the auditor exhibited excessive integrity in resisting questionable accounting policies. In contrast, firing the auditor is a dangerous strategy because of SEC disclosure rules that permit the auditor to explain the nature of its disagreement with the client. See Coffee, *supra* note 20, at 1411–12.

33. See Hong & Kubik, *supra* note 22, at 345–46 (finding optimism appears to be more important than accuracy in predicting analyst’s advancement).

34. This proposal would require the “transaction engineer” law firm to review the disclosures prepared by the “gatekeeper” counsel and consult with the latter in order that the corporate management not be able to blind the gatekeeper, who would be less familiar

sure, this would involve costly duplicative and redundant work. But cost considerations are not necessarily dispositive. For example, in preventing the auditor from serving its client as a consultant, Sarbanes-Oxley may have also precluded the corporate client from similarly realizing cost-efficient synergies. The difference between the auditor and the attorney is then one of degree, not of kind. In all likelihood, the synergies in permitting one law firm to serve as both transaction engineer and disclosure counsel are greater than the synergies in permitting an auditor also to serve as a software consultant. Still, this is debatable on a case-by-case basis. In short, those who point to the multiple roles played by the attorney as a reason for not holding attorneys responsible as gatekeepers are making the same argument unsuccessfully made by auditors prior to Sarbanes-Oxley's severance of auditing from consulting. Possibly, a complete divorce of these multiple (and potentially conflicting) roles is less feasible in the case of attorneys, but if so, this may only suggest that other, less restrictive means of dealing with the same conflicts need to be found. As this Essay suggests, section 307 offers a path to this end.

In some respects, it may even be easier to impose gatekeeper obligations on the attorney than on the auditor. The individual audit partner often has a "one client" practice, at least when the audit partner serves a large firm (such as Enron). Lose that client, and the partner probably has no future with his or her firm. Although a "one client" practice is also possible in the case of partners in a law firm, this pattern has become far less common. General counsel have learned to move their legal business around to foster price competition among law firms; increasingly, recurring and/or less specialized activities are cheaper for the corporate client to internalize by moving such services "in house."³⁵ In short, because corporations make the same "make or buy" decision with respect to legal services as they do with respect to other commodities and services, the law firm partner has increasingly become a specialist—one with high reputational capital who markets his or her services to multiple clients (for example, the mergers and acquisitions or bankruptcy specialist who typically has a "one shot" relationship with the corporate client and then moves on to the next client). In contrast, neither the auditor nor the investment banking firm has the same "one shot," nonrecurring relationship with its corporate clients that law firms increasingly have. In overview, this "one shot" relationship is precisely the profile of the profes-

with the transaction. The "transaction" counsel would, of course, be subject to a duty to report up the ladder if it detected a material error and could not resolve the matter with disclosure counsel. Although this proposal is, of course, unlikely to be adopted because of its costs, it is intended primarily as a heuristic example of the type of reforms that follow once we recognize that attorneys sometimes perform a role functionally similar to that of auditors. The more practical alternative to use of dual counsel is attorney certification. See *infra* notes 50–55 and accompanying text.

35. For an overview of these developments, see generally Ronald J. Gilson, *The Devolution of the Legal Profession: A Demand Side Perspective*, 49 *Md. L. Rev.* 869 (1990).

sional who can best serve as a gatekeeper, because the professional remains more independent of the client and suffers less from a single client's dismissal.³⁶

Nonetheless, some argue that the attorney's mindset as an advocate for the client blinds the attorney to signs of illegality.³⁷ But this only begs the real question: Compared to whom? The auditor or the investment banker has little expertise in spotting or identifying violations of law, while the attorney is far more capable of detecting them. Although it may be true that the attorney does not want to find legal violations, why is that a defense? The more we suspect that attorneys will avert their gaze, the more we need to raise the penalties to deter them from so doing.

The claim that auditors make good gatekeepers and attorneys bad ones is also undercut by the limited empirical evidence. Since the passage of the Private Securities Law Reform Act in 1995, auditors have been under a statutory obligation to report to the SEC any material violations of law that they uncover in the course of their work for publicly held corporate clients.³⁸ The evidence to date suggests that they have reported such violations on very few occasions.³⁹ This could conceivably be read to mean that there have been very few such violations to report or, more realistically, that human beings predictably will rationalize and find

36. Yet for this same reason it becomes apparent that the corporation's general counsel is unlikely to make a satisfactory gatekeeper, because the inside general counsel has by definition a "one client" practice.

37. For the argument that there are cognitive constraints on the corporate attorney that cause the attorney to overlook fraud, see Donald C. Langevoort, *Where Were the Lawyers? A Behavioral Inquiry into Lawyers' Responsibility for Clients' Fraud*, 46 *Vand. L. Rev.* 75, 95 (1993).

38. Securities Exchange Act of 1934 § 10A(b), 15 U.S.C. § 78j-1(b)(1) (2000) (specifying steps that an independent public accountant must take when it "detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred"). Section 10A's coverage is far broader than that of the SEC's rules under section 307, because it requires the auditor to respond even to apparently immaterial illegal acts.

39. Richard Walker, then the Director of the SEC's Enforcement Division, told an American Institute of Certified Public Accountants (AICPA) National Conference in 1999 that the SEC had received fewer than a dozen Section 10A reports since that section was enacted as part of the PSLRA in 1995. Richard H. Walker, *Behind the Numbers of the SEC's Recent Financial Fraud Cases, Remarks Before the 27th Annual National AICPA Conference on Current SEC Developments* (Dec. 7, 1999), at <http://www.sec.gov/news/speech/speecharchive/1999/spch334.htm> (on file with the *Columbia Law Review*). Addressing the same conference a year later, Walker noted that his "concern remain[ed]. We have received only a handful of additional reports—fewer than five—during the past year." Richard H. Walker, *Remarks Before the AICPA National Conference on Current SEC Developments* (Dec. 5, 2000), at <http://www.sec.gov/news/speech/spch447.htm> (on file with the *Columbia Law Review*). Mr. Walker concluded that this low response rate suggested that auditors were "failing to fulfill their 10A responsibilities." *Id.*; see also Darin Bartholomew, *Is Silence Golden When It Comes to Auditing?*, 36 *J. Marshall L. Rev.* 57, 93-94 (2002) (giving specific examples of auditors' failures to report illegal acts according to their 10A obligations).

reasons for avoiding what is not in their self-interest to do. Both attorneys and auditors are subject to this same urge, and hence generalizing the obligation to report so that it applies to the attorney as well as the auditor increases the chance that material violations will come to light. Also, from a deterrence perspective, the corporate client may be more apprehensive that the attorney will report than that the auditor will, either because the attorney may be perceived as more law-abiding or because the attorney is simply better at spotting law violations.

B. *Attorney-Client Communications*

The most important argument against imposing gatekeeper obligations on securities attorneys is that attorneys may be less able to communicate freely with their clients if such obligations—and, in particular, a noisy withdrawal requirement—were imposed. In response to this claim, it is first necessary to recognize that the ultimate goal of the law is to achieve law compliance, not to maximize uninhibited communications between the attorney and the client. Client confidentiality is a means to an end, not an end in itself. Thus, the law has long placed some limitations on attorney-client communications (such as the crime/fraud exception).⁴⁰

Still, even with this concession, it remains true that lawyers can counsel most effectively when there is open, relatively unconstrained communication between their clients and themselves.⁴¹ Hence, the practical issue becomes whether gatekeeper obligations would necessarily chill desirable attorney-client communications. The stress here should be on the word “desirable.” What would be the likely impact of the SEC’s proposed noisy withdrawal standards on such communications? A starting point for this analysis should be the recognition that the client knows little law and will almost always want to know if contemplated action is illegal. From this premise, it follows that the corporate official contemplating prospective action will still inquire of counsel whether the course of action under consideration is lawful. Indeed, the more the government pursues white-collar criminal prosecutions and punitive regulatory actions in the contemporary post-Enron environment, the more likely it is

40. Some believe that prosecutors have already so expanded the “crime/fraud exception” to the attorney-client privilege in the corporate context as to make the existence of the privilege uncertain. See, e.g., David M. Zornow & Keith D. Krakaur, *On the Brink of a Brave New World: The Death of Privilege in Corporate Criminal Investigations*, 37 *Am. Crim. L. Rev.* 147, 153–58 (2000) (describing government efforts to get corporations under investigation to waive privilege). But see *In re Richard Roe, Inc.*, 168 F.3d 69, 71 (2d Cir. 1999) (defining crime/fraud exception more narrowly than prosecutors requested). Given this uncertainty, those who predict a sudden decrease in lawyer-client communications following the adoption of any noisy withdrawal rule have some obligation to explain why it has not already occurred.

41. See *Upjohn Co. v. United States*, 449 U.S. 383, 391–92 (1981) (recognizing the importance of candid dialogue between corporate officers and counsel in defining the scope of the attorney-client privilege).

that corporate officers will consult counsel before acting. When, then, will communications be most likely to be chilled? The logical answer is that the officer who has already acted may fear inquiring of an attorney if the officer's conduct was lawful—precisely because the officer fears that the attorney may be under an obligation to report unlawful actions to higher authorities or, indirectly, to the SEC. In short, it is the *ex post* inquiry by the client of the attorney that is most likely to be chilled.

If one accepts this premise that *ex ante* communications between counsel and the client are less likely to be chilled than *ex post* communications, several implications follow. First, the impact of imposing gatekeeper obligations on attorneys may be socially desirable. In a well-known article, Professors Kaplow and Shavell have argued that the case for protecting *ex ante* communications between attorneys and clients is far stronger than the case for protecting *ex post* communications.⁴² Advice before action leads individuals to comply with the law, they argue, whereas *ex post* advice does not provide a guide for action; rather, it may simply allow the defendant to discuss defense strategies and means of evasion, thereby reducing the expected penalty costs and encouraging illegality. It is not necessary to accept fully the Kaplow and Shavell analysis, which might limit the attorney-client privilege to *ex ante* advice, to see that its core distinction between *ex ante* and *ex post* advice suggests that we should be more concerned about chilling *ex ante* communications between attorney and client. Yet this is not what most gatekeeper obligations do; rather, they may induce such communications by making *ex post* advice less possible.

Second, requiring noisy withdrawals and up-the-ladder reporting also has a deterrent value that is independent of this issue of whether the initial corporate actor will still consult counsel. Few significant actions within a corporation can be taken by a single actor.⁴³ Decisions made by one person still need to be implemented by others. Thus, even after the initial corporate actor has taken an irrevocable step (and will thereafter be arguably less willing to consult with counsel *ex post*), other corporate actors must be convinced to cooperate with the initial actor. They will have every incentive to consult with counsel because they are still at the *ex ante* stage. In turn, knowledge that others are necessarily likely to learn of the original actor's conduct and then to consult with counsel about its legality may deter the original actor. The modern public corpo-

42. See Louis Kaplow & Steven Shavell, *Legal Advice About Information to Present in Litigation: Its Effects and Social Desirability*, 102 Harv. L. Rev. 565, 597-99 (1989) (suggesting *ex ante* advice promotes law compliance, while *ex post* advice does not); see also Richard A. Posner, *An Economic Approach to the Law of Evidence*, 51 Stan. L. Rev. 1477, 1531-33 (1999).

43. This point was made by Senator Corzine when he co-sponsored section 307. See *supra* note 1 and accompanying text. Within the modern corporation, lawyers are always being consulted by someone, and the fact that multiple actors consult them implies that a wrongdoer cannot anticipate that his or her own silence will prevent the organization's lawyers from learning of the conduct in question.

ration is embedded with in-house attorneys, and even the possibility that they will report up the ladder should deter some illegal conduct. Accordingly, even if under some conditions there may be less direct communication between corporate actors and counsel, the knowledge that sooner or later counsel is likely to learn *ex post* (because of the multiple parties likely to consult counsel) may still deter corporate actors *ex ante*.

Third, this *ex ante/ex post* distinction also helps clarify when exceptions may need to be created to any obligation on the part of the attorney to report out information relating to violations of the law. The ABA Task Force on Corporate Responsibility recommended this year that some legal roles should be exempted from any obligation to "report out" violations of law, including through a noisy withdrawal.⁴⁴ The clearest case arose, it said, when the lawyer "has been engaged by the organization to investigate whether an organizational constituent has committed a material violation of law or a breach of duty to the organization."⁴⁵ This setting of internal corporate investigations is, of course, precisely the *ex post* context. When the corporation's lawyer is functioning in this capacity, the ABA Task Force concluded that the corporation "has an especially compelling need for the ground rules of that investigation to promote open and frank communications between the investigating lawyer and organizational constituents."⁴⁶ The ABA Task Force may well be right that greater confidentiality is needed in these circumstances and that a carefully crafted exemption should apply to internal corporate investigations. But to reach this conclusion is in essence to accept the *ex ante/ex post* distinction and concede that *ex ante* communications are less likely to be chilled by a limited obligation to report out.

Finally and most importantly, the principal practical effect of imposing gatekeeper obligations on attorneys is that a client who has been advised by an attorney that contemplated action is unlawful now has greater reason to heed that attorney's advice—again precisely to the extent that the client believes that the attorney may be under a legal obligation to report material misconduct (either within the corporation or outside to the SEC). Thus, even if it were true that clients would consult their lawyers less often, this impact could be more than fully offset by the fact that it would become more dangerous to disregard the lawyers' advice. Add to this mix the likelihood that *ex ante* advice will not be chilled, and the net impact is to increase the attorney's leverage over the client by making it more dangerous to ignore the attorney's advice. If law compliance is the goal, such an impact seems socially desirable. Put simply, the logical remedy for gatekeeper failure is to empower the gatekeeper, and a noisy

44. See ABA Task Force on Corporate Governance, *supra* note 6, at 59–60.

45. *Id.* at 59.

46. *Id.* The ABA Task Force also recommended that a lawyer defending the corporation against criminal or civil charges be similarly exempted. A lawyer operating in this capacity is, of course, a classic advocate and probably should not be expected to perform a gatekeeping role.

withdrawal obligation makes it more costly for the client to ignore the lawyer.

IV. IMPLEMENTING THE GATEKEEPER ROLE OF ATTORNEYS

Although the debate over section 307 to date has been dominated by the issue of noisy withdrawal, the scope of section 307 is far broader. What else can or should the SEC do to make the attorney an effective guardian of the integrity of publicly filed disclosure documents (without imposing obligations that subordinate the attorney's duty of loyalty to the client to this mission)? This Essay will make three proposals: (1) a due diligence obligation; (2) an independence requirement; and (3) an attorney certification requirement. Each is premised on A.A. Sommer's normative claim that the securities attorney must behave in some respects less like an advocate and more like an auditor,⁴⁷ but each proposal also recognizes that the attorney cannot undertake an obligation to audit its client.

A. *The Due Diligence Obligation*

Few norms are less controversial among securities attorneys than that they should perform some due diligence in preparing prospectuses or other disclosure documents. Yet no SEC rule actually requires this. Thus, a logical first step would be for the SEC's Rules of Practice to mandate due diligence by the attorney (within the time realistically available) in the preparation of disclosure documents. Indeed, such an obligation sounds very much like a "minimum standard of professional conduct" that section 307 authorizes. Why? Because it is semantically impossible to assert that an attorney who has behaved in a grossly negligent fashion has behaved "professionally." Interestingly, in its existing Rules of Practice, the SEC already holds auditors to precisely such a standard and asserts the power to suspend or disbar them for merely negligent conduct.⁴⁸ If this can be done, then it seems to follow a fortiori, after the enactment of section 307, that the SEC could require attorneys to take reasonable steps to investigate the accuracy of statements made in documents that they prepare.⁴⁹ The impact of such a rule is to give fair notice

47. See *supra* note 16 and accompanying text.

48. See 17 C.F.R. § 201.102(e)(iv) (2002) (specifying that two forms of "negligent conduct"—either "[a] single instance of highly unreasonable conduct" or "[r]epeated instances of unreasonable conduct"—could trigger sanctions under Rule 102(e)).

49. The attorney would, of course, be entitled to rely on the auditor with respect to financial information certified by the auditor, as in the case of the "reliance on an expert" defense under section 11(b)(3)(C) of the Securities Act of 1933. 15 U.S.C. § 77(k)(b)(3)(C) (2000). In addition, such a rule would not require the attorney to verify or corroborate every material fact in the disclosure document, but only to take reasonable steps to seek corroboration of facts or claims that otherwise seem unsupported or suspicious. In many cases, a certification by an appropriate corporate officer could satisfy the obligation (if the officer had personal knowledge).

to the attorney that he or she cannot simply rely on the client's assertions, but must perform at least some minimal examination to corroborate those assertions, whose depth and intensity would basically be determined by the profession's own norms and standards.

By no means is it here suggested that negligence should support a private cause of action under Rule 10b-5 against attorneys (or others).⁵⁰ But negligence is improper professional conduct, which should in appropriate cases justify the imposition of sanctions under section 307.⁵¹ Such a tradeoff—i.e., public liability but not private liability for negligence—again seems desirable in that it enhances deterrence without threatening insolvency for law firms.

B. Independence

Auditors, of course, must be independent of their client, and SEC rules have long defined tests for auditor independence. Increasingly, a new literature has warned that attorneys are becoming too economically intertwined with their clients, as a result, in part, of the increasing practice of law firms taking (and even demanding) equity stakes in the client in return for professional services.⁵² If some level of independence is necessary for an attorney to function as a gatekeeper (as A.A. Sommer, Jr. recognized over a quarter century ago), SEC rules of professional conduct could define these limits. To illustrate, a law firm that holds in its portfolio ten percent of the corporate client's equity (or, alternatively, equity in the client equal to ten percent of its own net asset value) will probably be a poor, or at least a biased, monitor.

Perhaps the context that is most sensitive and would most benefit from such rules is that of internal corporate investigations. Should the corporation's normal outside counsel perform such an investigation? Or should SEC rules define the level of independence necessary to conduct such a sensitive inquiry? Absent SEC action, individual state bar associations will either do nothing (the most likely outcome) or prescribe differ-

50. Not only will negligence not be sufficient to support an action under Rule 10b-5, see *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) (requiring scienter), but the SEC's Rules of Practice, which section 307 addresses only in terms of authorizing additional SEC rulemaking, would not under existing precedents give rise to a private cause of action. See *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575-76 (1979) (declining to imply private cause of action under section 17(a) of Securities Exchange Act of 1934).

51. Historically, the SEC did once hold attorneys liable for professional negligence in "aiding and abetting" cases. See, e.g., *SEC v. Spectrum Ltd.*, 489 F.2d 535, 542 (2d Cir. 1973). This has no longer been possible since the Supreme Court mandated a scienter standard in *Ernst & Ernst*, 425 U.S. at 193, but sanctions for professional misconduct could look to a similar negligence standard.

52. See John S. Dzienkowski & Robert J. Peroni, *The Decline in Lawyer Independence: Lawyer Equity Investments in Clients*, 81 *Tex. L. Rev.* 405, 408-10 (2002); see also Royce de R. Barondes, *Professionalism Consequences of Law Firm Investments in Clients: An Empirical Assessment*, 39 *Am. Bus. L.J.* 379, 380 (2002).

ent and inconsistent standards, thereby creating needless disparities. Uniform standards for corporate internal investigations are desirable and as a practical matter can come only from the SEC. There is no need to offer precise rules here, only to recognize that professionals are expected to be independent of their clients. Accordingly, the SEC should read section 307 to grant it authority to define the point at which the attorney is not sufficiently independent of the client to perform certain sensitive tasks.

C. *Attorney Certification*

Today, the auditor certifies the firm's financial results, and under Sarbanes-Oxley, senior management certifies that the financial information in periodic reports filed with the SEC "fairly presents in all material respects" the firm's financial condition and results of operations.⁵³ Even the securities analyst must now certify that its recommendations reflect the analyst's own personal views.⁵⁴ Alone, the attorney escapes and need not certify in any way as to the accuracy of the client's disclosures. Yet, traditionally, the attorney is the field marshal of the disclosure process. More importantly, because the auditor's certificate covers only the financial statements that it reviews, no independent professional today expresses any view that the statements made in the textual portions of a Form 10-K or a registration statement are correct or have at least been subjected to a reasonable "due diligence" examination by the professional. Yet increasingly, the most important statements made by a corporate issuer are those set forth in its "Management's Discussion and Analysis of Financial Condition and Results of Operations" (MD&A).⁵⁵ If after the Enron-era scandals we are concerned about the quality and reliability of the financial disclosures reaching the market, one of the most obvious, logical, and necessary steps would be to insert a gatekeeper into the disclosure process at exactly this stage and require some professional vetting of the issuer's textual statements.

Still, there remains a problem with this proposal that requires it to be downsized significantly. Put simply, what can the attorney reasonably be asked to certify? After all, the attorney has not audited the client; nor is a law firm organizationally or logistically equipped for any form of inquiry analogous to an audit. Nonetheless, a less onerous form of certification

53. Both sections 302 and 906 of the Sarbanes-Oxley Act require certifications by both a covered corporation's chief executive officer and chief financial officer that the "financial information included in the report . . . fairly present in all material respects the financial condition and results of operations of the issuer . . ." 15 U.S.C.A. § 7241(a)(3) (West Supp. 2003). Section 906 has been codified as part of the federal criminal code and carries up to a twenty-year sentence. 18 U.S.C.A. § 1350.

54. See Regulation Analyst Certification, Securities Act Release No. 33-8186, 17 C.F.R. § 242 (2003); see also Andrew Countryman, SEC Adopts New Rule on Analyst Assurance, *Chi. Trib.*, Feb. 7, 2003, at N3 (discussing Regulation AC).

55. See Item 303 of Regulation S-K. 17 C.F.R. § 229.303.

seems possible. Based on the opinions normally delivered by attorneys in registered offerings in the securities market, it would seem justifiable to ask the attorney principally responsible for preparing a disclosure document or report filed with the SEC to certify: (1) that such attorney believes the statements made in the document or report to be true and correct in all material respects; and (2) that such attorney is not aware of any additional material information whose disclosure is necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.⁵⁶

In essence, this proposed certification simply tracks the language of Rule 10b-5. Far from intruding significantly into the marketplace, this obligation only generalizes existing practices in the private market. Today, in most public underwritten offerings, issuer's counsel delivers an opinion to the underwriters—sometimes called a “negative assurance” opinion—stating that it is not “aware” of any material information required to be disclosed that has not been disclosed.⁵⁷ In this light, such a negative certification requirement would simply mandate for 1934 Act periodic filings what is already done by the private issuers in the primary market for 1933 Act disclosure documents. The marginal difference is

56. Issues could arise as to which attorney was principally responsible for preparing a document. The simplest answer to this issue is to require the corporation to disclose the identity of such attorney in the filing and then require that attorney's certification. The real thrust of this proposal is to require the issuer to subject its principal disclosure documents to the review of an attorney who would be subject to SEC sanctions for professional negligence. This author would not require the attorney to be an outside counsel (although others might think that such an additional requirement was also justified).

57. For a description of this standard opinion in registered public offerings, see Richard R. Howe, *The Duties and Liabilities of Attorneys in Rendering Legal Opinions*, 1989 Colum. Bus. L. Rev. 283, 287. Mr. Howe, a partner at the New York firm of Sullivan & Cromwell, properly observes that “such opinions are not really ‘legal opinions’ at all in that they do not state any legal conclusion but only say that the attorney believes certain facts to be true.” *Id.* Precisely for this reason, such an opinion is more a pledge of the law firm's reputational capital, which the underwriters demand. The counsel giving such opinion does not purport to conclude that all information required to be disclosed has been disclosed (as an auditor might by analogy), but only that it lacks personal knowledge or belief as to any such failure. See also Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 Yale L.J. 239, 291 (1984) (also describing such opinions); Richard W. Painter, *Toward a Market for Lawyer Disclosure Services: In Search of Optimal Whistleblowing Rules*, 63 Geo. Wash. L. Rev. 221, 226–27 & n.19 (1995) (discussing judicial interpretation of such opinions). The American Bar Association has characterized this type of opinion as a “negative assurance” and finds such opinions to be “unique to securities offerings.” See ABA Comm'n on Legal Opinions, *Third-Party Legal Opinion Report, Including the Legal Opinion Accord*, of the Section of Business Law, 47 Bus. Law. 167, 228 (1991). Although the ABA considers it generally inappropriate for attorneys to request such “negative assurance” opinions from other attorneys, the special context of securities offerings is exempted, reflecting the fact that underwriters consider such an assurance to be necessary to them. That the ABA, as the representative of the bar, “disfavors” such opinions because of the demands they place on the attorney probably only underscores their value.

that, in the case of periodic filings under the Securities Exchange Act, there is no private party in a position analogous to the underwriter who can demand such an opinion or certification from the attorney. SEC action would fill this void. The one respect in which this proposal does change current practice is that it would require that some attorney—whether inside or outside the corporation—assume responsibility for supervising the preparation of the disclosure document.⁵⁸ Thus, it effectively requires the involvement of a gatekeeper and precludes internal corporate personnel from filing a Form 10-K or Form 10-Q without some review by counsel.

Beyond this structural value, such a requirement would have a profound symbolic and psychological effect on the bar because it would establish the attorney's obligations as a gatekeeper. Potentially, the SEC could go even further and require the certifying attorney responsible for the disclosure document to certify that the attorney believed adequate disclosure had been made "after making such inquiry that the attorney reasonably believed appropriate in the circumstance." This would integrate the certification requirement with the earlier discussed due diligence obligation. As here proposed, either in-house counsel or an outside attorney could provide such certification, but either would be subject to a due diligence obligation.

Admittedly, limits need to be recognized on what an attorney can certify. Because the attorney does not audit its client, the attorney should not be asked to certify the accuracy and completeness of all information disclosed in SEC filings. Thus, the proposal here made requires only a negative certification that the attorney had no reason to believe, and did not believe, that the information was materially false or misleading. Legally, such a certification would trigger "aiding and abetting" liability that the SEC could enforce if the attorney knew of the materially false or misleading information,⁵⁹ and it could even trigger criminal liability under various federal statutes.⁶⁰ But its primary effect is to mandate that an

58. A major question surrounds whether this certification should be given by an inside counsel, such as the general counsel, or an independent outside firm. As noted earlier, the general counsel has a "one client" practice and thus does not make a natural gatekeeper. See *supra* note 36 and accompanying text. On the other hand, requiring use of an outside law firm will increase the costs of compliance with SEC disclosure requirements for many corporations.

59. As part of the Private Securities Litigation Reform Act of 1995, section 20(e) was added to the Securities Exchange Act of 1934 to expressly authorize the SEC to sue "any person that knowingly provides substantial assistance to another person in violation of a provision of this chapter, or of any rule or regulation issued under this chapter." 15 U.S.C. § 78t(e) (2000). Thus, although private persons cannot sue an aider and abetter, the SEC can.

60. The attorney can be held criminally liable under the federal "aiding and abetting" statute, 18 U.S.C. § 2 (2000). Or, the attorney could be held liable for securities fraud because now the attorney has made his or her own "attributed statement." Under the *Central Bank* decision, a secondary participant can be held liable—both civilly and criminally—for the statements that it makes itself. See *Cent. Bank of Denver, N.A. v. First*

attorney serve as a gatekeeper for investors with respect to important disclosure documents.

Still other rules may be desirable, dealing with more specific problems.⁶¹ This discussion has not been intended to be exhaustive or to offer precise rules, but rather to advance a more general proposition: To the extent that the quality of disclosure declined in the 1990s, the most logical response is to identify a gatekeeper who can be asked to play a more active role in monitoring the issuer's disclosures. This is not a role that attorneys will want to play because it does impose costs on them, but it is a role they may be obliged to play because the social costs of allowing them to escape responsibility are even higher.

Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994) (stating that any "lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or 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").

61. An example of additional standards of professional conduct that the SEC might adopt involves the ongoing controversy over "pay-to-play" in securities class actions. Plaintiffs' firms that specialize in securities class actions increasingly make political contributions to elected state and municipal officials, usually controllers, who have discretionary control over public pension funds, in order that they can use the pension funds as "lead plaintiffs" to win the lucrative position of class counsel. Under the Private Securities Litigation Reform Act of 1995, the plaintiff with the largest stake in the action is made the presumptive lead plaintiff and is entitled to choose class counsel. See section 21D(a)(3) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-4(a)(3)(B). Normally, public pension funds are the largest investor willing to assume this role, and one motivation for their doing so is the elected state official's desire to obtain political contributions. This problem has been noted by courts, journalists, and student law review notes. See, e.g., *In re Cendant Corp. Litig.*, 264 F.3d 201, 270 n.49 (3d Cir. 2001); Malcolm P. Heinicke, Note, *The ABA Should Not Delay on Pay-to-Play: Regulating the Political Contributions of Lawyers to Government Officials Who Award Legal Contracts*, 49 *Stan. L. Rev.* 1523 (1997); Kevin McCoy, *Campaign Contributions or Conflicts of Interest?*, *USA Today*, Sept. 11, 2001, at B1. The injury to investors is either that the lead plaintiff will pick an inferior class counsel or, more likely, acquiesce in excessive counsel fees. Arguably, the SEC could bar attorneys or firms that make such contributions from representing the pension fund for a one or two year period thereafter. The SEC long ago adopted such a prophylactic rule in the case of investment bankers who make political contributions in order to obtain managing underwriter status for municipal bond offerings. In the mid-1990s, the Municipal Securities Rulemaking Board adopted Rule G-37, which bars a broker-dealer firm that has made such contributions from acting as an underwriter for the jurisdiction's bonds for a defined period. See *Self-Regulating Organizations; Order Approving Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Consultants*, Securities Exchange Act Release No. 34-36727, 61 *Fed. Reg.* 1955 (Jan. 24, 1996); see generally Jon B. Jordan, *The Regulation of Pay-to-Play and the Influence of Political Contributions in the Municipal Securities Industry*, 1999 *Colum. Bus. L. Rev.* 489. Presumably, what is unethical for investment bankers is also unethical for lawyers, and a similar rationale would justify a similar rule. Still, a jurisdictional issue arises here as to whether the securities class action plaintiff's lawyer is "appearing" or "practicing" before the Commission, as required under section 307 before the SEC obtains jurisdiction, when the attorney litigates a securities class action in federal court.

CONCLUSION

This Essay has moved from the diagnosis that gatekeepers failed investors during the late 1990s to the prescription that, in order to align the gatekeepers' incentives with those of investors, two strategies need to be pursued: deterrence and empowerment. Deterrence is easy, but empowerment is more complex. The latter requires new aspirational duties and new ethical standards, even if they will be only rarely enforced. Today, it is not only anomalous but irrational that the auditor and analyst are closely regulated and required to certify, while the attorney is not.

Although this Essay by no means advocates the federalization of most professional rules of ethics applicable to securities attorneys, it does recognize that guild-like regulation by state bar associations will not establish meaningful gatekeeping standards for securities attorneys. Indeed, bar association enforcement of ethical rules has never deterred, and probably will never deter, the bar. The blunt truth is that private self-regulation of attorneys through bar associations means the continued government of the guild, by the guild, and for the guild. Unless relatively uniform norms are clearly established, gatekeeper failure is likely to remain the prevailing pattern because the client's inevitable pressure on the gatekeeper is not matched by countervailing regulatory pressure. SEC rules thus offer the best prospect for a relevant, precise response that avoids pointless disparity while clearly notifying securities attorneys that—like it or not—they are gatekeepers.

To paraphrase Clemenceau, professions are too important to be left to the professionals.