BNA, INC.

SECURITIES REGULATION & LAW

BNA Employee-Owned Since 1947

REPORT

SEC ENFORCEMENT

Lawyer Liability: Why The SEC Should Clarify Its Recent *Ira Weiss* Decision

BY MITCHELL E. HERR AND STEPHEN P. WARREN

For the last 25 years, the Securities and Exchange Commission has been exceedingly cautious about bringing actions challenging attorneys' legal advice and has repeatedly affirmed that it will not proceed against attorneys for mere professional negligence. Indeed, there has been a broad consensus that it would be an inappropriate exercise of its prosecutorial discretion for the SEC to do so. This consensus is grounded in the concern that suing securities attorneys for mere professional negligence would chill their exercise of independent judgment and cause them to pay undue attention to their self-preservation as they resolve the close questions of professional judgment that are their daily fare.

However, the SEC's recent decision in *In re Ira Weiss*[1] has the potential to create considerable confusion about whether the SEC has reversed course and now intends to sue securities lawyers whose mere professional negligence results in violations of the federal securities laws. If the SEC did not intend to reverse its course of the last 25 years—and presumably it did not—it should issue a formal Policy Statement clarifying its intent. In the absence of such a clarification, the *Ira Weiss* decision is bound to cause mischief in the SEC's enforcement program.

Historically, the SEC Has Not Sued Lawyers For Mere Professional Negligence. Any discussion of the SEC's enforcement policy towards securities lawyers must start with its seminal 1981 decision in *Carter and Johnson*.[2] There, the SEC reversed an initial decision by an Administrative Law Judge ("ALJ") that sanctioned two attorneys under former SEC Rule of Practice 2(e)[3] for aiding and abetting their client's violations of the federal securities laws by failing to correct misstatements contained in its press releases and SEC filings. In absolving the attorneys, the SEC made clear that it did not intend to sanction lawyers who make negligent errors in counseling their clients, even if those errors lead to, or fail to prevent, securities violations:

> If a securities lawyer is to bring his best independent judgment to bear on a disclosure problem, he must have the freedom to make innocent—or even, in certain cases,

[1] 2005 WL 3273381 (Dec. 2, 2005).

Mitchell E. Herr is a Holland & Knight LLP partner who concentrates his practice exclusively in securities litigation, with an emphasis on the defense of regulatory matters. Prior to joining Holland & Knight, Mr. Herr served as the chief trial counsel for the SEC's Southeast Regional Office. Stephen P. Warren is an associate in Holland & Knight's litigation department, where he focuses primarily on federal securities fraud litigation.

[2] 1981 WL 384414 (Feb. 28, 1981).

[3] Now SEC Rule of Practice 102(e), 17 C.F.R. § 201.102(e).

careless—mistakes without fear of legal liability or loss of the ability to practice before the Commission.[4]

Over the years, the SEC, its Commissioners and its General Counsel have reiterated this policy.[5] For instance, in 1996, SEC Commissioner Norman Johnson stated that the *Carter and Johnson* decision ''viewed the practice of law as to allow even negligence, as necessary to accomplish the Commission's larger purposes.''[6] As recently as April 2005, SEC General Counsel Giovanni Prezioso stated that ''the Commission ordinarily will not sanction lawyers under the securities laws merely for giving bad advice, even if that advice is negligent and perhaps worse.''[7]

Even the SEC's Recent Cases Against Lawyers Were Not Grounded in Negligence. In September 2004, the Director of the SEC's Division of Enforcement warned that the SEC would target lawyer ''gatekeepers'' in its enforcement investigations:

> [P]ursuing gatekeepers [is] the most targeted and effective way of using the agency's limited enforcement resources. . . . Consistent with Sarbanes-Oxley's focus on the important role of lawyers as gatekeepers, we have stepped up our scrutiny of the role of lawyers in the corporate frauds we investigate.[8]

Since that speech, the SEC has brought a number of settled enforcement proceedings against attorneys based on their performance as lawyers.[9] Most of these cases were brought against in-house general counsel of public companies who allegedly aided and abetted their company's securities violations.[10] Because aiding and abetting liability requires an actual awareness of improper conduct,[11] these cases are not grounded in mere professional negligence.[12]

Additionally, the SEC recently brought two widely reported settled cease-and-desist proceedings against attorneys that were not based on aiding and abetting. In both cases, the SEC charged general counsel with ''causing'' their company's violations of the securities laws. Although mere negligence can sustain a ''causing'' charge, neither of these two cases was grounded in professional negligence.

The wording that the SEC used in its opinion may leave the Staff with the impression that they have the authority to investigate attorneys who they suspect gave negligent legal advice resulting in a violation of the securities laws.

In the first case, *In re Isselmann*,[13] a corporate general counsel was charged with ''causing'' his client to file an inaccurate quarterly report. The company's disclosure committee had considered a quarterly filing that reflected cost savings from terminating vested retirement and severance benefits belonging to employees in Asia, but the general counsel had received legal advice that these benefits could not legally be terminated. Not only did the general counsel fail to speak up at the disclosure committee meeting and fail to reveal this advice in response to an audit committee member's questions, but he signed the quarterly filing improperly reflecting these savings. Thus, the SEC's enforcement proceeding in *Isselmann* is based on the general counsel's actions and omissions in the face of actual knowledge, and not on mere negligence in rendering legal advice.

In the second case, *Google, Inc. and David C. Drummond*,[14] Google's general counsel was charged with ''causing'' Google's violation of the registration provisions of the securities laws. While the SEC's rules exempt only the issuance of $5 million of stock options during a twelve-month period, Google issued over $80 million of unregistered stock options to its employees. On two occasions, Google's general counsel recommended that the board of directors continue issuing such options, but failed to disclose the legal basis for, and risks attendant upon, continuing to issue such options. Senior SEC Staff have since made it clear that the SEC charged the general counsel because, in failing to give nothing more than his bottom-line conclusion to his client, the general counsel stepped out of his role as legal advisor to the company and became a corporate actor responsible for causing his company's violation.[15]

---

[4] *Carter and Johnson*, 1981 WL 384414, at *25.

[5] *See, e.g.*, Edward F. Greene (former SEC General Counsel), *Lawyer Disciplinary Proceedings Before the Securities and Exchange Commission*, Speech Before the New York County Lawyers' Association (Jan. 13, 1982), in Federal Securities Law Reporter, CCH ¶ 83,089 (promising restraint in proceeding against attorneys).

[6] Norman S. Johnson, Speech before the American Bar Ass'n Fed. Sec. Law Comm. (Nov. 8, 1996), at 4, available at http://www.sec.gov/news/speech/speecharchive/1996/spch137.txt.

[7] Giovanni P. Prezioso, Remarks before the Spring Meeting of the Ass'n of General Counsel (April 28, 2005), at 5, available at http://www.sec.gov./news/speech/spch042805gpp.htm.

[8] Stephen M. Cutler, Speech before the UCLA School of Law (Sept. 20, 2004), at 4-5, available at http://www.sec.gov/news/speech/spch092004smc.htm.

[9] The SEC has also brought a number of cases against securities laws violators who happened to be lawyers. *See, e.g.*, *SEC v. Shlansky*, SEC Litigation Release No. 19332 (Aug. 10, 2005) (announcing settled insider trading charges against attorney). However, these cases do not implicate the policy concerns at play when a lawyer is charged with respect to the performance of his professional duties.

[10] *See, e.g.*, *SEC v. Woghin*, SEC Litigation Release No. 18891 (Sept. 22, 2004), *In re Stanley P. Silverstein*, SEC Litigation Release No. 49676 (May 11, 2004), *In re Jonathan B. Orlick*, SEC Litigation Release No. 51081 (Jan. 26, 2005), *In re Leonard Goldner*, SEC Litigation Release No. 53375 (Feb. 27, 2006), *SEC v. Ferguson*, SEC Litigation Release No. 19552 (Feb. 2, 2006).

[11] *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004).

[12] Another important principle of aiding and abetting liability is that the accused aider-and-abettor must ''associate himself with the venture, that he participate in it as something that he wishes to bring about, [and] that he seek by his action to make it succeed.'' *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 36 (D.C. Cir. 1987) (*quoting Nye & Nissen v. United States*, 336 U.S. 613, 619 (1949) (citations omitted)).

[13] Release No. 50428 (Sept. 23, 2004).

[14] Release No. 8523 (Jan. 13, 2005).

[15] For example, in discussing the *Drummond* proceeding, SEC General Counsel Prezioso cautioned that ''the lawyer's continuing participation in the activity without providing advice to others may, in some cases, constitute part of a course of conduct that effectively makes the ultimate business deci-

  SRLR ISSN 0037-0665

In contrast to the facts in the *Drummond* proceeding, bond attorney Ira Weiss was sued by the SEC for acting in a purely legal advisory role. Indeed, the SEC ultimately found that he had violated the securities laws by merely issuing an incorrect legal opinion. Moreover, the SEC did not find that Weiss knew his legal opinion was incorrect at the time he issued it, thus distinguishing the *Isselmann* decision. It is for these reasons that the *Ira Weiss* decision warrants closer scrutiny.

The *Ira Weiss* Decision. Ira Weiss, a seasoned bond counsel, was sued by the SEC for legal work that he performed in connection with a tax-exempt municipal bond offering by a Pennsylvania school district. Weiss had issued an unqualified legal opinion that the bonds had been validly issued and that the interest payable on the bonds would be exempt from the federal income tax. The IRS later determined, however, that the interest was, in fact, taxable.[16]

In April 2004, the SEC commenced administrative proceedings against Weiss for allegedly violating, and causing the School District to violate, Section 17(a) of the Securities Act of 1933 (''Securities Act'') and Section 10(b) of the Securities Exchange Act of 1934 (''Exchange Act'').[17] The charging document (or ''Order Instituting Proceedings'') alleged that Weiss had ''knowingly or recklessly'' issued his unqualified legal opinion in the face of information casting substantial doubt on the tax-exempt status of the offering.[18] Weiss contested the SEC's charges.[19]

Following a four-day hearing, an ALJ dismissed all of the charges against Weiss. The ALJ concluded that Weiss had not violated the securities laws because he had ''acted with the requisite standard of care''[20] and had not caused the School District to violate the securities laws.[21] The SEC Staff appealed the ALJ's decision to the Commission of the SEC, arguing that Weiss had violated both Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act.

In December 2005, the SEC in effect reversed the ALJ's dismissal[22] and found that Weiss had violated the federal securities laws when he issued his unqualified legal opinion. Notably, the SEC Staff had urged the SEC to find Weiss liable under Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act, both of which require proof of intentional or, at a minimum, reckless conduct.[23] However, the SEC grounded its opinion solely on Sections 17(a)(2) and 17(a)(3) of the Securities Act, which do not require proof of intentional or reckless conduct. Under these sections, mere negligence suffices to establish a violation. Indeed, on multiple occasions in its opinion, the SEC remarked that Weiss's conduct was ''at least negligent'' and that Weiss's conduct had ''departed from the standard of reasonable prudence.''[24] The SEC could not cite any legal precedent for holding an attorney liable for violating the securities laws through mere professional negligence.[25] Based on its finding that Weiss was ''at least negligent,'' the SEC determined that he committed primary violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, ordered him to cease and desist from committing or causing similar violations in the future, and to disgorge his $9,509.63 legal fee, plus prejudgment interest.[26] Curiously, the SEC did not address, or even mention, the Staff's contention that Weiss had violated Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act.

The SEC Should Clarify the Intent of Its *Ira Weiss* Opinion. At first blush, an observer might conclude from reading the *Ira Weiss* decision that it represents a sharp break with the SEC's well-established enforcement policy towards attorneys. It is not at all clear, however, that this would be an accurate conclusion. Although *Ira Weiss* arguably gives the SEC Staff a precedential basis for investigating and commencing enforcement actions against attorneys whose mere professional negligence results in a violation of the securities laws, the language used in *Ira Weiss* may simply be the product of compromise and may not reflect an intent to change the Commission's enforcement program.

First, the fact that the *Ira Weiss* opinion repeatedly states that his conduct was ''at least negligent'' leaves open the possibility that at least some of the Commissioners believed that Weiss acted recklessly. Second, if the SEC had intended to depart from its 25-year policy of not pursuing enforcement actions against attorneys for professional negligence, it chose an odd platform to announce such a seismic shift in policy. The bond counsel community is a highly specialized subset of the securities bar. Predictably, the *Ira Weiss* decision has received scant attention from the mainstream securities press. Indeed, the only legal periodical which has covered the *Ira Weiss* proceedings in any depth is *The Bond Buyer*, a daily newspaper serving the municipal finance industry. Finally, senior enforcement officials from the SEC's Office of Municipal Finance responsible for investigating and prosecuting *Ira Weiss* have repeatedly reassured the municipal finance bar that they do

---

sion for the company.'' Giovanni P. Prezioso, Remarks before the Spring Meeting of the Ass'n of General Counsel (April 28, 2005), available at http://www.sec.gov/news/speech/spch042805gpp.htm.

[16] *In re Ira Weiss*, 2005 WL 3273381, at *11-12 (Dec. 2, 2005).

[17] *In re Ira Weiss*, 2004 WL 877632, at *1 (April 24, 2004).

[18] *Id.*

[19] *In re Ira Weiss*, 2005 WL 454017 (Feb. 25, 2005).

[20] *Id.* at *14.

[21] *Id.* at *20.

[22] On appeal from an ALJ's Initial Decision, the SEC conducts an independent *de novo* review of the evidentiary record. If the SEC does not agree with the ALJ's decision, the SEC issues its own decision and the ALJ's Initial Decision is effectively revoked.

[23] Recklessness is defined as ''an extreme departure from the standards of ordinary care . . . present[ing] a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it.'' *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1044-45 (7th Cir. 1977).

[24] *Weiss*, 2005 WL 3273381, at *13-14.

[25] Instead, the SEC cited a single non-precedential settled action (*In re Constanza*, 1999 WL 7695 (Jan. 6, 1999)). *Id.* at n.39. The SEC has been clear that settled orders have ''little, if any, precedential weight.'' *In re Shipley*, 1974 WL 161761, at *2 n.6 (June 21, 1974). The non-precedential status of settled orders reflects the fact that, as negotiated compromises, they may not articulate supportable legal positions.

[26] *Weiss*, 2005 WL 3273381, at *16-17. Weiss has appealed the SEC's decision to the U.S. Court of Appeals for the District of Columbia. He is due to file his opening brief on May 30, 2006.

not intend to pursue bond attorneys for mere professional negligence.[27]

If the SEC intends to investigate and prosecute attorney negligence that results in securities violations, that is a matter of grave concern to the securities bar, and the SEC should clearly state that intent.

All of these factors suggest that the SEC did not intend in *Ira Weiss* to reverse its enforcement policy of the last 25 years with respect to attorneys. Nevertheless, the wording that the SEC used in its opinion (*i.e.,* ''at least negligent'' and ''depart[ing] from the standard of reasonable prudence'') may leave the SEC Staff with the impression that they have the authority to investigate attorneys who they suspect gave negligent legal advice resulting in a violation of the securities laws. Indeed, some senior SEC officials have already indicated publicly that they view the *Ira Weiss* decision as opening the door to the investigation and prosecution of mere professional negligence. For example, former Commissioner Harvey Goldschmid is reported to have asked an SEC Assistant General Counsel at a conference earlier this year whether *Ira Weiss* opened lawyers to SEC enforcement action for mere negligent conduct. The Assistant General Counsel is reported to have responded that ''lawyers . . . when they act negligently . . . can be liable.''[28]

Given that it is unclear whether the SEC intended to cast aside its historic reluctance to prosecute attorney negligence, the SEC should issue a Policy Statement clarifying its intent.[29] If the SEC does intend to investigate and prosecute attorney negligence that results in securities violations, that is a matter of grave concern to the securities bar, and the SEC should clearly and unambiguously state that intent. If the SEC did not intend for *Ira Weiss* to usher in a brave new world of attorney liability, it is all the more imperative that the SEC issue a clarifying Policy Statement. In the absence of such a Statement, *Ira Weiss* will cause considerable mischief in the SEC's enforcement program. Given the SEC's continued focus on ''gatekeepers,'' virtually every enforcement investigation today examines the conduct of the attorneys. The line level Staff attorneys and their Branch Chiefs who conduct and guide these investigations will justifiably read *Ira Weiss* as indicating that it is appropriate to investigate and charge attorneys whose professional negligence results in violations of the securities laws. Even if senior Enforcement Division Staff ultimately recommend against enforcement action, it will not be before the unfortunate attorney has been put to the unwarranted expense and considerable anxiety of defending his conduct in an enforcement investigation. A clear Policy Statement from the SEC would avoid such mischief.

Conclusion. Unless *Ira Weiss* is reversed on appeal, it will leave the waters muddied as to whether attorneys are subject to SEC enforcement actions for mere professional negligence. The SEC should issue a Policy Statement that clarifies whether it intends to prosecute professional negligence by attorneys that results in securities violations.

[27] Of course, SEC Staff lack authority to speak for the Commission and preface their remarks with an appropriate disclaimer.

[28] Lynn Hune, *Weiss Called 'Extremely Negligent'*, 355 Bond Buyer (USA) 1 (March 6, 2006).

[29] The SEC issues Policy Statements from time to time to clarify its position on a particular matter. For a compilation of the SEC's Policy Statements, *see* http://www.sec.gov/rules/policy.shtml.

Note to Readers

The editors of BNA's *Securities Regulation & Law Report* invite the submission for publication of articles of interest to practitioners.

Prospective authors should contact the Managing Editor, BNA's *Securities Regulation & Law Report*, 1231 25th St., N.W., Washington, D.C. 20037; telephone (202) 452–4339; fax (202) 728–5208; or e-mail to srlr@bna.com.

  SRLR ISSN 0037-0665