Choice of Federal or State Law for Attorneys' Professional Responsibility in Securities Matters

Ted J. Fiflis
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Professional standards of duty are implicated in the federal securities laws in two types of cases: those instituted by the SEC to impose sanctions for lack of character or unethical conduct and those brought by the SEC or private parties for violations of substantive provisions of the securities laws. The question faced by Professor Fiflis is whether state or federal standards should define the duties imposed under these laws. He argues that the proper method of resolving this question is to apply an interest analysis. Analyzing the various state and federal interests leads Professor Fiflis to the conclusion that federal courts and the SEC must look to state corporate laws and rules of professional responsibility to assess the conduct of attorneys in securities matters, except for appearances before, and transactions directly with, the SEC.

INTRODUCTION

A generation ago Henry Hart noted that the law that "governs daily living in the United States is a single system of law: it speaks in relation to any particular question with only one ultimately authoritative voice, however difficult it may be on occasion to discern in advance which of two or more conflicting voices really carries authority."1 One voice is necessary, he said, if we are to avoid forcing people to react like Pavlov's dogs to conflicting rules, resulting eventually in the society's nervous breakdown.2 Which is that authoritative voice for establishing attorneys' professional responsibilities in corporate law matters?

In a variety of actions ranging from publicity releases3 through injunctive suits4 to rule 2(e) proceedings5 the Securities and Exchange

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2 Id.

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Commission (SEC or Commission) has sought to impose enforceable duties upon attorneys who represent clients in the marketing of securities. These duties, developed through the Commission's "access theory," are defined by federal standards of professional conduct for attorneys that are independent of and generally more expansive than those standards traditionally imposed by state law. For example, in


Rule 2(e)(1) of the SEC's Rules of Practice, 17 C.F.R. § 201.2(e) (1981), reads:

(e) Suspension and disbarment.

(1) The Commission may deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice of and opportunity for hearing in the matter (i) not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities laws (15 U.S.C. secs. 77a to 80b-20), or the rules and regulations thereunder.

See note 28 infra.


A proposal of the ABA Standing Committee on Professional Discipline, Rules of Federal Agency Discipline, supports application of state standards except for transactions directly with federal agencies. To my knowledge, no other sources address the issue whether state rules regarding attorneys' professional responsibility should be adopted as federal law. I raised the issue at the Southwestern Legal Foundation's Short Course in Securities Regulation, Dec. 10, 1981, in Dallas, Texas. After this Article went to press, the issue was adverted to by Edward F. Greene, General Counsel to the SEC, in remarks to the New York County Lawyers' Ass'n (Jan. 13, 1982), reprinted in 14 Sec. Reg. & L. Rep. (BNA) 168, 170 (1982) [hereinafter Greene Speech]. A more radical and perhaps less defensible suggestion has been made in Note, SEC Disciplinary Proceedings Against Attorneys Under Rule 2(e), 79 Mich. L. Rev. 1270, 1276-77 (1981) [hereinafter Michigan Note], in which the author, through analogy to Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977), and its abdication to state law for the regulation of corporate fiduciary obligations, id. at 478-80, concludes that state rules of professional responsibility should operate of their own force to regulate attorneys. This suggestion would call for a construction of the various federal antifraud statutes to exclude breaches of professional duties from their scope, just as Santa Fe excludes breaches of fiduciary duty from the scope of rule 10b-5.

There is general agreement that the SEC's standards exceed traditional bounds, see, e.g., The Evolving Problems For and Responsibilities of Attorneys Under the Federal Securities Laws, A Program by the Comm. on Fed. Reg. of Sec. (Section of Corporation, Banking and Bus. Law) and Comm. on Sec. Transactions (Section of Litigation), 36 Bus. Law. 1777 (1981) [hereinafter Program]; Gruenbaum, Clients' Frauds and Their Lawyers' Obligations: A Response to Professor Kramer, 68 Geo. L.J. 191, 201 (1979); Mathews, SEC Injunctive Proceedings Against Attorneys, 36 Bus. Law. 1819, 1827 (1981); Pickholz, The Proposed Model Rules of Professional Conduct—And Other Assaulst Upon the Attorney-Client Relationship: Does "Serving the Public Interest" Disserve the Public Interest?, 36 Bus. Law. 1841, 1848-61 (1981); Pitt, The George-
its most extreme effort, the Commission shocked the bar by taking the unprecedented position that attorneys representing corporate clients are susceptible to liability under the federal securities laws' antifraud provisions for failing to "blow the whistle" and disclose the wrongdoing of management and the board of directors to shareholders or the SEC. 9

If the Commission succeeds in imposing federal standards of conduct in injunctive actions, presumably these standards also would apply against attorneys in express or implied private actions under the securities laws. Lawyers would then risk civil liability as principals or secondary liability on a basis such as aiding and abetting. 10

Although many express outrage at the Commission's attempt to expand the duties of lawyers under the federal securities laws and feel that the Commission exceeds its rulemaking authority when it prescribes new standards of professional conduct, few have successfully identified a theory upon which to effectively challenge this assertion.

town Proposals, 36 Bus. Law. 1831, 1838 (1981). Several commentators have noted the problems that expansive SEC standards place on attorneys attempting to represent clients effectively. See, e.g., Downing & Miller, The Distortion and Misuse of Rule 2(e), 54 Notre Dame Law. 774 (1979); Marsh, supra note 5, at 988-94. But see Gruenbaum, Corporate/Securities Lawyers: Disclosure, Responsibility, Liability to Investors, and National Student Marketing Corp., 54 Notre Dame Law. 795, 800-04 (1979) (arguing that the securities lawyer's role as adviser rather than advocate justifies the imposition of stringent duties under the SEC's access theory).

9 SEC v. National Student Marketing Corp., 457 F. Supp. 682, 699-701 (D.D.C. 1978); see Comment, SEC v. National Student Marketing Corp., 25 N.Y.L. Sch. L. Rev. 79 (1979). The issue of attorney liability was never fully resolved in the National Student Marketing litigation. However, one court did state in its opinion that "the attorneys' responsibilities to their corporate client required them to take steps to ensure that the information would be disclosed to the shareholders." SEC v. National Student Marketing Corp., 457 F. Supp. at 713. See also Fels v. National Account Sys. Ass'n, 469 F. Supp. 54, 67-68 (N.D. Miss. 1978) (finding that securities laws place attorney under duty to disclose client's misrepresentations).

It generally is believed that the Commission has now retreated from this extreme position. See Mathews, supra note 8, at 1829; Program, supra note 8; Pickholz, supra note 8, at 1846-47; Timmeny, Responsibilities of Lawyers in Connection with the Sale of Municipal Securities, 36 Bus. Law. 1799, 1802 (1981); Lawsco, 67 A.B.A.J. 1243 (1981). In William R. Carter, SEC Exch. Act Release No. 17,597, 22 SEC Docket 292 (1981), the Commission expressly reserved the question of the scope of an attorney's duties, thus throwing into question this general belief.


10 For example, in one of several civil suits against the lawyers arising out of National Student Marketing, plaintiffs sought to establish liability based on the expanded SEC formulation of lawyers' obligations. For a recent opinion in this ongoing litigation, see Wachovia Bank & Trust Co. v. National Student Marketing Corp., [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,712 (D.C. Cir. 1980).
of jurisdiction. The thesis of this Article is that modern judicial policy established in recent Supreme Court decisions requires the SEC to apply state corporation law, codes of professional responsibility, and other state law as the single authoritative voice when assessing the conduct of attorneys representing clients in securities-related matters. Of course, federal law controls in these actions brought against attorneys, but the question considered in this Article is whether state standards must be adopted as federal law to define attorneys' duties under the securities laws. The argument made here is that the traditional substantial interest of the states in determining the incidents of the relationship between attorney and client and the Supreme Court's recent decisions calling for greater incorporation of state law in federal law determinations when a state governmental interest outweighs competing federal interests compel adoption of state standards. If state law standards are found to govern, then the Commission's more radical expansions of attorneys' duties will be substantially circumscribed and securities lawyers will have a clearer and more consistent definition of the duties under which they act in securities transactions, uncomplicated by conflicting state and federal rules.

In this Article, I first analyze how attorneys' professional conduct gets called into question under federal securities law. I then consider

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11 See Marsh, supra note 5, at 1006-07 (noting the problems raised by expansive federal standards and suggesting that Congress did not intend to grant the SEC authority to establish such standards); Michigan Note, supra note 7.
12 See, e.g., Glazer v. J.C. Bradford & Co., 616 F.2d 167, 169 (5th Cir. 1980) (deferring to state law concerning attorney's authority to settle federal claim largely because of the "state's substantial interest in defining the relationship between attorney and client"); Daley & Karmel, Attorneys' Responsibilities: Adversaries at the Bar of the SEC, 24 Emory L.J. 747, 749 (1975).
13 See text accompanying notes 98-159 infra.
14 The respondents in William R. Carter, SEC Exch. Act. Release No. 17,597, 22 SEC Docket 292 (1981), apparently so believed. In that case, the SEC staff sought to impose rule 2(e) sanctions on two attorneys for their alleged breaches of duties arising under the expanded SEC standards. The staff claimed that the attorneys' knowledge that the chief executive had ignored their advice to disclose the deteriorating cash flow of the client corporation to its shareholders gave rise to a duty to report such misconduct promptly to the board, and when the board failed to take corrective action, to report this further misconduct to the shareholders or the SEC. The decision of the administrative law judge, which found that the attorneys had failed to fulfill their professional responsibilities, did not reach the issue whether the application of state law would have made a difference. William R. Carter, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,175, at 82,181 (July 24, 1978) (Admin. Proc. File No. 3-5464). The respondents raised the issue, however, and since the Carter Pleading, supra note 7, shows the Commission contested their claim, both sides may have perceived at least some small advantage to respondents from limiting attorney responsibility to that mandated by state rules.
15 See Marsh, supra note 5, at 1007.
the recent development by the Supreme Court of principles for determining when state law should be adopted to give content to unspecified federal law. In the final section, these principles are applied to a hypothetical case to illustrate how state law standards of professional responsibility should be adopted to determine the duties of attorneys acting in matters subject to federal securities regulation.

I

HOW PROFESSIONAL STANDARDS ARE IMPlicated
UNDER THE FEDERAL SECURITIES LAWS

Before analyzing and applying the appropriate test to determine whether state rules of professional responsibility should be incorporated into federal securities laws, detailed consideration must first be given to how professional standards become involved in securities litigation. Attorneys are infrequently charged as principals for securities violations. Rather, they are generally alleged to be secondarily liable for aiding and abetting principal violators. Under these circumstances, no liability can be found unless professional standards place the attorney under some duty. Whether this duty exists and the degree of care required to satisfy the duty in a given case ultimately will depend on whether state or federal standards define an attorney's obligations.

A. Theories for Reaching Attorneys
UNDER THE SECURITIES LAWS

Attorneys' professional standards have figured prominently in two types of securities law proceedings. First, in SEC proceedings brought under clause (ii) of rule 2(e)(1) of the SEC's Rules of Practice, an attorney, who is judged to have acted improperly or unethically in performing securities-related services, becomes susceptible to suspension or disbarment from SEC practice. Second, in proceedings alleging violation of substantive provisions of the securities laws—typically the antifraud provisions, such as section 17(a) of the 1933 Secur-
CHOICE OF LAW

Ities Act\textsuperscript{18} or section 10(b) of the 1934 Securities Exchange Act\textsuperscript{19}—an attorney may be enjoined or held liable for damages or may, here too, risk suspension or disbarment from SEC practice under clause (iii) of rule 2(e)(1).

There is no mystery as to how professional standards become involved in cases raising rule 2(e)(1)(ii) claims. Rule 2(e)(1) states that the Commission may suspend or disbar an attorney from practicing before it if he or she is found "(ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct."

This is simply a generically stated, SEC-devised rule of professional conduct and does not purport to promulgate independent professional standards. The professional standards by which attorney conduct is to be judged must be imported from some outside source.

\textsuperscript{18} 15 U.S.C. § 77q(a) (1976) reads:

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or
(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

\textsuperscript{19} 15 U.S.C. § 78j (1976) reads:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange.

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 10(b) is not self-executing and actions are generally brought for violations of rule 10b-5, 17 C.F.R. § 240.10b-5 (1981), promulgated under the SEC's § 10(b) rulemaking authority. The rule reads:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

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

\textsuperscript{20} 17 C.F.R. § 201.2(e)(1)(ii) (1981).
Thus, although the rule itself is vague and ambiguous, requiring content from state or federal law, there is no ambiguity as to how violations of standards relate to it.

Professional standards of conduct become implicated in cases involving substantive provisions of the securities laws in a less direct manner. The former general counsel for the Commission has described two theories used by the SEC to proceed against attorneys for substantive securities law violations. An infrequently applied theoretical addresses the question whether “the lawyer directly violated a provision of the federal securities laws? For example, did the lawyer make a misstatement or involve himself in a conspiracy to violate the law?” More commonly, the SEC questions whether a lawyer, who acted solely as a professional in a particular transaction, “should be held derivatively or secondarily liable for the direct violations of another.” In this case, the SEC requires a theory upon which to hang the derivative claim. For example, if the lawyer is a control person, then, unless he or she has a good faith defense, the SEC can establish liability under section 20(a) of the '34 Act. More often, however, the SEC attempts to establish the liability of the lawyer as

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21 For an analysis of some of the ambiguities in the rule, see Marsh, supra note 5, at 993-1003.

The Second Circuit held the application of rule 2(e) to accountants valid in Touche Ross & Co. v. SEC, 609 F.2d 570, 580-81 (2d Cir. 1979). However, the general validity of rule 2(e) as to attorneys continues to be called into question. See Keating, Muething & Klekamp, SEC Exch. Act Release No. 15,982, 17 SEC Docket 1149, 1157-83 (1979) (Karmel, Comm't, dissenting); Marsh, supra, at 1004-15; Michigan Note, supra note 7, at 1283. The SEC, in William R. Carter, SEC Exch. Act Release No. 17,597, 22 SEC Docket 292, 293-98 (1981), upheld the validity of the rule in a thorough analysis.

The scope of rule 2(e) is also the subject of some concern. See Marsh, supra, at 994 (pointing out that although rule 2(e) refers to practice before the SEC, the staff, at least at that time, defined this broadly to include securities law advice beyond dealings with the Commission). This view may be changing. See Greene Speech, supra note 7, at 169.


22 Id. at 1809 (citing United States v. Benjamin, 328 F.2d 854 (2d Cir.), cert. denied, 377 U.S. 953 (1964)); see note 16 supra.

23 For a recent analysis of secondary liability under rule 10b-5, see Fischel, Secondary Liability Under Section 10(b) of The Securities Act of 1934, 69 Calif. L. Rev. 80 (1981). The article is written in an adversarial manner, advocating the elimination of aiding and abetting liability.

24 Section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t(a) (1976), reads:

   Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.
an aider or abettor. To do this, it attempts to show that the attorney substantially assisted the principal violator either affirmatively, such as by drafting a false filing, or, as is more often the case, through "failure to act in a derogation of a duty to do so." 26

The Commission has focused on professional standards in attempting to establish substantive violations based on claims against attorneys for "substantial assistance" in aiding and abetting through an act or omission. With respect to claims of affirmative assistance, such as in the drafting of an alleged false document to be filed with the SEC, the analysis is rather straightforward, with inquiry addressing the attorney's duties of diligence and skill. 27 It is in cases arising from an attorney's failure to act that the Commission has deviated furthest from established standards of professional conduct to find enforceable duties to press upon attorneys. For example, the Commission has attempted to establish secondary liability by using its so-called "access theory" 28 to place a duty on attorneys to "blow the

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26 Ferrara, supra note 22, at 1810. The author notes that when an attorney's breach of duty is alleged an important issue will be whether that duty has been previously articulated, thus giving the attorney fair warning. Id. at 1810.

The elements of an aiding and abetting cause of action under the securities laws are spelled out in Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47-48 (2d Cir.), cert. denied, 439 U.S. 1039 (1978). These appear to be based on the Restatement of Torts § 876(b) (1939) which reads: "For harm resulting to a third person from the tortious conduct of another, one is liable if he . . . (b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself . . . ."


28 The SEC's "access theory" is premised on the role of lawyers in the marketing of securities. Through their role in providing services for clients and advising them in various aspects of securities transactions, such as in drafting registration statements and in providing opinions on exemptions, attorneys are seen to provide the passkey into the marketplace for clients who buy or sell securities. Sommer, The Emerging Responsibilities of the Securities Lawyer, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,631, at 83,659. The SEC believes that if lawyers face potential liability for permitting clients to violate the securities laws, they will be more alert to prevent such violations. The SEC made its belief express in Emmanuel Fields, 45 S.E.C. 262 (1973), aff'd, 495 F.2d 1075 (D.C. Cir. 1974), in which it focused on:

the peculiarly strategic and especially central place of the private practicing lawyer in the investment process and in the enforcement of the body of federal law aimed at keeping that process fair. Members of this Commission have pointed out time and time again that the task of enforcing the securities laws rests in overwhelming measure on the bar's shoulders. These were statements of what all who are versed in the practicalities of securities laws know to be a truism, i.e., that this Commission with its small staff, limited resources, and onerous tasks is peculiarly dependent on the probity and the diligence of the professionals who practice before it. Very little of a securities lawyer's work is adversary in character. He doesn't work in courtrooms where the pressure of vigilant adversaries and
whistle” or to notify the board of directors of management’s securities law violations.

B. The Duty Analysis

The juristic process involved in establishing the secondary liability of attorneys is the conventional duty analysis used to determine the obligations of parties in tort actions. Attorneys can be held liable for their inaction relating to the substantive violations by principals only if they can be found to have breached an obligation to act. Here, professional responsibility standards will be incorporated into a duty analysis to define, in part, the obligations under which attorneys act in serving clients in securities-related matters. This conventional duty analysis begins with the premise that a secondary actor can have a duty either to warn a third party of the potential harm risked by the principal actor’s violations or to control the principal actor only if the secondary actor shares with either the principal or the third party a special relationship that will support such a duty. This is the analysis proposed in the Restatement of Torts and adopted generally by the courts.

alert judges checks him. He works in his office where he prepares prospectuses, proxy statements, opinions of counsel, and other documents that we, our staff, the financial community, and the investing public must take on faith. This is a field where unscrupulous lawyers can inflict irreparable harm on those who rely on the disclosure documents that they produce. Hence we are under a duty to hold our bar to appropriately rigorous standards of professional honor.


31 It is important to understand that “duty” is an elusive concept that gains definition from a host of independent policy considerations. The California Supreme Court observed, to ask whether a duty exists is merely to state the problem in an abstract way. Tarasoff v. Regents of Univ. of Cal., 17 Cal. 3d 425, 434, 551 P.2d 334, 342, 131 Cal. Rptr. 14, 22 (1976). The court noted, quoting W. Prosser, Handbook of the Law of Torts 325-26 (4th ed. 1971), that duty “is not sacrosanct in itself, but only an expression of the sum total of those considerations of policy which lead the law to say that the particular plaintiff is entitled to legal protection.” 17 Cal. 3d at 434, 551 P.2d at 342, 131 Cal. Rptr. at 22.

32 See Restatement (Second) of Torts §§ 314-320 (1965). Section 315 of the Restatement bars the finding of a duty unless there exists either “(a) a special relation . . . between the actor and the third person, which imposes a duty upon the actor to control the third person's conduct, or (b) a special relation . . . between the actor and the other which gives the other a right to protection.”
Although Affiliated Ute Citizens v. United States\(^3\) did not involve an issue of attorney's liability, it is perhaps the most familiar illustration for securities lawyers of the need to establish a duty as a prerequisite to liability. There, the Supreme Court determined that a person acting as a market maker and soliciting buyers for securities held by Indians had a duty as a fiduciary to disclose to the Indians the market value of the shares sold.\(^4\) More recently, the Supreme Court employed the duty analysis in Chiarella v. United States,\(^5\) finding that an employee of a financial printer hired by a takeover company owed no duty to the tender offer target's shareholders to refrain from using sensitive inside information to purchase securities and therefore could not be held liable for alleged violation of rule 10b-5.\(^6\) In each case, the Court stressed that a duty to disclose is premised on the existence of a relationship of trust and confidence between the defendant and one of the relevant parties.\(^7\)

To gain a perspective on how codes of professional responsibility become incorporated into a duty analysis relating to substantive securities law violations by attorneys, we may consider briefly the National Student Marketing case.\(^8\) There, the SEC brought an action in the District of Columbia seeking an injunction under rule 10b-5 and other antifraud provisions of the federal securities acts\(^9\) against two merging corporations and various individual defendants including the lawyers representing the corporations. One of the corporations, National Student Marketing Corporation (NSMC), was organized under Delaware law, and the other, Interstate National Corp. (INC), under Nevada law. Their attorneys practiced in New York and Chicago, respectively. The SEC alleged that the corporations issued a misleading joint proxy statement to solicit their shareholders' approval of the merger. The statement included an interim income statement of

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\(^3\) 406 U.S. 128 (1972).
\(^4\) Id. at 152-54.
\(^6\) Id. at 232-33.
\(^7\) Id. at 228; 406 U.S. at 152.

A recent Second Circuit opinion indicates that a person in the position of the printer in Chiarella may be held liable under rule 10b-5 on the basis of a duty owing to the printing company. United States v. Newman, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) \(\$\) 98,332 (2d Cir. Oct. 30, 1981) (employees of investment banking firm owed duties to their employer and to its client takeover companies).

\(^8\) SEC v. National Student Marketing Corp., 457 F. Supp. 682 (D.D.C. 1978); see note 4 supra.

NSMC which showed a profit of $700,000. After successful proxy solicitations and shareholders’ meetings, the attorneys and certain officials of each corporation were advised by the NSMC auditors’ “comfort letter” at the closing that in fact NSMC had suffered a loss of $80,000 for that interim period. The SEC charged in its complaint that under these circumstances both sets of attorneys had duties not only to withdraw certain opinion letters required by the merger contract, but also “to insist that the financial statements be revised and shareholders be resolicited, and failing that, to cease representing their respective clients and, under the circumstances, notify the . . . [SEC] concerning the misleading nature of the [interim statements].”

To determine whether these invocations of a duty by the SEC are valid we must consider the nature of the relationship of the attorneys to the alleged principal violators of rule 10b-5—the management of either corporation—and to the injured third parties—the corporate shareholders. A finding that the appropriate special relationship existed would support the SEC's claim that the attorneys were under a duty requiring them to control the management or protect the shareholders from management and would justify holding the attorneys liable for breach of that duty. For example, if the INC lawyers are held to have had a duty to control the INC management's conduct through their relationship to management or to protect the INC shareholders because of their relationship to shareholders, then attorneys will be liable for a breach of that duty.

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40 NSM Complaint, supra note 4, ¶ 93,360, at 91,913-17.

41 Some may suggest that under its access theory the SEC could argue that an attorney's membership in the SEC bar establishes a special relationship to the SEC supporting a duty, or that, alternatively, the attorney's special relationship to corporate clients warrants the finding of a duty to ensure against injury to SEC enforcement policies. It is hard to say, however, that there is an “SEC bar,” given 5 U.S.C. § 500(b) (1976), which prohibits the establishment of such a bar.

42 The lawyer's duties doubtless will vary with the circumstances of each case, just as do directors' duties. See, e.g., Lanza v. Drexel & Co., 479 F.2d 1277, 1306-09 (2d Cir. 1973) (en banc) (outside directors who were unaware of false representations and had not participated in the merger negotiations were held to have had no duty to inquire and convey information to prospective stock purchasers). The same directors were held liable for breach of duty in different circumstances in Escott v. BarChris Constr. Corp., 283 F. Supp. 643, 687-92 (S.D.N.Y. 1968).

The court in National Student Marketing never reached the question of what specific duties might be imposed on the attorneys. As to the INC attorneys in particular, the court held merely that they should have done something to forestall the merger. SEC v. National Student Marketing Corp., 457 F. Supp. 682, 714, 716-17 (D.D.C. 1978). NSMC's counsel, meanwhile, reached a prior settlement with the SEC promising to “adopt, effectuate and maintain certain procedures . . . in matters involving the Federal Securities Laws.” SEC v. National Student Marketing
The attributes of a special relationship necessary to support the finding that the attorneys in National Student Marketing had a duty will be determined by relevant considerations of policy; duty is always a flexible concept whose existence depends on whether considerations of policy lead to the conclusion that a party should be held responsible for the injury resulting to another.\(^4\)

Several factors promise to be particularly relevant to a court's determination of whether an attorney's relationship to shareholders or management creates a duty to shareholders, the breach of which will support a finding that the attorney violated a substantive provision of the securities laws. First are the relevant policies underlying the federal securities laws. Under its access theory, the SEC seeks to enhance its ability to enforce the securities laws by holding attorneys to a duty to police their clients' disclosure to the public and to the SEC.\(^4\) The SEC's belief is that this would provide greater assurance that the public receives sufficient and accurate information upon which to make informed investment decisions.\(^4\)

Also relevant to a determination of a duty and of subsequent substantive violations are expressions of legislative policy and the allocation of corporate powers and fiduciary duties found in applicable state corporation codes. For example, a court could readily conclude that a corporation code's allocation of power solely to the directors to make a particular decision forecloses placing a duty to disclose to shareholders on an attorney, unless the board is disqualified by a conflict of interest from representing the corporation and the attorney has knowledge of the facts that would give the shareholders an action against the directors.\(^4\) Thus, a court might find no obligations on attorneys if a fully informed, disinterested board validly exercises its power to act without a shareholders' vote in a short-form merger and

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\(^4\) See note 31 supra.
\(^4\) See note 28 supra.
\(^4\) See Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1969) (en banc), cert. denied, 345 U.S. 908 (1969); Pappas v. Moss, 393 F.2d 865 (3d Cir. 1968); cf. Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) (in fraud action involving an alleged "take out" of minority shareholders by a short-form merger under Delaware law, the Court explicitly held the state corporation law as controlling internal corporate affairs).
approves the merger after considering material adverse facts concerning the merger partner. 47 Under these same circumstances, however, an attorney who learns that the corporate president is making a secret profit on the transaction might be held to have a duty, as the corporation's attorney, at least to inform the board. 48 If the merger is a long-form type, requiring a shareholder vote, as in National Student Marketing, a court could find a duty to disclose to shareholders, despite the board's knowledge and disinterest, depending on which party the applicable corporation law identifies as the corporate client for purposes of applying standards of attorneys' professional conduct vis-à-vis that client. This reasoning shows that the attorney's responsibilities may be dependent in part on the underlying substantive rules of the corporation law.

Codes of professional responsibility may also be highly relevant to the determination of an attorney's duties under the securities laws. These professional codes embody generally accepted resolutions of the conflicting policies regarding professional conduct that courts are likely to consider in making the duty analysis. The rules reflect the long experience of their drafters in attempting to accommodate many of the conflicting considerations. 49 These codes of professional conduct should be considered not only when they are incorporated into statutes or court rules; codes adopted exclusively by professional societies such as local or national bar associations may also give rise to enforceable duties. Moreover, duties may arise from standards developed through professional custom. 50


49 One vastly complicating problem here is the widespread disagreement as to the meaning of the codes of professional responsibility and the even greater discord as to the direction of change in this area of law. See [1980] Sec. Reg. & L. Rep. (BNA) No. 566, at AA-112 (a report of the ABA August 1980 program of the Sections of Litigation and Corporation, Banking and Business Law).


For a survey of more general factors courts should consider in determining whether a duty to protect third parties arises, see Rowland v. Christian, 69 Cal. 2d 108, 113, 443 P.2d 561, 564, 70 Cal. Rptr. 97, 100 (1968).
Another body of law that may be relevant to the determination of an attorney's duties is that of agency and principal. If an attorney is considered an agent of the corporation, as has been suggested by the Kutak Commission, then he or she owes primary duties not to corporate officers, who are also agents, but to the entity. Such a determination would cause a definition of duties that differs significantly from that which many have urged as appropriate when an officer confides some wrongdoing to the attorney.

Finally, a court should find relevant to the determination of an attorney's duties the duties implicit in various evidentiary rules of attorney-client privilege, the materiality of the undisclosed information, the extent to which the attorney profited from the transaction, and the nature of his or her participation.

Manifestly, in this duty analysis, a crucial question will be whether, in determining these federal law duties, lower courts and the SEC must adopt state law as a matter of federal law, or, instead, may make federal common law determinations unhindered by state

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31 The ABA's analysis of rule 1.13 of its proposed Model Rules of Professional Conduct applies agency principles to resolve the question of conflict between the lawyer's professional judgment and that of an officer or employee of the corporate client. See ABA Model Rules of Professional Conduct rule 1.13, Legal Background 90-92 (proposed final draft May 30, 1981). It would seem that these agency principles applied here "smell of the lamp" and should not be relied upon as other than persuasive analogy. Corporate structures are sui generis. They are inanimate entities acting through boards of directors which, regardless of what scholars might think, do not function as principals directing the president and other officers as agents. In practice, if anyone is the "boss," it is the chief executive officer (CEO). Business executives would find stultifying a legal rule that treated the CEO and corporate counsel as co-agents.

52 Id.

53 An attorney-client privilege will come into play only rarely in a duty analysis, for, in most situations involving the alleged participation of an attorney in substantive securities violations, the client will not have communicated confidences necessary to invoke the privilege in seeking legal advice. See 8 J. Wigmore, Evidence § 2292 (rev. ed. J. McNaughton 1961 & Supp. 1959). Moreover, in a shareholder action, it is doubtful that any privilege could be asserted since, under most state corporation codes, shareholders are entitled to inspect the corporate books and records. E.g., Del. Code Ann. tit. 8, § 220 (1974); N.Y. Bus. Corp. Law § 624 (McKinney 1963 Supp. VI 1981). This shareholder right to inspect would apply even if the state law limits that right to a "proper purpose." Id. The federal proxy rules clearly compel disclosure of interim data to shareholders. 17 C.F.R. §§ 240.14a-9, .14a-101 (Item 14(b)(7)) (1981). The right of shareholders to receive information concerning the company may also override certain duties of attorneys arising from professional codes to maintain client secrets. See Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970), cert. denied, 401 U.S. 974 (1971); ABA Code of Professional Responsibility Canon 4 (1980); id. Disciplinary Rule 4-101.


55 Cf. Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673 (N.D. Ind. 1966) (issuer profiting from a broker's misrepresentation to investors held to have a duty either to control the broker's action or to warn investors), motion to dismiss denied, 286 F. Supp. 702 (N.D. Ind. 1968), aff'd, 417 F.2d 147 (7th Cir. 1969), cert. denied, 397 U.S. 999 (1970).
The determination of which source of law supplies the federal rule will direct the amount of weight to be given to each of the factors identified above in defining an attorney's duty. In *National Student Marketing*, for example, the court, in determining the INC attorneys' duties, had to decide whether to (1) apply state law to govern the attorneys' obligations or (2) ignore state law and apply a federal rule not tied to that state's law. In either case, the court would be applying federal law, but under the first alternative that federal law would obtain its content by adoption of state law standards.\(^\text{57}\)

Incidentally, if the adoption alternative applies, a further question arises—*which* state's law shall be adopted when there are contacts with two or more states. The facts in *National Student Marketing*, involving contacts in at least four states and the District of Columbia, illustrate poignantly the degree of complexity that is likely to inhere in such a determination. Presumably, this second choice-of-law question is to be decided as a matter of federal policy, rather than by the law of the state in which the forum court sits, as would be required in *Erie*-type cases in which the substantive law questions are also regulated by state law.\(^\text{58}\)

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\(^\text{56}\) An important difference between formulation of a uniform rule and adoption based on state contacts is that ultimately a uniform set of federal rules could emerge under the former approach, thereby eliminating variations in legal standards in federal question cases and also eliminating the need to litigate the choice-of-law question, see note \(^\text{58}\) infra, as each case came to court. Of course, the dynamics of the federal court system make it unlikely that a uniform set of adjudicated rules will ever fully emerge in this context. See Mishkin, *The Variance of "Federal Law": Competence and Discretion in the Choice of National or State Rules for Decision*, 105 U. Pa. L. Rev. 797, 813 (1957). Nevertheless, because the ABA continues to take the leadership in the development of a model code of professional responsibility, and federal courts are likely to give great weight to its formulations, there is a greater probability that a fairly uniform body of law will develop even on a case-by-case basis and if federal courts decide that the adoption of state law on a contacts basis is inappropriate.

\(^\text{57}\) It may be urged that with respect to determining attorneys' duties under the federal securities laws, the adoption alternative is not applicable. One asserting such a position would claim that, unlike issues of procedure, such as the proper statute of limitations on an implied right of action, or of corporation law, such as the powers of an impartial board of directors, here the issue merely involves interpretation of the substantive statutory provision of the federal securities laws. This claim would find support in two recent Supreme Court cases that analyzed duty without mention of state law. *Chiarella v. United States*, 445 U.S. 222 (1980); *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972). However, as the analysis that follows seeks to demonstrate, the trend in recent Court decisions favoring adoption of state law, combined with the strong interest states traditionally have in defining standards of professional conduct, should cause the courts to define attorneys' duties in securities matters through the adoption of applicable state law.

\(^\text{58}\) Neither *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938), nor *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941) (on issues governed by *Erie*, a federal court must observe the choice-of-law rules of the state in which it is located), govern the choice of which state's law to borrow as a matter of federal law. Rather, the decision should be made according to federal choice-of-law
II

THE ADOPTION ANALYSIS

When a federal law fails to define adequately the terms it uses, a court, charged with construing that law, may derive the necessary meaning from relevant state law. Clearly, under such circumstances, the state law chosen does not operate of its own force; rather, it is adopted as a matter of federal law. For example, in Reconstruction Finance Corp. v. Beaver County the Supreme Court approved the use of state law to determine whether machinery constituted “real property” in a poorly articulated federal statute that established a United States-owned corporation to aid business in constructing defense plants during World War II and permitted the states to tax the “real property” of the corporation. More recently, in Burks v. Lasker, the Court held that state law should be adopted as federal law to determine whether a committee of directors of a corporation had the authority to discontinue a shareholders’ derivative suit that asserted a federal right of action against that corporation. State law is not always invoked to fill the interstices left in federal law, however. For example, in Clearfield Trust Co. v. United States, the most famous case in point, the Court found use of state law inappropriate to determine whether an unreasonable delay in notifying a guarantor that a check issued by the United States bore a forged endorsement would provide a defense in a suit brought by the United States to recover on the guaranty. The Court reasoned that efficient regulation of the federal interests involved required a single rule that would be applied uniformly throughout the country. The Court feared the disparate results risked by application of fifty different state standards. Hence, the Clearfield Trust result may be

standards. Cf. Oil, Chem. & Atomic Workers Int’l Union v. Mobil Oil Corp., 426 U.S. 407 (1976) (choice of state law to be adopted to control right to work under federal statute made without reference to Erie or Klaxon). See also Wilson v. Omaha Indian Tribe, 442 U.S. 653 (1979) (treaty setting interstate boundary governed the issue of which state’s law must be adopted by federal courts). Hence, the choice of which state law will be borrowed in a particular case presumably will be left to federal policy.

35 328 U.S. 294 (1946).
36 Id. at 210.
38 Id. at 486.
40 Id. at 367.
41 Id.
referred to as the "uniformity" result, or as the "uniform federal rule" principle, and the result typified by the Beaver County/Burks v. Lasker decisions may be referred to as the "adoption" result.

Clearly, the question whether to apply state or federal standards to determine an attorney's duties in performing securities-related services for clients will be resolved by deciding whether to follow the "uniformity" result or the "adoption" result. What criteria apply to determine when state law should be adopted as a matter of federal law and when, instead, a uniform federal rule should be fashioned? Until recently, the standards for making this determination were difficult to ascertain. In the past few years, however, the Supreme Court has begun to fashion a coherent technique for analyzing the question.

In undertaking this adoption analysis, we should keep in mind that we are analyzing the requirements of the federal securities laws as to an attorney's professional responsibility and, therefore, the command of the Erie doctrine, that state law be applied as the rule of decision, does not arise.66 Under Wallis v. Pan American Petroleum Corp.,67 federal courts must go beyond a mere determination that some federal statute, treaty, or constitutional provision affects the activity at issue before concluding that Erie does not control and application of a federal rule is warranted.68 That requirement is clearly satisfied here. The federal securities statutes manifest a sufficiently strong federal interest to take the case outside the Erie rule.69

66 Erie R.R. v. Tompkins, 304 U.S. 64 (1938). Under Erie, cases brought in federal court that do not raise a federal question—i.e., a question arising under a federal statute or treaty or the Constitution—must be decided through application of the appropriate state law. Id. at 78.
68 Id. at 68-69.
69 The mere fact that some federal legislation, treaty, or constitutional provision is related to the controversy is not enough to avoid the requirements of Erie. See, e.g., id. at 69 (federal regulation of railroads did not make personal injury claim against railroad company a federal question avoiding the requirement to apply state law). The issue we are addressing here, however, not only relates to a federal statute, but arises under one. The source of the federal basis for a decision removing a case from the Erie doctrine is not always explicit. See, e.g., Nebraska v. Iowa, 406 U.S. 117, 125-26 (1972) (state law rejected and federal law applied to resolve a boundary dispute between two states despite the absence of an express federal statutory, treaty, or constitutional provision giving rise to a federal question). In the area of attorneys' duties under the securities laws, however, direct federal statutory and regulatory law provide the federal basis for removing the question from Erie; there is no question that the issue arises under federal and not state law. For recent discussions of the inapplicability of Erie to cases requiring adoption analysis but arising under federal statutes or regulations, see United States v. Kimbell Foods, Inc., 440 U.S. 715, 726-27 & n.19 (1979); United States v. Little Lake Misere Land Co., 412 U.S. 590, 592-93 (1973).
What we are concerned with here is a second problem addressed in Wallis—whether, after finding a sufficient federal interest to invoke federal law, that federal law should comprise a uniform federal rule or a rule adopted from the law of an appropriate state. In making that determination, the Wallis Court indicated that it would be necessary to consider further “the strength of the state interest in having its own rules govern, ... the feasibility of creating a judicial substitute, ... and other similar factors.”70 It is this second problem to which we now turn.71

A. The Adoption Issue Generally

Nearly a quarter century ago, Paul Mishkin explained the process courts used to decide whether to adopt state law as the federal rule of decision.72 Borrowing from the insights of Hart and Wechsler,73 he noted that the principal explanation for federal adoption policy was the nature of federal lawmaking; while state legislatures legislate against the background of judge-made law, Congress legislates against the background of state law—both legislative and judicial.74 This state law background, he found, helped guide courts in their attempts to fill the interstices left by Congress in federal statutes.75

The adoption issue does not arise when Congress expresses its intent, either directing the courts to apply state law—as in the Federal
Tort Claims Act—or, as is more often the case, expressly supplying a uniform substantive rule. In these cases, no judicial inquiry as to the choice between a uniform federal rule and an adopted state law is required. However, when Congress does not so clearly express its will, courts must make the choice-of-law decision. To a great extent this choice involves inferring legislative intent, or more accurately, implementing perceived legislative policy. As the Court has recently stated: "[I]n fashioning federal principles to govern areas left open by Congress, our function is to effectuate Congressional policy."

In implementing congressional policy, courts should be cognizant of the state law backdrop against which Congress drafts its statutes. Mishkin noted that "all the indicators of 'legislative intent' generally employed in such an inquiry, including the broad historical pattern of legislative development in the area," are relevant to the determination of congressional policy. Clearly, one factor that is highly relevant to such an inquiry is the degree to which states traditionally have regulated the subject matter that is encompassed and left ambiguous in the federal legislation at issue. For example, when Congress enacts a law concerning a person's "child," courts could presume that it intended to adopt long-standing state law definitions to resolve such questions as whether illegitimate children are to be included. And when courts imply a cause of action, they may also infer a congressional intent to have the appropriate state statute of limitations apply. Thus, Justice Jackson, in D'Oench, Duhme & Co. v. Federal

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Other statutes expressly direct courts to adopt state law to resolve various federal law issues. E.g., 42 U.S.C. § 1988 (1976) (requiring application of state law in § 1983 actions when federal law provides no rule of decision); see Board of Regents v. Tomanio, 446 U.S. 478, 484-86 (1980) (relining on § 1988 to apply state statute of limitations). See generally Mishkin, supra note 56, at 797 n.1 (providing other examples).

77 E.g., Boulder Canyon Project Act, 43 U.S.C. § 617c(a) (1976) (providing for apportionment among states of water from Colorado River); see Arizona v. California, 373 U.S. 546, 560 (1963) (relining on Act to reject state's water rights claim based on state law); cf. Sunderland v. United States, 266 U.S. 226, 232-33 (1924) (acknowledging Congress' power to displace state law by imposing restrictions on alienation of Indian property despite the exclusive control states generally exercise over the control and disposition of real property).

79 Mishkin, supra note 56, at 811.
80 See DeSylva v. Ballentine, 351 U.S. 570, 581 (1956). See also United States v. Standard Oil Co., 332 U.S. 301, 309 (1947) ("[I]n [some] situations it may fairly be taken that Congress has consented to application of state law, when acting partially in relation to federal interests and functions, through failure to make other provision concerning matters ordinarily so governed.") (footnote omitted).
Deposit Insurance Corp., noted that even in cases in which the statute is silent, congressional intent may be presumed from the milieu in which the statute was drafted:

I hardly suppose that Congress intended to set us completely adrift from state law with regard to all questions as to which it has not provided a statutory answer. An intention to give persuasive or binding effect to state law has been found to exist in a number of cases similar in that they arose under a law of the United States but were not governed by any specific statutory provision.

The task of divining legislative intent or policy, however, is not a clear-cut exercise. It is widely recognized that determining legislative intent is one of the more elaborate chimeras of the law and may be more a technique for rationalizing judicial policy than for discovering a legislative norm. Judge Friendly describes the exercise of imputing congressional intent to apply state law. "The issue that must be determined in each instance is what heed Congress intended to have paid to state law...—more realistically, in Gray's famous phrase, 'to guess what it would have intended on a point not present to its mind, if the point had been present.'" Indeed, the Supreme Court has recognized that situations arise in which there is no discernible legislative policy to be implemented and that some judicial policy must be invoked to decide whether state law should supply the content for unspecified federal law.

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81 315 U.S. 447 (1942).
82 Id. at 473-74 (concurring opinion).
85 In United States v. Standard Oil Co., 332 U.S. 301 (1947), the Court took occasion to elaborate on its reasons for adopting state law in certain instances:

It is true, of course, that in many situations, and apart from any supposed influence of the Erie decision, rights, interests and legal relations of the United States are determined by application of state law, where Congress has not acted specifically. "In our choice of the applicable federal rule we have occasionally selected state law."... The Government, for instance, may place itself in a position where its rights necessarily are determinable by state law, as when it purchases real estate from one whose title is invalid by that law in relation to another's claim. In other situations it may fairly be taken that Congress has consented to application of state law, when acting partially in relation to federal interests and functions, through failure to make other provision concerning matters ordinarily so
Until very recently, this judicial policy, used to decide whether to fill interstices left in federal legislation with a federal or state rule, has lacked a coherent rule that could guide consistent decisionmaking on the adoption issue. Rather, various factors in the contemporary decisionmaking environment, the most important of which was the prevalent judicial attitude toward federalism, caused nonuniformity in judicial precedent. This pattern becomes manifest through review of some of the early Supreme Court decisions addressing the adoption issue.

Even during the pre-Erie reign of *Swift v. Tyson*, federal courts deferred to state rules to regulate limited issues of a "local" nature, such as those involved in real property or family relations. Courts acknowledged in these cases the strong state governmental interest in regulating these issues and the relatively weak federal interest traditionally attaching to the subject matter in question. In other areas governed. And in still others state law may furnish convenient solutions in no way inconsistent with adequate protection of the federal interest.

The rationale underlying both the legislative and judicial policies, equally compelling for both lawmaking agencies, must be that accommodation of state interests, when not upsetting to federal interests, is more socially desirable than ignoring state interests. Indeed, this policy of accommodating state interests may be implicit in the federal system designed by our Constitution; thus, just as *Erie* is probably constitutionally compelled, see *Erie R.R. v. Tompkins*, 304 U.S. 64, 80 (1938) ("in applying the doctrine [of federal common law] this Court and the lower courts have invaded rights which in our opinion are reserved by the Constitution to the several States."); Friendly, supra note 85, at 394-98, so too, adoption of state law may be constitutionally compelled, absent congressional expression of a federal rule. Alternatively, the courts may be compelled by the Rules of Decision Act, 28 U.S.C. § 1652 (1976) (corresponds to Judiciary Act of 1789, ch. 20, § 34, 1 Stat. 92), to adopt state rules absent a congressional choice. See text accompanying notes 147-48 infra. But see Guaranty Trust Co. v. York, 326 U.S. 99, 103-04 (1945) (Rules of Decision Act does not limit authority of federal government to make law); Westen, *After "Life for Erie"—A Reply*, 78 Mich. L. Rev. 971, 982-89 (1980). (Rules of Decision Act contains no independent limit on courts' power to fashion federal common law).


of law, however, where state interests did not enjoy such a tradition, courts were far more reluctant to adopt state standards.

To illustrate, in the *Clearfield Trust* decision, written soon after *Erie* and on the rising tide of national power, the Court set a federal tone for subsequent decisions in two respects: (a) it opted for a uniform federal rule as a good thing in and of itself; and (b) it did so without due regard for the relevant state interests. Mishkin preceded numerous commentators in criticizing both aspects of *Clearfield Trust*:

The importance of uniformity in relation to a particular issue may at times be clearly settled by careful analysis of the given problem—particularly when it is viewed against its legislative background. But more often, perhaps, the force attributed to it in fact depends upon assumptions, only rarely articulated, about our federal system. Thus, not infrequently the call for “uniformity” seems basically to represent a desire for symmetry of abstract legal principles and a revolt against the complexities of a federated system of government. Under such circumstances, the importance assigned to this argument in fact incorporates an implicit judgment about the relative value of federalism. The same point seems to apply more generally as well. Many other factors also contain implicit judgments on the questions of distribution of power between national and state governments. So long as these underlying considerations are not articulated, it is fairly easy, in these days of increasing reliance on and attention to our central government, to underestimate the importance of the states and the accompanying diversity and diffusion of power.

We shall see that Mishkin’s suggestions seem to have taken hold in recent Supreme Court decisions. Certainly the first difficulty with *Clearfield Trust*, involving the overly solicitous regard given to the concept of a uniform federal rule, has been overcome. The Court now requires a far more complete analysis of the underlying federal interests before it will find a “uniform” federal rule neces-

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90. Id. at 366-67. Although the Court acknowledged that federal law may employ state law in some situations, it concluded without discussion that adoption would be inappropriate in this case. Id. at 367.
92. See text accompanying notes 116-57 infra.
The analysis employed by today's Court also requires that far greater deference be given to state interests than was shown in Clearfield Trust and its initial progeny. The difference is one of the degree of respect held for state interests. Unlike the Court's analysis in Clearfield Trust, wherein one perceives an impatient, almost arrogant attitude toward state interests, today one finds embodied in Court opinions an attitude of solicitude—a judicial perception that there is a fundamental federal interest in seeking to accommodate both federal and state interests in fashioning the rule of law.

Thus, we shall see that the precedents call for an interest analysis, requiring courts to balance state and federal interests before deciding whether to adopt state law as a matter of federal law. The two changes in judicial attitude since Clearfield Trust, calling for careful analysis of the need for uniformity and recognizing a national interest in accommodating both state and federal interests, dictate the main outlines of the interest analysis.

B. The Interest Analysis for the Adoption Issue

Almost immediately after Erie was decided, the Court, in Board of County Commissioners v. United States, made express its recogni-

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95 See id. at 739-40.
96 This criticism may seem unduly harsh if Clearfield Trust is read narrowly, limiting it to its facts involving the protection of United States governmental proprietary interests in claims brought by the United States. The tendency of courts and commentators to read the case broadly, however, warrants this harsh epithet. See, e.g., Mishkin, supra note 56, at 813-14; Note, The Federal Common Law, supra note 91, at 1529-31. But see Bank of Am. Nat'l Trust & Sav. Ass'n v. Rocco, 226 F.2d 297, 299 (3d Cir. 1955) (Clearfield not precedent when dispute involves private parties and does not involve the rights and duties of the United States), rev'd sub nom. Bank of Am. Nat'l Trust & Sav. Ass'n v. Parnell, 352 U.S. 29 (1956).
97 Judge Wisdom, writing for the majority in Georgia Power Co. v. 54.20 Acres of Land, 563 F.2d 1178, 1188-89 (5th Cir. 1977), cert. denied, 440 U.S. 907 (1979), held that a federal rule was required to regulate the matter in controversy, although he noted that the presumption in favor of federal law, evidenced in early Supreme Court decisions, had been departed from in later cases. Judge Simpson, writing in dissent, said, "[a] review of the Supreme Court's decisions in this area reveals a far more certain direction than what the majority calls 'a changing emphasis of factors and shifting preferences for one law or the other'." Id. at 1194. Three years later, the majority opinion was overruled in an en banc opinion which, after reviewing Supreme Court decisions, said the cases "do indeed evidence 'a growing desire to minimize displacement of state law.'" Georgia Power Co. v. Sanders, 617 F.2d 1112, 1118 (8th Cir. 1980) (en banc), cert. denied, 450 U.S. 936 (1981). Those who have been reared on contemporary social values may find it difficult to understand that only a few years ago the zeal for centralized power far exceeded in intensity today's interest in state power. This attitude is only partially illustrated by phrases such as that of Judge Clark, who referred to the "trend of nationalism [that] was happily developing in 1938." Clark, Federal Procedural Reform and States' Rights: To a More Perfect Union, 40 Tex. L. Rev. 211, 220 (1961).
98 308 U.S. 343 (1939).
tion of the need to apply an interest analysis to resolve the adoption question. The Court noted that in areas in which federal law continued to apply, but in which Congress had left undefined certain elements within the law, it would be necessary to analyze state and federal governmental interests to determine whether the content of the unspecified federal law should be a uniform rule or, instead, should be borrowed from a state's law. In this case the issue arose in deciding the right of the United States to recover interest on a judgment for illegally imposed tax payments made by an Indian to the state of Kansas. The Court's analysis noted that Congress had left resolution of this issue for judicial determination through the application of equitable principles including considerations of "public convenience." The Court found that here due regard for local institutions and local interests was particularly appropriate, as states had considerable interests in laws regulating Indian life within their territorial boundaries and these interests did not impinge on federal interests. As the Court observed: "the state law has [in the past] been absorbed, as it were, as the governing federal rule not because state law was the source of the right but because recognition of state interests was not deemed inconsistent with federal policy."

It was Justice Rutledge, however, in United States v. Standard Oil Co., who first identified the main elements of the adoption analysis that the Supreme Court now uses to decide adoption cases. The case involved a claim by the United States against Standard Oil of California for injuries caused by one of its employees to a soldier. The government sought compensation for loss of services and costs of treatment. After holding the matter to raise a federal question and therefore to fall outside of Erie's governance, Justice Rutledge encapsulated the essential elements of the interest analysis:

[T]he answer to be given necessarily is dependent upon a variety of considerations always relevant to the nature of the specific governmental interests and to the effects upon them of applying state law. These include not only considerations of federal supremacy in the performance of federal functions, but of the need for uniformity and, in some instances, inferences properly to be drawn from the fact that Congress, though cognizant of the particular problem, has taken no action to change long-settled ways of handling it.

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99 Id. at 351-52.
100 Id.
101 332 U.S. 301 (1947).
102 Id. at 305-09.
103 Id. at 310.
Although this quotation portrays the then-prevalent preference for federal law, with its deemphasis of state interests, it accurately reflects the rudiments of an interest analysis.\footnote{104} That analysis requires determination of the congressional policy, if any, concerning choice-of-law, the federal governmental interests, the potential effect on those interests risked by adoption of state law, the degree to which federal supremacy applies, and the need for uniformity. Subsequent decisions, including the most current ones, have relied on Standard Oil as the touchstone for analyzing whether state law should be adopted.\footnote{105} However, the Court's tone in its most recent decisions evidences a greater solicitude for state interests.\footnote{106}

The Court's analysis in *Little Lake Misere Land Co. v. United States*\footnote{107} seems to mark the turning point at which the Court came to treat the accommodation of state interests in federal law as itself an important federal interest. There, the Court considered whether to adopt a Louisiana state statute to regulate the prescriptive rights of the United States to oil, gas, and minerals on lands that it had obtained under grants that provided separately for those rights. Although in this case the Court found application of the state statute inappropriate because it was enacted after the land grants in question had taken effect, it acknowledged the strong interest of Louisiana in preserving grantors' mineral rights so as to facilitate voluntary surface conveyances to the United States.\footnote{108} It implied in dicta that such an interest, under appropriate circumstances, could carry sufficient

\footnote{104} Justice Rutledge did in fact give due consideration to the perceived state interest in the deterrence of torts, but found that interest largely unrelated to enforcement of the statute since adding United States' claims to the potential tortfeasor's liabilities would do little to enhance deterrence. Id. at 310 & n. 14. Thus, he found the state interests insufficient to outweigh federal interests and justify adoption. Id. at 310-11.

It should be noted that the Court did not purport to establish a rule, but only to develop a framework for making the interest analysis of *Jackson County*. See text accompanying notes 98-100 supra. The Court stated, "we do not undertake to delimit or categorize the instances where [state law] is properly to be applied outside the *Erie* aegis." 332 U.S. at 309.


\footnote{106} Again, if *Standard Oil* is read narrowly, confined to the acutely federal interest there involved of injury to United States servicemen and compensation to the United States arising therefrom, then inferences of a judicial indifference to state interests may be unwarranted. Cf. Note, Tort Remedies for Servicemen Injured by Military Equipment: A Case for Federal Common Law, 55 N.Y.U.L. Rev. 601 (1980) (noting the peculiarly federal interests raised by injuries to servicemen).

\footnote{107} 412 U.S. 580 (1973).

\footnote{108} Id. at 599.
weight to justify the adoption of state law to govern conveyances occurring after enactment of the statute despite a differing federal interest. 109

In this case, however, such a balance did not occur. The primary importance of Little Lake Misere, for our purposes, lies in its demonstration of the need for care in balancing federal and state interests and the need to preclude adoption of state law that risks defeating the policies of the federal law. In the Court's principal holding it found Louisiana's interests insufficient not on the issue of retroactivity, but on the ground that its interests contradicted federal policy. It held that "even assuming in general terms the appropriateness of 'borrowing' state law, specific aberrant or hostile state rules do not provide appropriate standards for federal law." 110

At this point, the Supreme Court had set forth all of the elements essential to an analysis of whether state law should be adopted as a matter of federal law and had redirected lower courts toward greater concern for state interests. 111 A perceptive student Note, published in 1976, 112 considered this line of Supreme Court precedents and provided insights into the process of deciding the adoption issue. 113 The author found that prior cases suggested a two-step framework for analysis:

First, a court should determine whether there is a conflict between the state law and the federal program. If a conflict is found, adoption of state law should be precluded. Second, if no conflict exists, the state and federal interests involved should be balanced. The federal interests to be considered at the second stage are the need for uniformity and the avoidance of interference, not amounting to a conflict, with a federal program. The relevant state interests are preserving the structure of state regulation in areas of traditionally local concern and avoiding disruptive effects on the operation of state law in other areas. 114

Court decisions since publication of this Note appear to have adhered to such a process. A consideration of these opinions will show the contours of this analysis as it is now applied by the Court. 115

109 Id. at 595, 599.
110 Id. at 595-96. The Court cited for support similar dicta in DeSylva v. Ballentine, 351 U.S. 570 (1956), and Reconstruction Fin. Corp. v. Beaver County, 328 U.S. 204 (1946).
113 Id. at 830-43.
114 Id. at 843-44.
115 Miree v. DeKalb County, 433 U.S. 25 (1977), was the first decision, following the Chicago Note, supra note 112, to raise the question whether state or federal law should control. The
Justice Marshall, in *United States v. Kimbell Foods, Inc.*, provides the most fully articulated recent statement of the process by which the choice-of-law determination is to be made. *Kimbell Foods* presented two cases requiring adoption analysis. The first involved whether a lien of the Small Business Administration (SBA) was to be given priority over a private security arrangement. In this case, an SBA loan, covered by a perfected security agreement, was made to a supermarket after a private lender had entered into a security agreement with that supermarket, but before it had actually extended credit. The issue of priority arose when the supermarket defaulted on both loans. The second case raised a priority contest between a federal contractual lien on a tractor and a private repairman’s lien.

The first issue addressed in both cases was whether federal law or, under *Erie*, state law was to provide the rule on priority. If the federal law was to control, then the Court next had to decide whether it should formulate a uniform federal rule or adopt state law as federal law. Justice Marshall, writing for a unanimous Court, concluded that *Erie* did not control. He further held that although the source of law was federal, a national rule was unnecessary to protect the federal interests underlying the loan programs.

In reaching this conclusion, Justice Marshall noted that under prior decisions, most notably *Little Lake Misere*, once the Court found that federal interests were sufficiently implicated to "warrant the protection of federal law," the first inquiry on the adoption issue is whether applying the state rule in point would frustrate the policy of the federal law; if so, the state rule will not be applied. The Court apparently saw no such threat from the particular state

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117 440 U.S. at 718-20.
118 Id. at 723-24.
119 Id. at 726-27.
120 Id. at 718.
122 440 U.S. at 726-27.
123 Id. at 728.
124 The Chicago Note, supra note 112, at 843, had phrased this first issue in terms of "whether there is a conflict between the state law and the federal program."
laws at issue, relegating the point to a footnote reference. It then turned immediately to isolating the federal and state interests, continuing the analysis rudely outlined in prior cases.

In accordance therewith, the Court first considered whether, under the circumstances presented by the cases, either an interest calling for a uniform federal rule, or an interest in avoiding state law that "would frustrate specific objectives of the federal programs," should control to preclude adoption. Next, the Court considered whether there was any relevant state interest in the matter.

Justice Marshall performed this analysis and concluded that neither federal interest was sufficiently weighty to control and that the state interests were strong enough to justify adoption of the state rule.

In examining the federal interest in uniformity, the opinion followed recent precedent and did much more than ask whether uniformity should be established merely for the sake of uniformity. Instead, the Court analyzed the question closely, stating that it was compelled "to reject generalized pleas for uniformity as substitutes for concrete evidence that adopting state law would adversely affect administration of the federal programs." Although its analysis leaves open the precise degree of administrative burden required to justify formulation of a uniform federal rule, its stance on uniformity itself is unmistakable. Unadorned pleas for uniformity or allegations of administrative inconvenience arising from lack of uniformity, standing alone, will not signal a sufficient federal interest to preclude adoption of state law. Accordingly, the Court noted that the SBA guaranteed loan program was already well adapted to "conform to

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125 440 U.S. at 736 n.37.
126 Id. at 729-33.
127 Id. at 728, 733-38.
128 Id. at 730.
129 The Court did not state its process so explicitly. Instead, it divided the opinion in three parts, considering, in order, the need for uniformity, id. at 729, the inconsistency of state and federal law, id. at 733, and the disruption of state interests, id. at 739.
130 The Chicago Note, supra note 112, suggests that the first step should be to determine whether there is a direct conflict between the state and federal interests, the existence of which results in immediate rejection of state law. The second step should then involve consideration of the need for uniformity, and the potential inconsistency of the state rule with the federal rule falling short of direct conflict. As the Note states, prior Supreme Court opinions had failed to discriminate between "direct conflict" and "inconsistency" between state and federal policies. Id. at 637. Kimbell Foods does seem to discriminate between the two, quickly finding no direct conflict, 440 U.S. at 736 n.37, but discussing the issue of "inconsistency" at length, id. at 733-33.
131 440 U.S. at 739-40.
132 Id. at 729-33.
It concluded that "[s]ince there is no indication that variant state priority schemes would burden current methods of loan processing, . . . considerations of administrative convenience do not warrant adoption of a uniform federal rule." 

As to the federal interest in avoiding "inconsistency" with the objectives of the federal program, the Court looked first to the underlying policy of the SBA program and found it to be a form of social welfare legislation designed to provide funds to small businesses that could not otherwise obtain loans on reasonable terms. The Court then addressed the state law and concluded that the law would not hinder the federal policy, although the law made it more difficult for the government to collect on defaulted loans made under the program. The final step in the interest analysis involved assessing the state interest in regulating the subject matter invoked by federal policy and balancing that interest against the federal interest in having a uniform federal rule apply. The Court identified a weighty state interest

132 Id. at 732.
133 Id. at 733.
134 Id. at 735.
135 Id. at 736 n.37. The Court concluded that Congress did not intend the costs of the federal program to be borne by other creditors of the debtor. The Court placed in contrast federal tax programs, in which the federal interest in collection of debts to the government was the primary federal policy and state laws burdening collection would be inconsistent with that federal interest. Id. at 735.
136 The Kimbell Foods opinion phrased the issue concerning state interest in terms suggesting that such interests should be weighed against federal interests to determine the ultimate issue of adoption. Id. at 728-29. However, because the Court had already found no federal interest in uniformity, id. at 733, and no evidence that state laws, if applied, would impair federal objectives, id. at 738, it had no need to engage in balancing before it held that state law should be adopted. Although it is possible that the Court would have found adoption of state law precluded by the existence of federal interests, it is far more likely that, upon finding such interests, the Court would have proceeded to balance them against those of the state. For if the mere existence of a perceived "weighty" federal interest would preclude adoption, then the Court's command to consider state interests in all cases would have no meaning. In fact, the very logic of the situation would seem to call for balancing if state law ever is to be adopted, since in every case held to invoke federal law under Wallis v. Pan Am. Petroleum Corp., 384 U.S. 63 (1966), which requires more than a formal inquiry into the federal basis of law, there are, by definition, federal interests of sufficient magnitude to foreclose adoption unless they can be overcome by a weightier state interest. Cf. Georgia Power Co. v. 54.20 Acres of Land, 563 F.2d 1178, 1194 (5th Cir. 1977) (dissenting opinion) ("Because the decision is one of federal policy, it will always be possible to identify some federal interest, and thus some conflict with state law necessitating a choice. The key, as stated in Wallis, is that this conflict be 'significant.'") (footnote omitted), cert. denied, 440 U.S. 907 (1979). The Chicago Note, supra note 112, at 846-48, also supports finding a balancing test implied in the Court's reasoning. It argues the strengths of the balancing test over other possible alternatives by showing that if maximum...
and adopted state law to decide the issue of priority. Subsequent cases make it apparent that this valuation of the state interest involves more than a rule of comity and more than the mere recognition of a state interest. Giving due weight to state interests also fulfills a truly federal interest in accommodating the interests of both state and federal governments to the maximum extent feasible without prejudicing the accomplishment of federal policies.\footnote{137}

In subsequent decisions, the Court has acted consistently with Kimbell Foods. In Burks v. Lasker,\footnote{138} the Court addressed the adoption issue in deciding what law should apply to resolve whether a disinterested committee of a corporation’s board of directors may vote to terminate a shareholders’ derivative suit brought as an implied private right of action under the Investment Company Act\footnote{139} and the Investment Advisers Act.\footnote{140} Although it did not expressly purport to follow the Kimbell Foods-Chicago Note framework, the Court, in a different sequence, addressed every element of that framework. First,

accommodation of state and federal interests is the fundamental objective of adoption, then balancing achieves the best accommodation.

The Kimbell Foods Court’s process leaves unanswered the resolution of a case in which all three Kimbell Foods questions are answered negatively. That is, when there is no federal interest in uniformity and the state rule would not impair the federal program, but there is also no state interest, should a uniform federal rule apply or should the state rule be adopted? In Georgia Power Co. v. Sanders, 617 F.2d 1112 (5th Cir. 1980) (en bane), cert. denied, 450 U.S. 936 (1981), the Fifth Circuit provided one tentative answer.

It found the decision largely dependent on whether there is a presumption in favor of one or the other law, and continued:

Basic considerations of federalism as embodied in the Rules of Decision Act, prompt us to begin with the premise that state law should supply the federal rule unless there is an expression of legislative intent to the contrary, or, failing that, a showing that state law conflicts significantly with any federal interests or policies present in this case.

Id. at 1115-16.

\footnote{137} The Supreme Court recently made express its acknowledgement that a strong federal interest in maintaining a viable federal system accompanies the interests of the states in having their own laws govern matters encompassed in federal law. In Board of Regents v. Tomanio, 446 U.S. 478 (1980), the Court stressed federalism concerns in its decision to adopt New York law:

We believe that the application of the New York law of tolling is in fact more consistent with the policies of “federalism” invoked by the Court of Appeals, than a rule which displaces the state rule in favor of an ad hoc federal rule. . . . Here New York has expressed by statute its disfavor of tolling its statute of limitations for one action while an independent action is being pursued. Considerations of federalism are quite appropriate in adjudicating federal suits based on 42 U.S.C. § 1983. See, e.g., Younger v. Harris, 401 U.S. 37 (1971). But the Court of Appeals’ rule allowing tolling can scarcely be deemed a triumph of federalism when it necessitates a rejection of the rule actually chosen by the New York Legislature.

Id. at 491-92.

\footnote{138} 441 U.S. 471 (1979).


\footnote{140} Id. § 80b-1 (1976 & Supp. IV 1980).
the Court found the state interest in having its corporation law govern a peculiarly "local interest" akin to the state interest in family law.\textsuperscript{141} It then disposed of the federal interest in uniformity. It gave a fuller elaboration of the rationale for rejecting barren pleas for uniformity than was given in \textit{Kimbell Foods}, stating that

\begin{quote}
[t]he real concern ... is not that state laws be uniform, but rather that the laws applied in suits brought to enforce federal rights meet the standards necessary to insure that the "prohibition of [the] federal statute ... not be set at naught ..." The "consistency" requirement ... guarantees that state laws failing to meet these standards will be precluded.\textsuperscript{142}
\end{quote}

This clearly embraces the requirement to give close analysis to the federal interest in uniformity established in \textit{Kimbell Foods}.

Finally, the Court considered whether a potential direct conflict or lesser inconsistency existed between state and federal rules.\textsuperscript{143} The Court clearly indicated that it would treat a direct conflict as a basis for placing an absolute bar on adoption of the state rule. It reasoned, however, that a slight inconsistency with the federal law would have to be weighed against the substantial interest of the state evidenced in its corporation law.\textsuperscript{144}

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{141} 441 U.S. at 477-78. The Court already had determined that the cause of action was federal, arising under the statutes, and that therefore \textit{Erie} was not controlling. Id. at 476.
\item \textsuperscript{142} Id. at 479 n.6 (quoting Sola Elec. Co. v. Jefferson Co., 317 U.S. 173, 176 (1942)).
\item \textsuperscript{143} Although the Court treats the two types of conflict together, the language of the opinion indicates recognition of the separate treatment each requires.
\item \textsuperscript{144} Id. The Court did not actually discuss lesser inconsistencies in terms of balancing. The opinion's language, however, see the last sentence quoted at note 143 supra, as well as the Court's analysis in the remainder of the opinion, see 441 U.S. at 480-86, and its reliance on cases that recognize the need to balance state and federal interests, e.g., United States v. \textit{Kimbell Foods}, Inc., 440 U.S. 715 (1979); United States v. \textit{Little Lake Misere Land Co.}, 412 U.S. 580 (1973); \textit{Wallis v. Pan Am. Petroleum Corp.}, 384 U.S. 63 (1966), indicate that the Court had balancing in mind. Presumably, the Court found no need to address directly the issue of balancing since it found that state law was not inconsistent with federal policy and that, in fact, Congress had impliedly intended state law to regulate the powers of independent directors. 441 U.S. at 484-85.
\end{enumerate}
\end{footnotesize}
The opinion is thus consistent with *Kimbell Foods* and can be best understood in its light. However, the *Burks v. Lasker* analysis provides a more streamlined means for determining adoption than does the *Kimbell Foods* approach. Under *Burks*, the Court determines first whether state interests exist and then whether those interests found to exist conflict with federal policies either directly or in the form of lesser inconsistencies. This analysis subsumes in the consistency analysis the determination whether nonuniformity of state laws violates a federal interest, and it also conditions the entire analysis on an identification of a strong state interest.

This streamlined format, calling for adoption of not inconsistent state law, is appealing not only for its simplicity but also because it may be congressionally mandated. It has been suggested that the Rules of Decision Act, which requires the use of state laws in federal courts when applicable, applies not only to diversity cases, as was held in *Erie*, but also to cases in which federal law governs and Congress is silent on the adoption issue. Other cases referring to state law as a

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145 Securities lawyers, dealing with cases in which an independent committee of the board of directors votes to discontinue a federal action raised in a shareholders' derivative suit, often assume that only one issue requires resolution—whether the state and federal interests are inconsistent. This stems from a narrow reading of *Burks* which fails to recognize that it is but one in a string of cases raising adoption issues subsequent to *Kimbell Foods*, see, e.g., *Wilson v. Omaha Indian Tribe*, 442 U.S. 653 (1979), and that these cases compel the resolution of other issues including the need for uniformity, the aberrance or hostility of the state rule to the federal policy, and the relative weight of the federal and state interests. Read in isolation, *Burks* may plausibly be understood to foreclose adoption whenever state and federal interests are inconsistent. 441 U.S. at 477-80. However, because *Burks* cites to *Kimbell Foods*, *id.* at 477, and was decided amid a string of cases that clearly reflect the Court's reliance on a balancing test, such a reading would seem erroneous. This is perhaps one of the casualties of intensive specialization in legal practice—securities lawyers apparently do not read non-securities opinions.

146 In this form, the analysis would be akin to that dictated by Congress in 42 U.S.C. § 1983 (1976), which instructs courts to refer to state law in § 1983 actions when federal law provides no rule of decision "so far as the same is not inconsistent with the Constitution and laws of the United States." See *Board of Regents v. Tomanio*, 446 U.S. 478 (1980) (analyzing the consistency of a state no-tolling rule with the objectives of 42 U.S.C. § 1983 (1976)).

147 28 U.S.C. § 1652 (1976) ("The laws of the several states except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.").

“convenient” ready-made rule may also be better explained by this streamlined version which looks first to whether a state interest exists that is sufficiently weighty to prompt the state to establish rules regulating the relevant subject matter. It may indeed be the analysis of certain of the Justices. In any event, even if the Rules of Decision Act does not dictate which analytical framework is to be used, presumably the Kimbell Foods form and the more streamlined Burks form will yield the same outcome. There is, of course, the possibility that the more complex form, giving express recognition to an interest in uniformity, may cause a different focus, which, when applied to particular fact patterns, may yield differing results.

The final Supreme Court opinion drawing on the Kimbell Foods analysis, Wilson v. Omaha Indian Tribe, clearly establishes an interest analysis that rejects unsupported pleas for uniformity and values state interests as the appropriate means for deciding the adoption issue. This case involved a question of title to riparian land held in trust by the United States under an Indian treaty. Although the treaty placed the case under the aegis of federal law, the Court, following

Indeed, as in Erie, the Constitution may dictate that state rules be adopted when Congress is silent, based on the requirements of its federal system. See note 86 supra.


The only other case in point, Carlson v. Green, 446 U.S. 14 (1980), similarly may be viewed as consistent with Kimbell Foods, although its analysis does not track Kimbell Foods in detail. The case involved a suit brought by the survivors of a federal prisoner whose death was alleged to have resulted from violations of certain constitutional rights. The Court, per Justice Brennan, found a uniform federal rule necessary to determine whether an implied private right of action arising from violation of a constitutional right survives the death of a claimant. Id. at 23. The Court’s decision, when read narrowly, is not inconsistent in result or analysis with one that would be reached under a detailed interest analysis. The federal government has a strong interest in protecting constitutional rights and the states have relatively little interest in protecting the defendant federal prison officials or the prison inmates who are placed in various states at the discretion of federal officials. Id. at 23 n.11. If the case is read broadly, however, disregarding the specialized facts evoking a peculiarly federal interest, and concentrating on the general structure of the Court’s analysis, it evidences a throwback to the elliptical pre-Kimbell Foods techniques of unsystematic analysis. The opinion seems to rest content with the assertion that “only a uniform federal rule of survivorship will suffice to redress the constitutional deprivation here alleged and to protect against repetition of such conduct.” Id. at 23. This language contrasts sharply with Kimbell Foods’ rejection of “generalized pleas for uniformity as substitutes for concrete evidence,” United States v. Kimbell Foods, Inc., 440 U.S. 715, 730 (1979). It is not enough for the Court to state that it knows the need for uniformity when it sees it. Justice Rehnquist brings to light this seeming failure in the majority’s analysis when he asserts, “[t]he Court articulates no solid basis for concluding that there is any interest in uniformity that should generally be viewed as significant.” 446 U.S. at 49 (Rehnquist, J., dissenting).
the *Kimbell Foods* analysis, held that state law should be adopted as the federal rule of decision.\(^{152}\) The Court found "little likelihood of injury to federal trust responsibilities or to tribal possessory interests" from adoption of state law, thus resolving both the direct conflict and inconsistency elements.\(^{153}\) It then noted that, "[t]his is also an area in which the States have substantial interest in having their own law resolve controversies such as these. Private landowners rely on state real property law when purchasing real property . . . ."\(^{154}\) The opinion further tracked the *Kimbell Foods* analysis, quoting its language in rejecting "‘generalized pleas for uniformity as substitutes for concrete evidence that adopting state law would adversely affect [federal interests].’"\(^{155}\)

The Court’s use of this analytical approach, prior to citing and describing *Board of County Commissioners v. United States*,\(^{156}\) may indicate most strongly its support for the *Kimbell Foods* analysis. Although *County Commissioners* supplied a closely similar fact pattern that might normally have been relied on as determinative, it contained a much more rudimentary interest analysis which the Court may have wished to avoid endorsing.\(^{157}\)

In summary, the adoption analysis relied on by the Supreme Court provides a process for finding the maximum accommodation of federal and state interests when federal law controls but no federal rule has been specified. This process of accommodation may be described as follows:

When the federal interests underlying federal law would be totally defeated by observing the state interest through adoption of the

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\(^{152}\) The *Wilson* Court reasoned:

*Kimbell Foods* advises that at this juncture we should consider whether there is need for a nationally uniform body of law to apply in situations comparable to this, whether application of state law would frustrate federal policy or functions, and the impact a federal rule might have on existing relationships under state law. An application of these factors suggests to us that state law should be borrowed as the federal rule of decision here.

442 U.S. at 672-73.

\(^{153}\) Id. at 673.

\(^{154}\) Id. at 674.

\(^{155}\) Id. at 673. The Court’s substitution of the words “federal interest” for those used in *Kimbell Foods*, “administration of the federal program,” makes even more clear the Court’s commitment to a balancing of interests. In this case, the Court found application of a uniform rule particularly inappropriate to decide whether riparian land ownership had changed by accretion or had not changed because sudden avulsion had altered the shoreline. It reasoned that adopting the various state rules would “avoid arriving at one answer to the avulsive-accretion riddle in disputes involving Indians on one side and possibly quite different answers with respect to neighboring land where non-Indians are the disputants.” Id. at 674.

\(^{156}\) 308 U.S. 343 (1939); see text accompanying notes 98-100 supra.

\(^{157}\) *Wilson v. Omaha Indian Tribe*, 442 U.S. at 674-75.
state rule, the federal interests will be given supremacy and a uniform federal rule will be announced.\textsuperscript{158} If no direct conflict exists, a court must then determine whether the federal interests, including any interest in maintaining a uniform rule to effectuate underlying federal policies, compete with identified state interests, in the sense that adoption of the state rule would partially hinder the full implementation of the federal interest. If this lesser conflict is found to exist, the court must measure the relative strengths of the federal and state interests to determine whether adoption of the state rule or determination of a uniform federal rule would yield the maximum satisfaction of all interests. In the event that federal interests do not compete with the state interests, the state rule should be adopted.\textsuperscript{159}

\textbf{C. Interstitial Law as a More Appropriate Concept than the Concept of Federal Common Law}

Before we apply this interest analysis to the question whether to adopt state rules of professional responsibility to regulate attorney behavior under the federal securities laws, a spurious potential obstacle to that application should be eliminated. Much of the relevant literature discusses the adoption issue in terms of "federal common law." This label, "federal common law," invites controversy since the term "common law" generally connotes judge-made law to the exclusion of statutory and constitutional interpretation.\textsuperscript{160} Hence, one might argue that there can be no application of the \textit{Kimbell Foods} analysis to a case, such as \textit{National Student Marketing}, in which the SEC seeks in an injunctive action to enforce the antifraud provision of rule \textit{10b-5} against an attorney pursuant to its \textit{express} authority under the 1934 Act.\textsuperscript{161} Clearly such an argument would be erroneous. Cases such as \textit{Reconstruction Finance Corp. v. Beaver County},\textsuperscript{162}


\textsuperscript{159} The Supreme Court's most recent statements regarding a federal court's power to compose federal common law indicate even greater deference to state interests. In these cases, the Court seems to move beyond requiring a mere balance of federal and state interests to establishing a rebuttable presumption that absent a clear statement from Congress that a federal rule is to govern, courts are to apply state law. See \textit{Texas Indus., Inc. v. Radcliff Materials, Inc.}, 101 S. Ct. 2061, 2066-67 (1981); \textit{City of Milwaukee v. Illinois}, 101 S. Ct. 1784, 1792 (1981).

\textsuperscript{160} See \textit{Hart & Wechsler, supra note 73}, at 770.

\textsuperscript{161} Securities Exchange Act of 1934, § 21, 15 U.S.C. § 78u (1976 & Supp. IV 1980). In the securities area, only \textit{implied private} actions have become known generally as "federal common law" cases.

\textsuperscript{162} 328 U.S. 204 (1946).
which adopted state law as a matter of federal law to define the term "real property" used in a federal statute, attest to the fact that adoption is appropriate in cases generally not regarded as involving "federal common law." The construct of "federal common law" is simply inapposite as a threshold to adoption analysis. Rather, the crucial factor that triggers the adoption inquiry is the existence of interstices, caused by unspecified elements left in federal law, that require either a state or federal rule to fill them. It is, therefore, advisable to discard entirely the label "federal common law" and to view all cases with interstices requiring adoption analysis as residing on a continuum with variations existing only as to the breadth of the interstices needing to be filled.

This new, single concept of "interstitial lawmaking" is supported by the nature of the lawmaking process giving rise to interstices. Neither the Constitution, nor Congress in legislating, nor the executive branch in drafting treaties, can anticipate every question likely to arise under its laws and, therefore, courts must of necessity fill these interstices when deciding cases under these laws. Sometimes the interstices in federal laws are so wide that courts appear to be indulging in common law rulemaking, thus giving rise to the term "federal common law." The cases do not differ in kind, however, but only in the degree of specificity used by the drafters of the congressional, constitutional, or treaty-based federal law. In all cases, the courts must supply meaning to a vague law in an area in which the intent of its drafters may not be apparent. Hart and Wechsler have noted this insight, stating that

the term federal common law, is not analytically precise. The demarcation between "statutory interpretation" or "constitutional interpretation," on the one hand, and judge-made law on the other, is not a sharp line. Statutory interpretation shades into judicial lawmaking on a spectrum, as specific evidence of legislative advertence to the issue at hand attenuates.¹⁰³

Thus, instead of classifying the cases into "federal common law" cases and other federal cases, it is far more useful for purposes of the adoption analysis to consider all federal cases requiring interstitial judicial lawmaking in one class. This classification would include cases like Beaver County, involving some word or phrase of a federal statute that Congress has left undefined,¹⁰⁴ as well as cases involving

¹⁰³ Hart & Wechsler, supra note 73, at 770.
¹⁰⁴ See also DeSylva v. Ballentine, 351 U.S. 570, 580-81 (1956) (Court adopted state law to define term "children" for purposes of copyright renewal under federal statute). See generally Hart & Wechsler, supra note 73, at 491-92.
an implied right of action, like Burks v. Lasker, in which most of
the elements of a cause of action are left for judicial implementation.
Also included, of course, would be cases like an SEC suit seeking an
injunction for alleged violations of rule 10b-5 against an attorney who
is aiding and abetting a fraud. Such cases require interstitial lawmak-
ing because rule 10b-5 says nothing about aiding and abetting or
about the standards of conduct to which attorneys are to be held, but
instead leaves the matter for judicial determination. Thus, employing
this single category eliminates the obfuscatory effects of the concept of
federal common law.

The issue of adoption arises in this judicial interstitial lawmaking
context as a logical outcome of our federal system of lawmaking.
Because federal lawmakers enact laws against the background of state
law, courts may turn naturally to state law to fill interstices in
federal statutes when the drafters of federal law have failed to make
their intent known. Thus, in every instance of federal interstitial
lawmaking, the option of creating a uniform federal rule of whole
cloth or of adopting ready-made state standards exists.

We turn next to the specific question whether state standards of
professional responsibility should fill interstices in federal law regard-
ing the obligations under which attorneys act in practicing securities
law.

III
APPLICATION OF THE ADOPTION ANALYSIS
FOR ATTORNEYS’ DUTIES UNDER THE
SECURITIES LAWS

A. The Hypothetical Worst Case

This paper does not seek to suggest the total content of profes-

sional responsibility rules to be incorporated into the securities laws.
The variety of factual patterns under which the issue of an attorney’s
duty may arise, as well as the debate over the meaning of the codes of
professional responsibility in various contexts, make clear that the
area is too unsettled to attempt such an enterprise. In this Article, I
address only the question whether state rules should be adopted as
federal law; and for this purpose it may be best merely to illustrate the
proposed process by one hypothetical case. To best advance the anal-

166 See text accompanying notes 72-74 supra.
ysis, I posit what may be the “worst case” for adoption—one in which a state rule is directly opposed to the duty that would be placed on attorneys by the SEC rule in William R. Carter. And to avoid loss of focus on the issue of adoption, the Kimbell Foods adoption analysis is applied only to the skeletal form of this worst case.

The Commission’s announced rule in Carter and a proposal of the American Trial Lawyers’ Foundation (ATLF) arising out of the National Student Marketing debate, compose the skeletal form of this worst case for adoption.

In Carter, the SEC sought to determine “the professional obligations of the lawyer who gives essentially correct disclosure advice to a client that does not follow that advice and as a result violates the federal securities laws.” It then incorporated its resolution of the issue in a recent “Request for Comments on Standard of Conduct Constituting Unethical or Improper Professional Practice Before the Commission,” stating that:

Within the context of the facts of In re Carter, the Commission determined that the following standard of unethical or improper professional conduct would be appropriate in similar cases in the future:

When a lawyer with significant responsibilities in the effectuation of a company's compliance with the disclosure requirements of the federal securities laws becomes aware that his client is engaged in a substantial and continuing failure to satisfy those disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's noncompliance.

... As a general matter the Commission found that a lawyer must, in order to discharge his professional responsibilities, make all efforts within reason to persuade his client to avoid to [sic] terminate proposed illegal action. Such efforts could include, where appropriate, notification to the board of directors of a corporate client.

168 Id. at 320.
169 SEC Exch. Act Release No. 6344, 23 SEC Docket 826 (1981). It is not clear whether the Commission proposes to adopt a regulation or merely wishes to issue a release in order to solidify the position it originally stated in Carter.
170 Id. at 827-28 (quoting Carter, 22 SEC Docket at 322).
171 Id. at 827 (quoting Carter, 22 SEC Docket at 320).
Under the asserted rule, in at least some situations, an attorney whose disclosure advice is ignored by the chief executive officer, and who fails to inform the board of directors of such noncompliance, risks SEC sanctions for violation of professional standards. This may be a perfectly reasonable requirement. But let us assume in our hypothetical case that this rule is contrary to applicable state law, as it could be if the state had adopted the ATLF proposal for standards of professional conduct and the corporation acted as described in the following hypothetical.

Rule 2.5 of the ATLF proposal reads:

2.5. A lawyer representing a corporation shall, at the outset of the lawyer-client relationship, inform the board of directors of potential conflicts that might develop among the interests of the board, corporate officers, and shareholders. The lawyer shall receive from the board instructions in advance as to how to resolve such conflicts, and shall take reasonable steps to ensure that officers with whom the lawyer deals, and the shareholders, are made aware of how the lawyer has been instructed to resolve conflicts of interest.

Under this rule of professional conduct we shall assume, as apparently was intended, that a lawyer would have no duty to discontinue representation or to inform the board or shareholders of the corporation, or the SEC, if there were a prior agreement between the lawyer and the board that obligated the attorney to maintain confidentiality after becoming aware of a corporate officer's misconduct. This, of course, is in direct conflict with the rule the SEC seeks to establish.

172 For a reasoned argument supporting the Carter rule under state law, see ABA Model Rules of Professional Conduct rule 1.13, Legal Background (proposed final draft May 30, 1981).
174 In commentary, the ATLF explains the policy underlying this proposed rule:

One of the conundrums of professional ethics has been the responsibility of a corporate lawyer who learns from a corporate official that the official has engaged in illegal conduct, either against or on behalf of the company. In informing the lawyer, the official has assumed a confidential relationship. Nevertheless, the lawyer may feel compelled to inform the board of directors, which is generally regarded as the embodiment of the corporate entity. If the board fails to take appropriate action, however, the lawyer may then feel an obligation to inform the shareholders (although the general public will then learn about the problem, to the likely disadvantage of the company). As the question is frequently posed, who is the lawyer's client in those circumstances?

Although it has not been generally recognized, the problem is basically a familiar and relatively simple one of conflict of interest. The lawyer's difficulty is insoluble only because the lawyer has failed to inform the board of readily foreseeable conflicts of interest and to receive guidance in advance. On the basis of the board's instructions, the lawyer can then
For our illustrative purposes let us assume that the chief executive officer of a corporation tells the corporation's general counsel, who advises on disclosure obligations, that he or she has used ten million dollars of the corporation's funds to bribe local officials over a period of time "to facilitate" the corporation's obtaining a cable television franchise from a municipality. Assume further that in accordance with ATLF rule 2.5, the board of directors had previously instructed the lawyer to maintain the chief executive's confidences and that the shareholders had been properly notified of this instruction. Further, to sharpen the instructiveness of the hypothetical, assume, despite the fact that it is not clear, that under these circumstances the SEC rule would require disclosure to the board while the ATLF rule, as implemented by the corporation, would prohibit such disclosure. Should the attorney, who observes his or her agreement under rule 2.5, be subject to liability in various securities law proceedings or should the state rule be adopted as federal law?

B. Applying the Adoption Analysis to Substantive Law Liability

Suppose the SEC charges the lawyer with aiding and abetting the chief executive of the corporation by failing to disclose the bribes and brings an action seeking an injunction for violation of rule 10b-5. Will the lawyer be successful in urging that he or she observed the professional obligations imposed by the state law rule, ATLF rule 2.5, and that this rule should control to excuse him or her from liability?

Although some question exists as to whether a duty to disclose would arise under federal securities laws, we shall assume that a court, given our hypothetical circumstances, would so decide. These facts may also show a violation of the accounting provisions of the Foreign Corrupt Practices Act of 1977, 15 U.S.C. § 78m(b)(2) (Supp. IV 1980) (amending § 13(b) of the Securities Exchange Act).
This hypothetical provides a classic case for adoption analysis. Manifestly the question in the injunction case is whether the last element of the aiding and abetting test is satisfied—whether a duty was violated. The outcome of the case will turn on how "duty" is defined by the court; the court must decide whether a special relationship existed between the attorney and the corporation or its shareholders and whether the attorney breached the resulting affirmative duty to reveal to the board of directors the chief executive officer's bribes. This is precisely the type of case that requires interstitial lawmaking through adoption analysis. The SEC's *Carter* rule was an attempt by the SEC to fill interstices left in federal law as to the attorney's professional duties. It was derived through interpretation of the phrase, "unethical or improper professional conduct" in rule 2(e). Thus, it is not an antifraud rule per se, but it is relevant, if at all, as a federal ethical rule in the duty analysis. It is of the same order as ATLF rule 2.5, and the determination of which of the conflicting rules controls substantive law liabilities depends on whether an interest analysis favors a federal rule or a state rule to define lawyers' duties.

1. The Special Problem of the SEC as an Independent Administrative Agency

The first question that should be raised in applying an adoption analysis to this hypothetical is whether the SEC, as an independent administrative agency, is obligated to observe the interest analysis of *Kimbell Foods* in adopting agency rules just as a court would be obligated in making a judicial interpretation of rule 10b-5. As previously noted, when Congress is silent on the issue of adoption and there is no basis for inferring legislative intent as to the ambiguous element of federal law, the Supreme Court requires the lower courts to determine whether state law should be adopted. In making this determination, unless something in the nature of the federal system or in such general statutes as the Rules of Decision Act governs, the adoption question is a matter of judicial, and not legislative, policy.

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178 For the elements of aiding and abetting, see text accompanying notes 25-26 supra.
177 See note 5 supra.
179 See text accompanying note 85 supra.
180 See notes 147-48 and accompanying text supra.
181 See text accompanying note 86 supra.
One might argue under this framework that because Congress has established the SEC as an independent administrative agency with jurisdiction to adopt rules to enforce congressional policy, the SEC may establish its own policy, independently of any judicial policy, to decide issues to which Congress did not address itself or express its intent. This policy would be established under the SEC's inherent rulemaking authority and would be beyond subsequent judicial scrutiny as to the propriety of its policy concerning adoption. From this perspective, the SEC is free to fashion its own rule to decide whether a uniform federal rule should apply, or under what circumstances state law should be adopted. Thus, the Commission would be free to adopt a uniform federal *Carter* rule without first applying *Kimbell Foods*.

This conclusion seems to conflict, however, with the strong federal interests that underlie the Court decisions leading to *Kimbell Foods*. First, the recent cases point to an intrinsic principle of the federal interstitial law, derived from the constitutional structure of the federal system, that regards the accommodation of state and federal interests as a truly federal interest. These federalism concerns would be exacerbated if administrative agencies were given discretion to resolve adoption issues free from the policies established by the Court. The resulting administration of federalism would then differ depending on whether a court or federal agency was interpreting federal law, and the treatment accorded state interests would probably also differ among agencies. Hence, as a matter of constitutional policy, administrative agencies should probably be required to follow the same framework of analysis as do the courts.

If the adoption question is not regulated by mere judicial policy but falls under the governance of the Rules of Decision Act, the express statutory law as well as constitutional policy would compel agencies to adhere to a *Kimbell Foods* interest analysis. Agencies would not be permitted to establish their own policies of adoption but rather would be subject to the same constraints that underlie the *Kimbell Foods* analysis.

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182 E.g., Board of Regents v. Tomanio, 446 U.S. 478, 491-502 (1980); see text accompanying note 137 supra; notes 86, 137 supra.


184 The fact that agencies may not be competent independently to promulgate professional standards should also constrain their action in this area. The Commission has been charged with lack of expertise in professional ethics. See Daley & Karmel, supra note 12, at 785. This, if conceded, should be a sufficient basis for deferring to bodies primarily concerned with that subject, such as bar associations.
Nevertheless, whether or not that analysis is specifically mandated by the above considerations, the interest analysis should be adopted as a matter of agency policy and should be similar to the analysis that follows.\footnote{There is precedent for the Commission to adopt state law to govern the existence of shareholders' rights. For example, Proxy Rule 14a-8(c)(1), 17 C.F.R. § 240.14a-8(c)(1)(I) (1981), promulgated under the 1934 Act, adopts the law of the state of incorporation to determine whether shareholders' proposals are proper subjects for inclusion in proxy solicitations. Another example of adoption in codified federal law, this one outside the securities context, is offered in the federal rule of evidence concerning privileged communications. Congress there refused a Supreme Court uniform rule proposal and instead established uniform federal rules of privilege for federal elements of law but provided for the adoption of state rules of privilege for elements for which state law supplies the rule of decision. Fed. R. Evid. 501.}

2. The Interest Analysis

Assuming that the questions just raised do not result in preclusion of an interest analysis by the court hearing the injunction suit, what would be the result of that analysis in determining whether the lawyer had a duty to resign or reveal the bribes to the board?\footnote{There remains some question whether rule 10b-5 liability can ever be imposed in a private action against an attorney for failure to go to the board of directors. Professor Fischel has argued that because the "enforcement rationale," enunciated by the Supreme Court in J.I. Case Co. v. Borak, 377 U.S. 426 (1964), has been rejected by the Court as a basis for inferring a private right of action under rule 10b-5, see Transamerica Mortgage Advisers, Inc. v. Lewis, 444 U.S. 11, 24 (1979) (court will not imply a private cause of action without a showing of congressional intent); Touche Ross & Co. v. Redington, 442 U.S. 560, 571, 577 (1979), it cannot support the bringing of private actions against aiders and abettors. Fischel, supra note 24, at 100-02. This "enforcement rationale," rejected by the Court, allows private parties to bring private actions in order to enhance the SEC's enforcement of the securities laws. In this way, it is akin to the "access theory," relying on private individuals to enforce fully SEC policies. See note 28 supra. Professor Fischel argues that the rule established by recent Court decisions, which rejects generalized references to remedial purposes as a basis for finding implied rights of action and instead requires evidence of congressional intent, bars use of the access theory as a means of reaching aiders and abettors. Fischel, supra, at 93-100. This reasoning is unpersuasive, however. Although the Court rejects the rationale of Borak, it refuses to overturn its rule of providing an implied right of action essentially because hundreds of lower court decisions have relied on it. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 190-97 (1976). Logically, the lack of congressional intent should also not bar aider and abettor liability under rule 10b-5 and § 14(a), since the lower courts are nearly unanimous in holding aiders and abettors liable. See Fischel, supra, at 81-84.}
process, as we have seen, requires first, a determination of whether
the state rule would frustrate the federal interests and second, if no
direct conflict arises, a balancing of the interests to determine the
weightier set to be served.

Under the suit to enjoin the attorney, the federal policy to be
served by rule 10b-5 is the protection of the securities markets from
manipulation, in a technical sense, or misrepresentations made with
scienter by issuers whose shares are being publicly traded. In the
present context, there is no manipulation; hence, the relevant interest
is in avoiding misrepresentation. This would include a duty to correct,
in certain circumstances, although the duty depends on various nu-
ances of fact.

(citing cases). The Supreme Court has expressly reserved this issue. Ernst & Ernst v. Hochfelder,
425 U.S. at 191 n.7.

187 See text accompanying notes 158-59 supra.
188 Aaron v. SEC, 446 U.S. 650 (1980) (scienter required in SEC actions); Santa Fe Indus.,
Inc. v. Green, 430 U.S. 462 (1977) (rule 10b-5 limited to deceit or manipulation); Ernst & Ernst
v. Hochfelder, 425 U.S. 185 (1976) (deceit or manipulation with scienter necessary in a private
action). An affirmative duty to disclose, although much discussed, and the subject of dicta in a
few opinions, has never been established by a court. See Goldberg v. Meridor, 567 F.2d 209, 221
n.10 (2d Cir. 1977), cert. denied, 434 U.S. 1089 (1976); Financial Indus. Fund, Inc. v. McDonnell
Douglas Corp., 474 F.2d 514, 519 (10th Cir.) (en banc) (per curiam), cert. denied, 414 U.S.
874 (1973). See generally Bauman, Rule 10b-5 and the Corporation's Affirmative Duty to
Disclose, 67 Geo. L.J. 935 (1979). Securities practitioners, however, believe that good practice

The Second Circuit recently has held that rule 10b-5 extends protection not only to buyers
and sellers of securities, but also to non-buyers and sellers when there is fraud in connection with
98,332 (2d Cir. Oct. 30, 1981). The court does not disturb, however, the Supreme Court's ruling
in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), that only buyers and sellers can
bring private actions under rule 10b-5.

189 See, e.g., Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 162-64 (2d Cir. 1980) (company
has no duty to correct outsider statements for which it is not responsible that do not accord with
the company's own evaluations); Ross v. A.H. Robins Co., 465 F. Supp. 994, 998 (S.D.N.Y.)
(company has duty to correct prior statement, accurate when made, which becomes misleading
due to subsequent events and which "remains alive" to public), rev'd on other grounds, 607 F.2d
180, 188-89 (S.D.N.Y. 1987); Fillis, Current Problems of Accountants' Responsibilities to Third
Parties, 28 Vand. L. Rev. 31, 128-30 (1975) (discussing other cases); Schneider & Shargel, supra
note 188, at 1643-44.

In our hypothetical case this federal policy of rule 10b-5 could reasonably be held to place
upon the chief executive officer and the corporation a duty to disclose the bribes. In Carter, the
Commission seems to have rejected the proposition that the circumstances warrant placing on
the attorneys a duty to correct prior representations of the client corporation. William R. Carter,
the only duty under the Carter rule applicable to our hypothetical case would be the duty to go
to the directors with the information.
Applying the first step of the _Kimbell Foods_ analysis, the state rule of ATLF rule 2.5, if adopted, probably would not frustrate the federal policy to the degree necessary to be considered "hostile or aberrant" under _Little Lake Misere_, and therefore would not be absolutely barred from adoption. Even if the attorney is excused from a duty to go to the board, the chief executive officer continues to be under a duty to disclose the facts. Moreover, the firm's auditors, internal or external, or its other employees, may uncover the bribes. The attorney is not the sole source of protection. Thus, the federal interest in truthful disclosure will not necessarily be defeated if counsel is not held to this duty. While it is true that threatening attorneys with liability will probably increase the likelihood of such disclosure, the absence of such a threat will neither prevent disclosure by principals nor otherwise totally frustrate this policy. It is also likely that many attorneys will exert equal pressure on management to make truthful disclosure with or without the threat of personal liability hanging over them. Moreover, preserving the chief executive officer's confidences may encourage him or her to seek legal advice which otherwise would not be sought and actually increase disclosure as a result of the attorney's counselling. Hence, the federal policy will not be totally defeated by excusing counsel, although perhaps it may be diminished by inconsistencies to be weighed under the _Kimbell Foods_ balancing test.

Next, we consider the federal interest in uniformity as the second phase of the adoption analysis. Uniformity is not required merely for the sake of uniformity; it becomes a legitimate federal interest only if "adopting state law would adversely affect administration of the federal programs," thereby frustrating the purpose of the federal statute. Thus, as the Court stated in _Burks v. Lasker_, the uniformity analysis is subsumed under the general inquiry into the consistency of

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180 See text accompanying note 110 supra.
181 The inanimate corporation may also be placed under this duty even though its directors are ignorant of the underlying facts. Cf. Franchard Corp., 42 S.E.C. 163, 178 (1964) (disclosure may be required in a prospectus when particular corporate transactions have raised questions of noncompliance with state or federal law).
182 Cf. United States v. Standard Oil Co., 332 U.S. 301 (1947) (increased deterrence produced by adding liability to the United States for loss of services of an injured soldier to potential tort liability did not sufficiently further the state interest to require adoption of state law). See also note 104 supra.
183 See ABA Code of Professional Responsibility Disciplinary Rule 7-102(B)(1) (1980), which requires this exhortation.
185 See text accompanying notes 132-33, 142 supra.
the state and federal interests. This "'consistency' requirement . . . guarantees that state laws failing to meet these standards will be precluded." Under this uniformity requirement, a uniform federal rule will apply only if the federal program would be totally frustrated, as in *Little Lake Misere*, or if the application of varying state rules adopted as a matter of federal law would cause undue interference with federal interests.

Applying this analysis to the policies of rule 10b-5, state law would be precluded only if the federal interest in preventing misrepresentation would be disrupted by the adoption of varying state rules. It may be urged that because corporations often transact affairs across numerous state lines, the determination of which state's law to adopt may disrupt effective enforcement of federal policy or that application of varying state laws will burden enforcement. However, the decision as to which state's law should control is probably a matter of federal law which can readily accommodate this federal concern as well as the competing state interests. In addition, the application of varying rules in this context is no more disruptive than what the Court required in *Burks v. Lasker* in another context. There the Court expressed no concern as to potential inconvenience to enforcement.

In further support of adoption, the Court has noted the value of establishing a single rule to regulate primary private activity. For example, in *Wilson v. Omaha Indian Tribe* the Court made express reference to the undesirable effects of having one rule regulate the riparian rights of Indians and a different rule regulate the rights of non-Indians. In the case of attorneys, the matter is exacerbated because the conflicting SEC and state rules may apply to the same attorney when he or she is involved with an SEC-regulated matter and a non-SEC matter. Moreover, the attorney may be subjected to

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197 See note 58 supra.
198 441 U.S. 471 (1979). If ATLF rule 2.5 were to become the general state law rule, there is some authority for rejecting an inconsistent federal rule. As *Kimbell Foods* itself pointed out, quoting Judge Friendly in *United States v. Wegematic Corp.*, 360 F.2d 674, 676 (2d Cir. 1965): When the states have gone so far in achieving the desirable goal of a uniform law governing commercial transactions, it would be a distinct disservice to insist on a different one for the segment of commerce, important but still small in relation to the total, consisting of transactions with the United States. 440 U.S. 715, 732 (1979). Although the securities markets are very large, professional responsibility in securities laws is very small compared to the general scope of attorney practice to which codes of professional responsibility apply.
200 Id. at 674.
suspension from SEC practice for behavior that he or she pursues in order to avoid violating the state rules of ethics.201

Finally, we must identify in the context of our hypothetical the state interests underlying ATLF rule 2.5 and weigh them against the federal interests evidenced in rule 10b-5. The very specific ATLF rule appears to embody state interests in (1) providing the chief executive officer with assurance that his or her confidence will be honored by the attorney, thereby encouraging the seeking of legal advice untramelled by a fear of exposure, (2) the attorney providing zealous representation to corporate officers free from the risk that he or she will be held liable for not disclosing confidential information,202 and (3) providing order to corporate affairs through adequate notice to all members of the corporation as to the nature of the attorney’s duties in representing the corporation. These state interests must be weighed against the federal interest of avoiding misrepresentation to investors.

Obviously the decision of how much weight to give to each set of interests in deciding the adoption issue is a subjective one and therefore opinions may differ. But since the federal interest in protecting investors from misrepresentations may be satisfied through duties placed on the corporate principals while the state interests in maintaining attorney-client confidences and giving adequate notice to shareholders may be served only if state law is adopted, the scales seem to favor adopting ATLF rule 2.5 to define the attorney’s duty in representing the chief executive officer. Hence, no liability for aiding and abetting should arise in our hypothetical.

C. Applying the Adoption Analysis to Clause (ii) of Rule 2(e)(1)

Suppose that instead of charging violation of a substantive securities law provision, the SEC in our hypothetical institutes a rule 2(e) proceeding to suspend the attorney from practice under clause (ii), charging the attorney with "unethical or improper professional conduct." If clause (ii) were merely an in-house rule, regulating only attorney conduct taking place before the SEC, and restricting only future practice before the SEC as a consequence of disbarment, the federal interest would be substantially stronger and the state could claim only a small interest in the administration of SEC actions. However, under the current application of clause (ii), the attorney

201 Cf. Hart, supra note 1, at 489 ("People repeatedly subjected . . . to two or more inconsistent sets of directions, without means of resolving inconsistencies, could not fail in the end to react as [Pavlov’s] dogs did. The society, collectively would suffer a nervous breakdown.").

202 See Marsh, supra note 5, at 1010-11; Michigan Note, supra note 7, at 1276-77.
may be reached even though his or her alleged misconduct does not take place in a transaction with the Commission or in a Commission hearing.\textsuperscript{203} Furthermore, under the SEC staff's view of the scope of disbarment from securities practice, the attorney may be prohibited from giving advice to clients on all securities law matters even though these also may not involve the Commission.\textsuperscript{204} Given the expansive scope applied by the SEC to the reach of clause (ii) actions, it is difficult to perceive any stronger federal interest than those involved in the rule 10b-5 injunctive proceeding. First, to the extent that violations of clause (ii) that do not involve dealings with the SEC could be used to disbar the attorney from filing documents with the Commission or participating in adjudicative proceedings before the Commission or one of its administrative law judges, the disbarment resembles a refusal to admit the lawyer to practice because of a claimed defect in character or fitness. In this instance, the violative conduct has no relationship to the practice for which the attorney is barred. Since the Administrative Procedure Act (APA) itself prohibits agencies from licensing persons for initial practice before it,\textsuperscript{205} the SEC's enforcement procedure itself may contravene this provision under these circumstances. Also, although the APA does not "limit the discipline, including disbarment, of individuals who appear in a representative capacity before an agency,"\textsuperscript{206} it does not authorize disbarment from the practice of securities law outside of the agency context. Thus, if there is a federal policy permitting the disbarment of the attorney from general securities practice in our hypothetical case, that policy must be the SEC's "access theory." This would place the attorney within the scope of practice before the SEC by requiring him or her to aid the SEC in enforcing the securities laws by revealing to the board the chief executive officer's bribes.

Even assuming the validity of the access theory in this context,\textsuperscript{207} its purpose is to prevent violation of the substantive provisions of the securities laws by principals, and hence the charge under clause (ii)

\begin{itemize}
  \item See Daley & Karmel, supra note 12, at 763-65; Marsh, supra note 5, at 993-95.
  \item 5 U.S.C. § 500(b) (1976) (any person is authorized to represent another before an agency if he is a member in good standing of the bar of the highest court of a state). Commentators have also argued that the legislative history of the securities laws suggests that the cause for disbarment must arise from misconduct in a transaction or proceeding with the SEC. Daley & Karmel, supra note 12, at 781.
  \item For an argument that an aiding and abetting rule is invalid in all contexts, see Fischel, supra note 24, at 93-100.
\end{itemize}
becomes the functional equivalent of charging the attorney with aiding and abetting a fraud. Therefore, the same federal interest is involved, and again this would not seem to carry sufficient weight to warrant a uniform federal rule in place of adopting state law.

If, on the other hand, a totally different situation arose in which, for example, the attorney in our hypothetical had intentionally provided perjured testimony in an SEC hearing, rather than merely failing to disclose, the express policy of the APA permitting disbarment for misconduct of individuals “who appear in a representative capacity before [the] agency”\(^{208}\) would provide an overwhelming federal interest which clearly should prevail. Indeed, it is doubtful that one could posit a reasonable state interest that could displace the federal interest in regulating practice before the SEC. Any state rule that approaches legitimization of such action would clearly violate the Little Lake Misere “aberrant or hostile” test.\(^{209}\)

**Conclusion**

Although at first blush it seems inconsistent with the concept of federal law, under a *Kimbell Foods* interest analysis some circumstances may warrant application of state law to determine the aider and abettor liability of attorneys for alleged substantive violations of the federal securities laws. This may have an important impact on the practice of securities law since state standards are generally less far-reaching than those recently espoused by the Commission. The determination of whether state law will indeed be adopted depends on application of an interest analysis, outlined in several recent Supreme Court opinions, to compare federal and state policies touching the particular activity left undefined in federal law. In the context of substantive violations by attorneys, under this analysis state interests may not conflict directly with federal policies and may be sufficiently compelling to justify adoption of state law. It also appears that the SEC, in adopting professional standards for the regulation of securities practice under its rule 2(e), may be obligated, if the interest analysis is rigorously applied, to adopt state law to regulate attorney conduct in transactions other than those directly with the Commission.


\(^{209}\) The application of a uniform federal standard to actual practice before an agency, but local rules for other practice, is espoused in the ABA Model Rules of Federal Agency Discipline promulgated by the ABA's Standing Committee on Professional Discipline. See Greene Speech, supra note 7.