[18]Section 35(c) (3)(c) provides: "If the taxpayer, in connection with the exchanges described in the foregoing exception, receives stock or securities which would be permitted to be received without the recognition of the gain if it were the sole consideration, and as a part of a consideration, another party to the exchange assumes a liability of the taxpayer, or acquires from the taxpayer property subject to a liability, then such assumption or acquisition shall not be treated as money and/or other property, and shall not prevent the exchange from being within the exceptions.

[19]BIR Ruling, February 17, 1976; BIR Ruling, April 26, 1976; BIR Ruling, May 25, 1977.

[20]Drybrough v. Commissioner, 42 T.C. 1029.

[21]Campbel v. Wheeler, 342 F2d 837 (1965).

[21a]See Note 16, *supra*

[22]Section 35(c) (4)(b) provides: "The bais of the property transferred in the hands of the transferee shall be the same as it would be in the hands of the transferor, increased by the amount of the gain recognized to the transferor on the transfer.

[22a]BIR ruling, February 27, 1976.

[23]See Section 24(c)(1). NIRC.

[24]Section 28, NIRC.

[25]See Section 255, Income Tax Regulations, for sources of distribution of dividends.

[26]Sec. 210.*Percentage tax on certain transactions. – (a) Tax on stock sale or exchange.* – There shall be levied, assessed, collected, and paid on every sale, exchange, transfer or similar transaction intended to convert ownership, of, or title to, any share or shares of a stock, a tax equivalent to one-fourth of one per centum of the gross selling price of the share or shares of stock sold or of the gross value in money of the shares of stock, exchanged or transferred, which shall be paid by the seller or transferor.

x x x

Pending the suspension of the effectivity of Section 34 paragraph (g) of this Code by Presidential Decree No. 1116, any capital gain arising from a stock transaction on which the tax herein imposed has been paid shall not be taken into account in computing net capital gain or loss under Section thirty-four of this Code if (1) both the acquisition and the disposition of said stock by the taxpayer are effected after the effectivity of this Code and (2) the sale, exchange, and transfer in bona fide and the consideration for the transaction represents the substantial fair market value of the stock; Provided, That gains from the sale or exchange of shares of stock acquired by a person in exchange for property where no gain or loss was recongized under the provisions of paragraph (c)(2) of Section 35 of this Code or under any other law, shall be subject to income tax imposed under Title II of this Code. However, any capital loss arising from such transaction shall be taken into account in computing net capital gain in accordance with the provisions of this Code: Provided, That there shall be no capital loss carry-over.

x x x

[27]Senate Congressional Record, September 17, 1970.

[28]Senate Congressional Record, *supra.*

[29]See Gregory v. Holvering, 293 U.S. 465; Hazeltine Corporation v. Commissioner, 89 F2d 513.

"BLOWING THE WHISTLE": THE NEW RESPONSIBILITIES AND LIABILITIES OF THE LAWYER IN SECURITIES TRANSACTIONS

JOSE MARI P. TRENAS, A.B. (ATENEO), LI.B (ATENEO), LI.M. (HARVARD)

I. INTRODUCTION

What standards must a lawyer apply when he deals with securities transactions? More particularly, what is the liability of the lawyer for failure to comply with the disclosure requirements that are contained in the registration statement required by Section 11 of the Federal Securities Act of 1933? A spate of recent developments and cases have made these issues very important. In the words of Securities and Exchange Commissioner A.A. Sommer, Jr.:[1]

> For many years the sponsors of securities institutes and programs have been blessed with innumerable occasions to promote their wares; attorneys have flocked to programs on Rule 10b-5, than the Texas Gulf Sulphur complaint (at this point we all ceased to wait for the decisions and spent endless hours and days discussing simply the charges) was the focus, then Bar Chris, accountants liabilities, and innumerable subtopics and variations of these. All these and others have now been subordinated in interest to a single topic: the legal exposure of lawyers under the securities laws administered by the Securities and Exchange Commission. Anyone organizing a program to which he expects to entice lawyers in substantial numbers cannot safely omit this topic. The topic is, in the vernacular, hot, a best seller.

This development is particularly interesting to this writer who comes from a country whose entire law on securities transactions is based on the Federal Securities Act of 1933, the Federal Securities Act of 1934, and the Uniform Sales of Securities Act.[2] Because of this umbilical cord, it is not surprising that Philippine courts often refer to American precedents when they are presented with issues on how the law should be interpreted and construed. It is of particular interest to this writer whether the whistle being blown in Mahattan will eventually be heard in Manila.

A. Scope of the paper

This paper will briefly trace the roots of the developing concept of the lawyer's liabilities in the securities laws. Then the Federal Securities Act of 1933, particularly Section 11 which contains the requirements of the registration statement will be considered. This part of the law is important since most of the cases which have sought to pin liability on the lawyer is based on this section. The jurisprudence will then be considered: Starting with cases which deal with the concept of the lawyer's due diligence under Section 11, to the precedent setting **Sec v. National Student Marketing Corporation**, and to the later developments, this paper will briefly discuss the issues and rulings of important cases. The paper will also discuss briefly the American Bar Association Code of Professional Responsibility that is relevant to the subject of this paper. Finally, there will be a brief discussion of the securities laws of the Philippines, especially those sections which correspond with Section 11 of the Federal Securities Act of 1933. Since there is no jurisprudence which can be useful to interpret the Philippine securities laws, the writer will compare such laws with the American counterpart and will seek to speculate whether it will head the same way that its American parents are going.

B. Roots of the Development

Although the concept of the lawyer's liabilities under Section 11 of the Federal Securities Act of 1933 is fairly recent, it did not spring, like Venus, fully grown from the sea. It has its roots in several diverse developments, and we will deal with these briefly.

1. Consumerism

Today, more than ever before, one of the strongest pressure groups that has emerged in society is the consumer. As aptly put by Commissioner A.A. Sommer, Jr.:3

> We live in the age of the consumer. All of the old articles of faith which frustrated him in efforts to achieve equity have fallen or are falling: cognovit notes are repudiated in most places; the sale of installment paper no longer immunizes the paper purchaser from responsibility for the shoddiness of the merchandise; people pressured into purchases on their doorstep have time to think over their decisions; the real costs of borrowing and purchases on installments must be disclosed. This pervading judicial and legislative concern for the interests of the consumer which has for forty years been present in large measure in the securities field (the securities laws may have been the first federal consumer legislation) is affecting and will affect increasingly the securities field – and those involved in it.

Consumerism is a term that is not easily defined. Although it is a term that has become popular only in the last decade, it has undergone several changes of meaning. As one commentator writes:[4]

> One of the earliest adopters of the term was Vance Packard, who linked it with strategies for persuading consumers to quickly expand their needs and wants by making them "voracious, compulsive (and wasteful)." His usage clearly reflected the concerns of the fifties with planned obsolescence, declining quality and poor service in saturated consumer goods markets. The term was not put to wider use until 1963 or 1964, when a variety of commentators identified it with the very visible concerns triggered indirectly by Rachel Carson, and directly by Ralph Nader's auto safety investigations and by President Kennedy's efforts to establish the rights of consumers: to safety, to be informed, to choose, and to be heard.

> The most common understanding of consumerism is in reference to the widening range of activities of government, business and independent organizations that are designed to protect individuals from practices that infringe upon their rights as consumers. This view of consumerism emphasizes the direct relationship between the individual consumer and the business firm.

Within this framework, it is indeed easy to see that the Federal Securities Act of 1933 and the Federal Securities Act of 1934 were government legislation engineered to protect the investor's right to be informed since they required the registration of new issues. It is interesting to note, however, that although these laws have been in existence for quite some time, it is only fairly recent that recourse has been made to Section 11, which has been mainly dormant for many years. Perhaps it is only because of the new vigor of the consumer movement that some "teeth" has been added to the civil remedy that is provided by Section 11 of the Federal Securities Act of 1933.

2. The View of the Securities and Exchange Commission

One practicing lawyer has been alert to the trend of the thinking of the Securities and Exchange Commission. He writes thus:[5]

... The Commission has adopted a view which suggests that the primary responsibility of the lawyer in the disclosure process is to assure that his clients' disclosure documents meet the demands of the securities market for full and adequate disclosure of information needed or denied by investors. It has spurned the niceties of legal reasoning on the subject, adopting instead an adversary stance which calls upon the bar to satisfy its standards, hurling a variety of abstract theories and procedural devices in its efforts to achieve the results which it seeks.

As early as 1971, Commissioner Phillip Loomis voiced out that, "the practicing bar has an indispensable role in the administration of securities laws."[6] He goes on to say that because of his peculiar role in securities transactions, the lawyer clearly has a public responsibility to the investors and stockholders whose interests are always at stake; because of this, the lawyer should be aware that his sole responsibility is not solely to the corporation that he is representing.[7] Loomis voices out his concern about the securities attorney in the following manner:[8]

... If he is not acting in good faith, if he is deliberately trying to help his client violate the law, we are going to be disturbed about it and we may well see what remedies are open to us.

This trend of thought was continued by then Securities and Exchange Chairman William V. Casey who expressed the view that many requests of orders for anti-fraud actions have shown schemes that clearly show the involvement of an attorney.[9] Casey concluded that the Securities and Exchange Commission would be intensifying their activities against lawyers, specially where it concerns opinion letters which are used for a distribution of unregistered securities.[10]

In 1973, former Securities and Exchange Chairman Ray Garrett, Jr. also stated:[11]

[Although] the lawyers' position in corporate and financial matters is subtler and less obvious [than that of accountants] . . . when it comes to matters affecting public stockholders and investors, we are not prepared to agree that the corporate lawyer's duty is solely, or even primarily, to protect the interests of the individuals constituting corporate management, when he is retained to serve the corporation.

A reading of an article of Securities and Exchange Commissioner A.A. Sommer, Jr. is useful in uncovering the rationale and logic behind the new aggressiveness of the Commission, although the article is prefaced with the usual disclaimer

that the views expressed therein are solely the author's own and do not necessarily reflect the views of the Commission or of the other Commissioners.[12]

Sommer begins by formulating a definition of the role of the lawyer before the Commission. He starts by saying that lawyers since the beginning have been deeply involved in the scheme of the federal scurities laws. Although their formal participation recognized by the Federal Securities Act of 1933 and the Federal Securities Act of 1934 is minimal because what is merely required by the 1933 Act is an inclusion in the registration statement of the names and addresses of the counsel who have passed on the legality of the issue, Sommer maintains that the registration statement has always been the main responsibility of the lawyer.[13] It has always been he who coordinated everything, who made the all important decisions on what was material enough to include and what to exclude. It is also the lawyer who complies with the disclosure form requirements, and with the necessities of avoiding omission of disclosure necessary to make those matters stated not misleading.

Particularly interesting is the word that Commissioner Sommer uses to describe the functions of the lawyer dealing with securities:[14]

In a word, and the word is Professor Morgan Shipman's, the professional judgment of the attorney is often the "passkey" to securities transactions. If he gives an opinion that an exemption is available, securities get sold; if he doesn't give the opinion, they don't get sold. If he judges that certain information must be included in a registration statement, it gets included (unless the client seeks other counsel or the attorney crumbles under the weight of client pressure); if he concludes it need not be included, it doesn't get included.

Since the Securities and Exchange Commission perceives the lawyer as the all-important figure in securities transactions, it is not surprising why they should insist that the lawyer be liable for any non-compliance with the securities laws. Sommer even goes further and says that this is not all: the role of the lawyer, the conduct of the lawyer, the competence of the lawyer, the integrity of the lawyer, and the independence of the lawyer with regard to transactions dealing with securities will be increasingly scrutinized.

This view is further expressed in the Matter of Emmanuel Field.[15] This case involved an attorney who had four times before consented to injunction from violating the registration and the anti-fraud provisions of the federal securities

statutes. In proceedings pursuant to Rule 2(e) of the Commision's Rules and Practice, the Commission came out with the decision permanently disqualifying Field from appearing or practicing before the Commission. The rationale behind this decision seems to have been the public interest, and the decision itself comes out with the statement that the Commission only imposed the ultimate sanction because they did not want to expose the investing public to an unacceptedly high degree of risk. The decision points out the central and pivotal place of the private practicing lawyer in the investment process; the lawyer in securities transactions does not work in the courtroom where he may be checked by an adversary or by the judge. On the other hand, he works in the privacy of his own office where he processes prospectuses, proxy statements, registration statements and other documents that the Commission, the business community, and the investing public must take on faith. As the decision aptly states;[16]

> 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. To expect this vital function to be performed entirely by overburdened state courts who have little or no contact with the matters with which we deal would be to shirk that duty.

3. The 1966 Revision of Rule 23 of the Federal Rules of Civil Procedure

The provisions for class or representative actions were completely rewritten and amended in 1966.[17] The new class action rule now substitutes functional tests for the ambiguous conceptualisms that characterized practice under the former rule; a new Rule 23.1 was also adopted to deal with derivative actions by stockholders.[18]

Concerned with the plight of the average investor in America, who when injured by a violation of the federal securities laws, is unaware of the injury of unable to prosecute the claim because of the expenses of gathering the sufficient facts, the lawyer's fees, and the complicated and protracted litigation, a commentator writes about the 1966 revision of F.R.C.P. Rule 23:[19]

> The new Rule 23 was promulgated on July 1, 1966, as an answer to the need for a procedural device which would solve a problem peculiar to "our complex modern economic system where a single harmful act may result in damages to a great number of people," a need which the "spurious" class action had inadequately fulfilled.
>
> With the adoption of the new Rule 23, the old "spurious" class action was eliminated, and much of the confused precedent which had attempted to cope with it became only a matter of historical interest. The new rule came to grips with the problem which the drafters of the old rule had felt was beyond their authority: the binding effect of a class action. The new rule supplied an answer: once it has been determined that a class action may be maintained, all absentees will be bound by the result, whether favorable or not.

It has been generally accepted that the revision of F.R.C.P. Rule 23 has begun a new period of class action, and has added a new strength to Section 11 as a mechanism of securities enforcement.[20] This revision, as applied in subsequent cases, has been called by one commentator as the "reawakening" of Section 11.[21]

II. THE LAW AND JURISPRUDENCE

A. Section 11 of the Federal Securities Act of 1933

The law on the liability of parties for misrepresentations or omissions of materials facts contained in the registration statement is clear and unambiguous. Section 11 (a) states:[22]

> Section 11. (a). In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue
>
> (1) every person who signed the registration statement;
>
> (2) every person who was a director of (or person performing similar functions) or partner in, the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;
>
> (3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has or with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statment and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

What is significant in the reading of the law is that the lawyer is not even particularly singled out for any specific liability involved in the misrepresentation or omission of any material fact in the registration statement. In fact, as mentioned before, the only formal participation of the lawyer as mandated by current securities laws is in Item (23) of Schedule A to the 1933 Act which requires that the names and addresses of counsel who have passed on the legality of the issue be included in the registration statement.[23] The main thrust of this paper is, therefore, to see how the courts and the Securities and Exchange Commission have teased out of present legislation the emerging concept of the emerging responsibilities of the securities lawyer, particularly his liability for the disclosure requirements in the registration statement.

B. Jurisprudence

1. Concept of Due Diligence under Section 11.

A commentator [24] has singled out Escott v. Bar Chris Construction Co.[25] and Feit v. Leasco Data Processing Equipment Corporation[26] as the leading cases where the parameters of the duty of "due diligence" under Section 11 have been drawn. Escott v. Bar Chris Construction Co. involved an action brought under Section 11 of the Securities Act of 1933. The plaintiffs allege that the registration statement with respect to the documents filed with the Securities and Exchange Commission contained material false statements and material omissions. The defendants were the directors plus the controller who was not a director. Of the nine directors, five were officers of Bar Chris; of the remaining four, defendant Grant was a member of the firm of Perkins, Daniels, McCormack and Collins, which had been acting in the capacity of Bar Chris' attorneys.

It is interesting to note the defenses put forth by the defendant. In addition to denying that the registration statement was false, they pleaded other defenses open to them under Section 11 of the Act, for most of which was the "due diligence" defenses. The relevant portion of the act states:[27]

Sect. 11(b) Notwithstanding the provisions of subsection (1) no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof –

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of an extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe, and did believe at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; *** and (c) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert. * * *.

Also relevant to the defense of due diligence is Section 11(c) which defines "reasonable investigation" as the following:[28]

Section 11(c). In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be required of a prudent man in the management of his own property.

The court examined these defenses meticulously, and applied different tests for the varying positions of the different directors. Particularly interesting is how they examined Grant's duty, since Grant was not only a director but the lawyer for the company as well. The court prefaces their discussion by saying that Grant's unique position cannot be disregarded, and that as the director most directly concerned with writing the registration statement and assuring its accuracy, naturally, "more was required of him in the way of reasonable investigation than could be fairly expected of a director who had no connection with this work." [29]

The court rejects outright Grant's contention that a finding that he did not make a reasonable investigation would be equivalent to a holding that a lawyer for an issuing company, in order to show due diligence, must make an audit independently of the figures given to him by his client.[30] The court states that there were errors and omissions that could have been uncovered even without an audit. The important issue, the court held, is whether, despite Grant's failure to detect the errors and omissions, he made a reasonable effort to find them at all. In the succint language of the court: [31]

It is claimed that a lawyer is entitled to rely on the statements of his client and that to require him to unify their accuracy would set an unreasonably high standard. This is too broad a generalization. It is all a matter of degree. To require an audit would obviously be unreasonable. On the other hand, to require a check of matters easily verifiable is not unreasonable. Even honest clients can make mistakes. The statute imposes liability for untrue statements regardless of whether they are intentionally untrue. The way to prevent mistakes is to test oral information by examining the original written record.

The court then went through a whole litany of things that Grant could have done without going through the whole auditing process: he could have checked the provisions of the relevant agreements; he could have checked if the figures referred to matched or were overstated. Since the court found that Grant failed to make an inquiry which he could have easily have made if he had been on guard, the court concluded that, without establishing an unreasonably high standard in other cases for company counsel who are also directors, Grant did not establish his due diligence defenses. [32]

This decision was greeted with a flurry of great interest; numerous articles have been written about it. As one commentator put it: [33]

Bar Chris, the first case to examine the diligence required by Section 11, has been variously described as a "legal blockbuster that is standing the financial community on its ear," a "landmark case" and a decision that has "upset allegedly established business practice." As these reactions suggest, Bar Chris has been widely viewed as requiring significantly higher standards of care in the preparation of registration statements than prevailed before the decision.

More significantly, the decision made lawyers realize their liability under Section 11. One commentator even went further to hazard an opinion: [34]

In addition to the possible application of Section 11 liability to the attorney as expert, there is the risk of common law liability on a tort theory, for negligence in the performance of an attorney's duties as agent in conducting the investigation on behalf of his client. Such risk is particularly potent to counsel for the lead underwriters, because underwriters often delegate to their attorneys the time consuming task of conducting the examination of the corporate books and records of the concern. One effect of Bar Chris is to remove any impression that this delegation of responsibility to legal counsel can insulate the underwriter from liability.

The other case that has often been referred to when examining the concept of the lawyer's duty of "due diligence" under Section 11 is **Feit v. Leasco Data Processing Equipment Corporation.** This case involved a class action where the plaintiff seeks damages resulting from alleged material misrepresentations and omissions in a registration statement. It appears that the plaintiff, a shareholder of an insurance company, had accepted issuer corporation's tender offer to exchange issuer's stock for insurance company stock. This action is directed against the issuer corporation, its directors and the dealer manager of the tender offer to recover damages which resulted from alleged material omissions from the registration statement. [35]

It is very interesting to examine the court's treatment of the lawyer-director, Hodes. The court starts by examining the real nature of the work of Hodes: he had participated extensively in the discussions leading to the exchange offer; he had been constantly involved with the deal in both the preliminary and execution stages of the transaction; he had attended all the meetings and had been consulted on all matters relating to the transaction. The court also concluded that he was directly responsible for the prepration of the registration statement. Therefore, the court concluded that not only was he acting in his capacity as counsel-director but that he was an insider as well.[36]

The court was careful to point out that the duty of each responsible person will vary with the degree of involvement, the expertise, and access to information and data. The court quotes an article relevant to the subject: [38]

It was clear from the outset, however, that the duty of each potentially liable group was not the same. The House report on the bill that became the original Securities Act stated that the duty of care to discover varied in its demands upon the participants with the importance of their place in the scheme

of distribution and the degree of protection that the public had a right to expect from them. It had been suggested that although inside directors might be better able to show that they undertook some investigation, the outside directors could more easily demonstrate that the investigation he actually undertook was sufficient to sustain his defense.

Having made this distinction, the court concludes that inside directors who, naturally, have a more intimate knowledge of the affairs of the corporation and of the particular transactions are expected to make a more complete investigation and have a more thorough knowledge of the facts supporting or contradicting the facts that are subsequently included in the registration statement.[39] Though not very definitely, the court even suggests that the director-counsel situated thus comes close to the status of a guarantor of accuracy.[40] With all these in consideration, the court, not surprisingly, held that they failed to find that Hodes had fulfilled his duty of reasonable investigation, and that he had failed to show that he had no reasonable ground to believe that an omission was present.

2. SEC v. National Student Marketing Corporation and Subsequent Jurisprudence

If there is any one case that can be seen as the "trigger which focused interest on the legal exposure of lawyers under the federal securities laws,"[41] it is **SEC v. National Student Marketing Corporation.**[42] One commentator describes the case thus:[43]

> The complaint filed by the Securities and Exchange Commission in SEC v. National Student Marketing Corporation has been described as "the best-read document since 'Gone with the Wind' only because it is the first such action against a major law firm, but even more importantly because it posits novel theories as to the duties and obligations of lawyers, which would appear to significantly expand their liabilities."

It is noted that this is not the first case where the SEC had proceeded against attorneys directly through Rule 2 (e) disciplinary proceedings, or indirectly through criminal proceedings; on the other hand, it is only one in a long line of many.[44]

It is interesting to examine the case of **SEC v. Frank,** [45] generally accepted to be the first injunctive action brought by the Securities and Exchange Commission against a lawyer based on false statements in the offering circular.[46] The court states:[47]

> In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar. A lawyer has no privilege to assist in circulating a statement with regard to securities which he knows to be false simply because his client has furnished it to him. At the other extreme, it would be unreasonable to hold a lawyer who was putting his client's description of a chemical process into understandable English to be guilty of fraud simply because of his failure to detect discrepancies between their description and technical reports available to him in a physical sense but beyond his ability to understand.

After the court had examined the facts of the case, the court concludes that the Securities and Exchange Commission is right in insisting that a lawyer should be liable for fraud when he closes his eyes to what he sees and could readily understand.[48] The significance of this case lies in the fact because it charges illegal conduct by the defendants in their capacity as lawyers.[49]

The list of defendants alleged to have violated provisions of the various securities laws in this case includes many legal luminaries of the country: they include the New York law firm of White & Case and one of its partners, Marion Jay Epley III; the Chicago law firm of Lord, Bissel, & Brook and two of its partners, Max E. Meyer and Louis F. Schanek; and Robert A. Katz, a lawyer from New York. The other defendants include the prominent accounting firm of Marwick, Mitchell & Co. and one of its partners and an auditor, the firm National Student Marketing Corporation, and various officers and directors of the National Student Marketing Corporation and its subsidiary, the Interstate National Corporation.[50]

The complaint involved an allegation of a fraudulent scheme which was basically an issuance of about 11.2 million unregistered shares of National Student Market Corporation stock in eighty-three separate transactions. Simultaneously, over the same period, the common stock of the company was also registered with the Securities and Exchange Commission; the same shares were also being traded over-the-counter.[51]

The charges against the law firms White & Case and Lord, Bissel, and Brook were based on their activities in connection with a stock for stock merger between National Student Marketing Corporation and its subsidiary, Interstate National Corporation. It appears that proxy solicitations had been sent to stockholders of both the parent company and the subsidiary which sought shareholders' approval to the merger, and these proxy soliciations apparently contained unaudited financial statements of the parent company; these financial statements showed net earnings of seven hundred thousand dollars.[52]

The accounting firm of Peat, Marwick, Mitchell and Company had an important role in these transactions. An important and crucial condition of closing was that the accounting firm should issue a statement that they have no reason to believe that the unaudited financial statements contained therein were not prepared in accordance with generally accepted accounting principles and practices nor did they require any material adjustments in order that the entire operation be represented fairly. Another condition was that the letter should state that the company had not suffered any adverse changes material to its financial positions.[53]

The actual letter of the accoutning firm which was presented at closing clearly did not comply with these conditions. First, the letter stated that the accounting firms audit which was still in progress disclosed certain important adjustments which should be shown retroactively in the books. Subsequently, and well before the merger, the accounting firm also informed the lawyers that they wished to add to their letter the fact that if the adjustments had been made to National Student Marketing Corporation's unaudited consolidated operations, it would show a net-loss, and only a break-even for its consolidated operations. Even later, the accounting firm said they wished to add still another paragraph to state that National Student Marketing Corporation and its subsidiary should submit interim unaudited financial reports to their shareholders before they proceed with the merger.[54]

What happens next is best described by a commentator:[55]

> When the actual comfort letter was received, White and Case and Lord, Bissel and Brook issued opinions stating that all steps taken to consumate the merger had been validly taken and that no violation had been incurred of any federal or state statute or regulation to the knowledge of counsel. . .The. . . comfort letter was mailed to all directors of National Student Marketing Corporation and Interstate but its contents were not disclosed to stockholders or otherwise made public. . .

> The gravamen of the complaint against White and Case and Lord, Bissel and Brook and their respective defendant partners is their failure "to refuse to issue their opinions" that all steps taken to consumate the merger had been validly taken" and "to insist that the financial statements be reissued and shareholders be resolicited, and failing that, to cease representing their respective clients," and notify the Securities and Exchange Commission "concerning the misleading nature of the nine-month financial transactions."

It is significant to point out that Epley and the law firm of White and Case have no connection with the National Student Marketing Corporation except as that of counsel.

This case was greeted with great interest, especially in the legal world. One newspaper article which came out soon after the case had been filed, described the situation thus:[56]

> Lawyers are scrambling for copies of an SEC complaint charging National Student Marketing Corporation and numerous other defendants with violations of the securities laws. They are keenly interested – and deeply shaken by the fact that two of the defendants are prestigious law firms: White and Case, a New York firm that ranks sixth in the country in size, and the Chicago law firm of Lord, Bissel, and Brooks. The attack on these lawyers is believed to be unprecedented.

The article went on to say that lawyers were generally wary of the case because it changed their role to that of a policeman instead of an advocate; they were also worried about subsequent effects the case might have on the attorney-client relationship. However, the article noted that one of the immediate effects of the case was to make the lawyer "super-cautious" about being involved in securities transactions, and saying that from then on, they were going to be more selective about choosing their clients. The lawyers who were interviewed also said that they would require more time and more documentation if they were involved in transactions that involved securities.[57]

After several years, Marion J. Epley III and the firm White and Case made a settlement with the Securities and Exchange Commission whereby White and Case promised to investigate any resignation of prior counsel or accountants of new securities clients; to institute internal procedures which will review potentially misleading developments; and to issue letters of opinion only if they follow specified procedural rules.[58]

The case of **SEC v. Spectrum, Ltd.**[59] has also been cited as another case which has heightened the apprehension of securities and corporate lawyers.[60] The **SEC v. Spectrum, Ltd.** involved a complaint filed by the Securities and Exchange Commission charging twelve defendants, Berger, with participation in a partially successful scheme to distribute over one million unregistered shares of the common stock of the corporation. The Securities and Exchange Commission alleged that this scheme violated the registration provisions of the Federal Securities Act of 1933. It is interesting to examine how the court perceives the role of the lawyer: the court declares that the "legal profession plays a unique and pivotal role in the effective implementation of the securities laws."[61] Although this case was remanded because of material factual conflicts raised by affidavits and depositions, the court gave several pronouncements on what the lawyer involved with registration provisions should be. First, the court states that a lawyer whose opinion letter is used to sell unregistered stock in violation of the securities laws is liable as an aider and abettor to participant in an illicit venture.[62] Second, the court states that when one examines the liability of the lawyer as aider and abettor when the lawyer prepares an opinion letter that sells unregistered stock, actual knowledge of the improper scheme plus an intent to further the scheme need not be shown; the standard to be used is "negligence".[63]

Another case that we should examine is **Black and Company v. Nova-Tech, Inc.** This was a consolidation of several actions including actions by Oregon residents who had bought unregistered securities from a California corporation through an Oregon broker, and an action by the broker against the California corporation. Among the defendants was Barton of the Rossaman firm who prepared the legal papers necessary for Nova Tech to complete the sale of its securities.[65]

In concluding that defendant Barton was guilty of violating the securities laws, the court stated that even if Barton did not known, or could not have known of Nova-Tech's failure to register the securities, he was a participant in the sale since his participation was crucial to the culmination of the sale.[66]

Then comes the case of Andrews v. Blue which actually states that where the lawyer participates in a transaction that violates the securities laws, the lawyer is really an "expert" and "underwriter" within the meaning of the Federal Securities Act of 1933. Very briefly, this case arose out of a controversy involving a joint venture in real estate. The plaintiff claims that the defendants, including the lawyer, had employed schemes which were designed to decrease the value of his participa-

tion, and to correspondingly increase the interest of the defendants. In the course of its examination of the facts, the court discovered that the lawyer had directly participated in one transaction in which defendants redistributed to the plaintiff shares in a corporation which they had received for their shares in the merged corporation.[68] These facts, concluded the court, were not disclosed and so constituted a violation of the federal Securities Act of 1933.[69] The lawyer was held liable as an "expert" or "underwriter" for his participation in such scheme.

III. THE AMERICAN BAR ASSOCIATION CODE OF PROFESSIONAL RESPONSIBILITY

It is generally accepted that the canons of professional ethics offer no clear standards to the securities lawyer. One practicing attorney comments:[70]

> The canons of professional ethics as set out in the Code of Professional Responsibility of the American Bar Association (ABA) do not offer any clear guidelines with respect to either the standard of care that the securities lawyers must satisfy to avoid liabilities or sanctions, or the priorities among parties to whom the lawyer owes his allegiance. As regards standard of care, this code of ethical pronouncements merely emphasizes the attorney's duty to represent his client competently and with integrity. While such admonitions are helpful as general guidelines, they fail even to begin to define the lawyer's public responsibilities regarding disclosure, rendering of opinion letters, conduct during SEC investigations and similar matters that the securities practitioner encounters on a daily basis.

The Code of Professional Responsibility[71] is an awesome document, and it is not within the scope of this paper to discuss it in detail, so the discussion of the document itself will be very brief. Very broadly, the document is divided into Canons, Ethical Considerations, and Disciplinary Rules. Canons are "statements of axiomatic norms, expressing in general terms the standard of professional conduct expected of lawyers in their relationship with the public, with the legal system, and with the legal profession."[72] Ethical considerations are aspirational in character and representing the objectives toward which every member should strive. . ."[73] The Disciplinary Rules are "mandatory in character. . . and stating the minimum level of conduct below which no lawyer can fall without being subject to disciplinary action."[74]

One commentator studying the Code of Professional Responsibility has created three general categories: one group of canons, ethical considerations, and disciplinary rules dealing with the lawyer's obligation to his client; a second group dealing with the lawyer's obligation to other parties, and the last group dealing with the lawyer's rights and obligations relating to continuation or withdrawal of representation.[75]

The first group starts with Canon 4 which states that the lawyer should preserve the confidences and secrets of a client.[76] This also includes Ethical Consideration 4-1 which states that both the relationship between the lawyer and the client (labeled as fiduciary) and the proper functioning of the legal system require that the attorney must preserve the confidences and secrets of the client.[77] Therefore, a lawyer cannot reveal a confidence or secret of his client or use a confidence or secret of his client for his own advantage, or for the advantage of a third person.[78]

The second group seems to be in direct contrast with the first. It starts with Canon 1 which states that a lawyer should "assist in maintaining the integrity and competence of the legal profession."[79] Significantly, this group contains Disciplinary Rule 1-103 (A) which states that a lawyer possessing unprivileged knowledge of a violation . . . shall report such knowledge to a tribunal or other authority empowered to investigate or act upon such violation.[80]

But even this attempt to deal with the code in distinct categories creates problems of conflict. In the words of the author:[81]

> Even within the construct of the particular Canons, Ethical Considerations, and Disciplinary Rules purporting to deal primarily with one of the three problems, internal conflicts and ambiguities immediately leap up to greet one.

In the final analysis, therefore, there is no clear guidance that the Code of Professional Responsibility can offer:[82]

> . . . In the great majority of instances, the lawyer's obligation to preserve his client's secrets and confidences will be paramount. However, there will be exceptional occasions where the lawyer's transactional presence is so public and crucial that third parties can reasonably be thought to rely on such presence as evidence that reasonable third party expectations are not being jeopardized by the client's concealment of crime or fraud. . .

In spite of the conflicts drawn by these broad standards, one commentator has noticed a trend among the various American Bar Association Committees on Professional Ethics.[83] He notes that:[84]

> . . . The traditional ethical principles that the legal profession itself has established to guide the conduct of lawyers support the standard of care and priorities of duties set up for securities lawyers in the traditional judicial and Securities and Exchange Commission administrative decisions . . . .

IV. SECURITIES REGULATION IN THE PHILIPPINES

A. The Philippine Securities Act

The main governing law of securities transactions in the Philippines is the Philippine Securities Act which was enacted in 1936.[85] It has been said that, because of its colonial experiences under Spain and the United States, "among the developing countries of Asia, the Philippines can boast perhaps of one of the most sophisticated legal systems. It has benefitted by its inheritance from other diverge systems . . ."[86] Like most Philippine law, the Philippine Securities Act is likewise of foreign parentage. It was mainly based on American law, more specifically on (1) the Federal Securities Act of 1933, (2) the Federal Securities Act of 1934, and (3) the Uniform Sales of Securities Act.[87]

Quite broadly, the Philippine Securities Act covers the registration and licensing of securities (Sections 4-13),[88] the registration of brokers, dealers and salesmen (Sections 14-15),[89] and the registration of stock exchanges (Sections 16-17).[90]

For the purposes of this paper, it is not necessary to examine the Philippine Securities Act in great detail. However, it is essential that we examine some sections more closely, especially those that correspond to Section 11 of the Federal Securities Act of 1933.

B. Section 30 of the Philippine Securities Act

Section 30 of the Philippine Securities Act deals with the civil liability of issuers and dealers for misrepresentations and omissions of material facts contained in the registration statement. Section 30 states:[91]

> Sections 30. – (a). Every sale made in violation of any of the provisions of this Act or wherein the purchaser shall have relied upon any statement which was at the time and in the light of the circumstances under which it was made false and misleading with respect to any material fact contained in any application, report, or document filed pursuant to the Act, or in any rule or regulation thereunder, shall be voidable at the election of the purchaser; and the person making such sale and every director, officer, or agent of or for such seller, if such director, officer, or agent may have personally participated or aided in any way in making such sale, shall be jointly and generally liable to such purchaser in an action in any court of competent jurisdiction upon tender of the securities sold or of the contract made, for the full amount paid by such purchaser, with interest, together with all taxable court costs and reasonable attorney's fees: Provided, that no action shall be brought for the recovery of the purchase price after two years from the date of such sale: And provided, further, that no purchaser otherwise entitled shall claim or have the benefit of this section who shall have refused or failed within thirty days from the date thereof to accept an offer in writing of the seller to take back the security in question and to refund the full amount paid by such purchaser, together with interest on such amount for the period from the date of payment by such purchaser down to the date of repayment***

Therefore, under this section, the seller and every director, officer, or agent of the seller, if the director, officer, or agent shall have personally participated or aided in such sale shall be jointly and generally liable to the purchaser of the securities for the omissions and misrepresentation of any material fact which is contained in the registration statement. This statement, it should be pointed out, is not as broad as it seems. To be read in conjunction with this section is Section 7 of the same act which states that:[92]

> Section 7. All securities shall be registered through the filing by the issuer or by the dealer interested in the sale thereof, in the office of the Commission, of a sworn registration statement with respect to such securities . . .

An issuer is defined by the Philippine Securities Act as:[93]

> Section 2(h). "Issuer" means every person who issues or proposes to issue any security; except that with respect to certificates of deposit, voting trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors (or persons performing similar functions), or of the fixed restricted management or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; except that in the case of an unincorporated association which provides by its articles for limited liability if any on all its members, or in the case of a trust, committee or other legal entity, the trustees or members thereof shall not be individually liable as aissuers of any security issued by the association, trust, committee, or other legal entity; and except that with respect to fractional undivided rights in oil, gas, or other mineral rights, or claims or properties, the term "issuer" means the owner of any such right or property or of any interest therein (whether whole or fractional) who creates fractional interests therein for the purpose of public offering.

A dealer is defined by the Philippine Securities Act as:[94]

> Section 2(g). "Dealer" shall include every person other than a salesman who engages either for all or part of his time, directly or through an agent, in the business of selling any securities issued by another person or purchasing or otherwise acquiring such securities from another for the purpose of reselling them or of offering them for sale to the public, or offering, buying, selling or otherwise dealing or trading in securities for a profit, or who deals in futures or differences in market quotations of price or values of any securities, or accepts margins on purchases or sales or pretended purchases or sales of securities: Provided, that the word "dealer" shall not include a person having no place of business for the purpose, who sells or offers to sell securities exclusively to brokers or dealers actually engaged in buying and selling securities as a business.

Also relevant to the concept of persons who may be liable for misrepresentations and omissions in the registration statement is Section 29 which deals with the liabilities of controlling persons. Section 29 of the Philippine Securities Act states that:

> Section 29. Liabilities of Controlling Persons. –
>
> (a) Every person who, directly or indirectly, controls any person liable under any provision of this Act or of any rule or regulation thereunder, shall also be liable jointly and generally 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.
>
> (b) It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unalwful for such person to do under the provisions of this Act or any rule or regulation thereunder through or by means of any other person.

(c) It shall be unlawful for any director or officer of, or any owner of any of the securities issued by, any issuer of any security registered in accordance with this Act without just cause, to hinder, delay, or obstruct the making or filing of any document, report or information required to be filed under this Act or any rule or regulation thereunder.

C. Comparison with the U.S. Law

One writer has stated that viewed from the perspective of the persons liable for misrepresentations and omissions of a material fact in the registration statement, Section 30 of the Philippine Securities Act is a "greatly emasculated version of Section 11 of the Federal Securities Act of 1933."[95] There is basis for this statement, since directors, officers, or agents of the issuers or dealers making the sale can only be liable for material omissions on misrepresentations if they have personally participated or aided in any way in making such sale. As to the controlling persons, they can only be liable if it is shown that they did not act in good faith and did, directly or indirectly, induce the act or acts constituting the violation or cause of action. The requirement of personal participation practically insulates these people from liability. Therefore, a lawyer participating in a scheme can always put forth the defense of non-personal participation and not be liable, although he may have actually been involved in the transaction in a less direct way.

In strict contrast, Section 11 of the Federal Securities Law of 1933 is more open to the concept of liability of various persons. For experts, they are liable unless they have made a reasonable investigation into the facts supporting the statements they have made. Non-experts reviewing the registration process must conclude that the statements made therein are true and that he had reasonable grounds to conclude such; otherwise, an investigation is necessary.

V. CONCLUSION

To paraphrase an eminent historian, Barbara Tuchman, one can always learn about the future by examining the past.[96] However, the developments concerning the new liabilities of the securities lawyer, particularly those involving the disclosure process, are too recent to help us make any predictions about the future.

Rather than attempt to forecast what the law will be with regards to the responsibilities and liabilities of the lawyer in securities transactions, one commentator has singled out general policy considerations that exist which should shape the responsibilities and liabilities of the lawyer in the future.[97]

The first policy consideration that the commentator considers is that the primary responsibility of the lawyer is to his clients. This view may run diametrically opposed to the view supported by the SEC, but the writer espousing this view has ably defended his stand. First, he states that the due diligence techniques employed by lawyers in the registration process originated in the efforts of lawyers to provide responsible counselling to clients.[98] Surely, the commentator concludes that there are some instances where, because the lawyer serves as the expert on the law, he gives opinions on the validity of the offering to the public; in which case, the lawyer obtains a new client, the "public," because the public assumes, rightly or wrongly, that the lawyer's opinion has been validly given. Even in these cases, the commentator insists that the need for disclosure is unclear. He says that, "in others, a study of the SEC rules, including applicable forms, may lead to the conclusion that the Commission did not intend disclosure."[99] He goes on to say:[100]

> Management may well decide in the doubtful situation not to disclose. In such circumstances, the lawyer has a duty to make his client's top officials, including the directors, aware of the possible consequences of that decision if the matter seems serious enough to him. To call upon him, however, to "blow the whistle" on the client is to place him in a position in which he becomes not the client's lawyer, adviser and confidant, but an agent for the Commission. In the process the relationship between attorney and client is frustrated, and the lawyer becomes an arm of the Commission in whose discretion and judgment no client will place its full trust and confidence.

The commentator buttresses this view by the fact that no law or statute has established the lawyer as the agent for the Securities and Exchange Commission. Also, he asserts that the role of the lawyer as the representative of the public as opposed to his client is incomsistent and alien to the traditional view of the profession.

The second policy consideration that should be examined is the need for the development of improved standards of lawyers' participation. It is submitted

by the commentator that the absence of distinct and clear guidelines concerning the lawyer's responsibilities can lead to a breakdown of communication between the lawyer and the other parties involved in securities transactions: namely, the Securities and Exchange Commission, the management of the corporation seeking to register the directors of such corporation.[101] There seems to be a basis for this statement because there is really no prescribed way which lawyers can refer to when they prepare registration statements. He submits that:[102]

> The legal profession itself can do a great deal to improve the quality of diligence in the registration process by focusing attention on the background and need for the process, on our own capabilities and limitations, as well as on the importance of management participation in the process, and by seeking to assure the adoption and adherence to procedures which will permit participation in the process by those most responsible for disclosure including senior executives, financial management and the directors.

The third policy consideration put forward by the commentator is that the bar itself should establish and enforce standards of responsibility for lawyers.[103] Because the bar has never attempted to have any self-regulation with regards to securities matters, the Securities and Exchange Commission has pre-empted the field, and not quite rightly. Once there is self-regulation and self-discipline within the bar with regards to securities transactions, the Securities and Exchange Commission should relax its stand and avoid any conflicts that might subsequently arise.

On the other hand, the other view is that lawyers will even be held more responsible for securities transactions, especially in the disclosure process.[104] It is believed that the concept of the public as a client will even be more pronounced. It appears to this writer that this view seems to be realistic, unless the bar comes out with a way to discipline and regulate its members, especially with regards to securities transactions. The consumer movement shows no sign of weakening, and the law, as we have seen, is vague enough not to prelude the lawyer from liability.

Will the trend be duplicated in the Philippines? This writer does not believe so. First, the law itself is less flexible and more specific, and the necessity of "personal participation" should be able to insulate lawyers from liability. Second, the consumer movement is just starting to get organized, and as of now they do not yet

possess enough clout to influence anything. There is a standing joke that the avant-garde in the Philippines is always ten years late, but unless there is a revision in Section 30 of the Philippine Securities Law, even this joke falls flat.

FOOTNOTES

1. Sommer, The Emerging Responsibilities of the Securities Lawyer, [1973-74 Transfer Binder] Fed. Sec. L. Rep. (CCH) 79, 631.

2. Agbayani, Commentaries and Jurisprudence on the Commercial Laws of the Philippines, at 793-94 (1970).

3. Sommer, supra note 1 at 83, 869.

4. D. Aaker and G. Day, Consumerism: Search for the Consumer Interest, at p. 23 (1971) Footnotes omitted.

5. Cooney, The Registration Process: The Role of the Lawyer in Disclosure, Bus. Law 33:1330-1342 (Mar. 1978) Special Issue.

6. Loomis, Practicing Law Institute's Securities Regulation Transcript Series No. 3 at 255-56 (1972).

7. Id. at 256.

8. Id. at 256.

9. Lowenfeld, Emerging Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties, 74 Colum. L. Rev. 426 (1974).

10. Id. at 255-256.

11. Garrett, Sec. Reg. & L. Rep. (BNA) No. 223, A-M (Oct. 17, 1973) as quoted in Hoffman, On Learning of a Corporate Client's Crime or Fraud – a Lawyer's Dilemma, Bus. Law 33:1389-1420 (Mar. 1978).

12. Sommer, supra note 1 at 79, 631.

13. Id. at 79, 631.

14. Id. at 79, 631.

15. In the Matter of Emmanuel Fields, SEC Securities Act Release No. 5404 [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) 79, 407.

16. Id. at 79, 407.

17. Text of Rule 23.

> (a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

> (b) Class Actions Maintainable. An action may be maintained as a class action if the rerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b) (3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivision (b) (1) or (b) (2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b) (3), whether or not

favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c) (2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

As amended Feb. 28, 1966, eff. July 1, 1966.

18. Wright & Miller, Federal Practice and Procedure: Civil Section 1601-1771, Fules 19-23.

19. Comment, Adequate Representation, Notice and the New Class Action Rule: Effectuating Remedies Provided by the Securities Laws, 116 U. Pa. Law Review at 889 (1968).

20. Sommer, supra note 1 at 79, 631.

21. Comment, Escott v. Bar Chris Construction Corporation, Section 11 Strikes Back, 21 Stan. L. Rev. 174, (1968).

22. For full text of the law, see Securities Act of 1933 as amended on December 1, 1978.

23. Sommer, supra note 1 at 83, 869.

24. Cooney, supra note 5 at 1330.

25. Escott v. Bar Chris Construction Company, 283 F. Supp. 643 (S.D.N.Y. 1968).

26. Feit v. Leasco Data Processing Equipment Company, 332 F. Supp. 544 (E.D.N.Y. 1971).

27. Supra, note 14, Section 11 (b).

28. Id. Section 11 (c).

29. 283 F. Supp. at 690.

30. Id. at 689-690.

31. Id. at 690.

32. Id. at 692.

33. Comment, Bar Chris: Easing the Burden of "Due Diligence" under Section 11, 117 U. Pa. L. Rev. 736 (footnotes omitted) (1969).

34. Wyant & Smith, Bar Chris: A reevaluation of Prospectus Liability, 3 Geo. L. Rev. 122, p. 136 (1968).

35. 332 F. Supp. at 545-549.

36. Id. at 576.

37. Id. at 577.

38. F. Supp. quoting Comment, Bar-Chris: Due Diligence Refined, 68 Colum. L. Rev. 1411, 1416 (1968).

39. Id. at 578.

40. 332 F. Supp. quoting Folk, Civil Liabilities Under the Federal Securities Act: The Bar Chris Case, 1 Sec. L. Rev. 3, 25 (1969).

41. Sommer, supra note 1 at 83, 869.

42. Civil Action No. 225-72 (D.D.C. Feb. 3, 1972).

43. Karmel, Attorney's Securities Laws Liabilities, Bus. Law 27:1153-1155, July 1972.

44. Id. at 1155-1156.

45. 388 F. 2d 486.

46. Id. at 488-489.

47. Id. at 489.

48. Id. at 490.

49. Karmel, supra note 36 at 1156.

50. Id. at 1153.

51. Id. at 1153.

52. Id. at 1153.

53. Id. at 1154.

54. Id. at 1154.

55. Id. at 1154-1155.

56. Green, Irate Lawyers – A Bid to Hold Lawyers Accountable to Public Stuns, Angers Firms, Wall St. J., Feb. 15, 1972, at 1, col. 1.

57. Id. at 17, col. 1.

58. Cooney, supra note 5 at 1331.

59. SEC v. Spectrum, Ltd., 489 F.2d 535 (1973).

60. Sommer, supra note 1 at 79, 631.

61. Id. at 542.

62. Id. at 541.

63. Id. at 541-42.

64. Black and Company v. Nova-Tech, Inc., 333 F. 2d 468 (1971).

65. 333 F. 2d at 472.

66. Id. at 470-472.

67. Andrews v. Blue, 489 F. 2d 367 (1973).

68. 489 F. 2d at 368.

69. Id. at 369.

70. Lowenfels, supra note 9 at 416.

71. American Bar Association Code of Professional Responsibility was adopted by the House of Delegates, American Bar Association on August 12, 1969 and became effective on January 1, 1970.

72. Hoffman, On Learning of a Corporate Client's Crime or Fraud – a Lawyer's Dilemma, Bus. Law, 33:1390 (Mar. 1978).

73. Id. at 1390-91.

74. Id. at 1391.

75. Id. at 1391-95.

76. Id. at 1391-92.

77. Id. at 1391.

78. Id. at 1392.

79. Id. at 1392.

80. Id. at 1392-93.

81. Id. at 1395.

82. Id. at 1419.

83. Lowenfels, supra note 9 at 416-17.

84. Id. at 419.

85. Commonwealth Act No. 83, approved October 26, 1936. See Commercial Laws of the Philippines 62 (NBS ed. 1977).

86. de Guzman, S., et al., Credit & Security in the Philippines, The Legal Problems of Development Finance, Univ. of Queensland Press, New York, 1973, p. 168.

87. Supra, Note 2 at 793-94.

88. Mantin, T.C., Commentaries and Jurisprudence on the Philippine Commercial Laws, Vol. 2, Period Edition, Central Book Supp. Inc., pp. 1859-1875.

89. Id. at 1875-1886.

90. Id. at 1887-1889.

91. Id. at 1926-1927.

92. Id. at 1864-1867.

93. Id. at 1920-22.

94. Id. at 1922-24.

95. Ricalde, The Civil Liability of Issuers, Dealers and Underwriters for Misrepresentations and Omissions in the Registration Statement under Section 30 of the Philippine Securities Act, p. 78 (unpublished LL.M. Thesis in the HLS Library, 1979).

96. Tuchman, A Distant Mirror, Foreword (1979).

97. Cooney, supra note 5 at 1332-1333.

98. Id. at 1333-34.

99. Id. at 1335.

100. Id. at 1335-36.

101. Id. at 1338.

102. Id. at 1338-39.

103. Id. at 1341.

104. Sommer, supra note 3 at 79, 631.

THE LIABILITY OF TEACHERS IN ACADEMIC INSTITUTIONS

By ERNESTO M. HIZON LI.B. '84

Are teachers in academic educational institutions liable for acts and omissions committed by their pupils during class hours, and in instances when these happen not during class time but within the perimeter of the school grounds?

Article 2180 of our Civil Code provides:

> The obligation imposed by Article 2176 is demandable not only for one's own acts or omissions but also for those of persons for whom one is responsible.
>
> x x x
>
> Lastly, teachers or heads of establishments of arts and trades shall be liable for damages caused by their pupils and students or apprentices, so long as they remain in their custody.

The liability imposed by Article 2180 upon parents, guardians and teachers or heads of establishments of arts and trades is based on their presumed negligence in failing to exercise the necessary care, vigilance and supervision over their dependents in order to prevent injury to persons and damage to property. This is the clear implication from the provisions of the last paragraph of Art. 2180 which reads: "The responsibility treated of in this article shall cease when the persons herein mentioned prove that they observed all the diligence of a good father of a family to prevent damage."[1] Hence, if the parents, guardians and teachers or heads of establishments of arts and trades prove that they exercised the diligence of a good father of the family to prevent damage, they are exempt from liability.[2]

From a reading of the above codal provision, only teachers of institutions of arts and trades would seem to be liable for damages caused by their students. In the case of **Esconde** v. **Capuno**[3] it was held that this provision only applies to an institution of arts and trades and not to any academic educational institution.[4] In the later case of **Mercado v. Court of Appeals**[5] the Supreme Court, in addition to affirming that the said provision is restricted to only establishments of arts and trades, further held that "It would seem that the clause 'so long as they remain in their custody,' contemplates a situation where the pupil lives and boards with the teacher such that the control, direction and influence on the pupil supersedes those