

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-13655

In the Matter of

THEODORE W. URBAN

Respondent.

DIVISION OF ENFORCEMENT

Petitioner.

BRIEF OF *AMICI CURIAE*

**THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION,
INCLUDING ITS COMPLIANCE & LEGAL SOCIETY**

AND

THE ASSOCIATION OF CORPORATE COUNSEL

IN SUPPORT OF APPELLEE-CROSS APPELLANT THEODORE W. URBAN

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INTEREST OF THE ASSOCIATIONS AS *AMICI CURIAE*

The Securities Industry and Financial Markets Association (“SIFMA”) and its Compliance & Legal Society¹ bring together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. The SIFMA Compliance & Legal Society includes over 1900 professionals and has worked for over 40 years to foster an effective self-regulatory system through the efforts of compliance and legal personnel. As a leading advocate in financial markets, SIFMA brings a market-wide perspective on effective supervision and the legal and compliance functions that is not represented by the parties.

The Association of Corporate Counsel (“ACC”) is a professional bar association of over 27,000 in-house counsel worldwide who practice in the legal departments of corporations and other private sector entities. ACC presents the perspective of in-house lawyers who advise their corporate clients on the full range of legal issues that arise in the course of day-to-day business. ACC members are employed by more than 10,000 private sector corporations in over 75 countries, including public and private companies, both large and small, and various non-profit organizations. Because ACC is a bar association, its members are individual lawyers and not companies, and ACC members work in a broad and representative cross-section of businesses and industries that make up a large portion of the corporate sector. ACC members have a direct interest in the outcome of this appeal because the standard applied in finding that the general

¹ SIFMA’s Compliance & Legal Society focuses on education, communication and advocacy for compliance and legal professionals in the securities industry. The Society also works to facilitate communication between the industry and the regulatory community on key issues.

counsel was a supervisor in this case, unless rejected, would set a precedent that would make it more difficult for in-house counsel to provide candid legal advice to their clients and to ensure corporate compliance with the law.

SUMMARY OF ARGUMENT

Theodore Urban served as General Counsel of the broker-dealer Ferris, Baker, Watts, Inc. (“FBW”) and its predecessor organizations for over twenty-four years, after beginning his career in the 1970s with the government, initially at the Securities and Exchange Commission (the “Commission”) and then at the Commodity Futures Trading Commission. In October 2009, the Division of Enforcement (the “Division”) commenced a proceeding alleging that Mr. Urban had failed reasonably to supervise Stephen Glantz, a broker who did not report to Mr. Urban or work in the FBW departments that he headed.

In a careful and thorough decision, Chief Judge Murray dismissed the proceeding against Mr. Urban. See Initial Decision of Chief Administrative Law Judge Brenda P. Murray, dated Sept. 8, 2010 (“Initial Decision”) at 56. She concluded that Mr. Urban was “honest and credible” and that, in responding to information he received regarding Mr. Glantz, Mr. Urban had carried out his responsibilities in a “cautious, objective, thorough and reasonable manner.” Id. As General Counsel, Mr. Urban made repeated recommendations to senior management and line supervisors to enhance oversight of Mr. Glantz and, indeed, to terminate his employment at the firm – recommendations that Mr. Glantz’s supervisors either failed to implement fully or rejected outright.

In the course of properly deciding to dismiss the proceeding against Mr. Urban, however, the Initial Decision reached a critical – and incorrect – threshold determination that Mr. Urban should be viewed as Mr. Glantz’s “supervisor.” In reaching this conclusion, the Initial Decision did not rely on the text of the Securities Exchange Act (“Exchange Act”) or on any standard

adopted by the Commission or a court in a litigated matter. Rather, it relied on a broad construction of a Section 21(a) investigative report which suggests that any lawyer “involved” in management’s collective response to a compliance matter becomes a supervisor if the lawyer has the requisite degree of responsibility, ability or authority to “affect” another employee’s conduct. See In the Matter of John H. Gutfreund, Thomas W. Strauss, and John W. Meriwether (“Gutfreund”), Exchange Act Release No. 31554, 52 SEC Docket 2849, 1992 WL 362753 (Dec. 3, 1992). While expressly recognizing that the facts and circumstances of Mr. Urban’s case were not analogous to those addressed in Gutfreund, the Initial Decision nonetheless concluded that Mr. Urban was a supervisor – based exclusively on his role as a lawyer and member of the firm’s Credit & Risk Committee (“Credit Committee”), and the fact that, as General Counsel, his “opinions on legal and compliance issues were viewed as authoritative” and his recommendations were “generally followed” by most of the firm’s business units (albeit not the Retail Sales unit in which Mr. Glantz was employed). Initial Decision at 52.

The erroneous determination to treat Mr. Urban as a supervisor raises serious issues for the securities industry and the effectiveness of broker-dealer compliance programs. Mr. Urban’s role as General Counsel conformed to sensible and well-established practices for legal and compliance professionals at securities firms. The ordinary role of these professionals is to perform precisely the functions that Mr. Urban performed: to provide advice and recommendations on a wide range of legal and compliance issues, not to substitute their decisions for those of line supervisors and senior management. Securities Industry Association Compliance & Legal Division, White Paper on the Role of Compliance, dated Oct. 2005 (“White Paper”) at 10.

The Initial Decision thus puts all legal and compliance professionals at risk for liability as “supervisors” merely as a result of performing their normal day-to-day functions properly. The Initial Decision will strongly discourage those professionals – who do not in fact have supervisory or other authority to compel implementation of their advice and recommendations – from becoming “involved” in any matter of potential concern. Even worse, it will discourage business personnel from seeking the advice of those professionals out of concern that fear regarding personal liability will lead compliance personnel to become excessively conservative. In both respects, it will undermine longstanding efforts by the Commission and the securities industry to integrate legal and compliance professionals deeply and broadly into broker-dealers’ business activities.

Further, in the case of lawyers, the Initial Decision is at odds with Commission policy explicitly acknowledging the distinctive role of counsel under both the securities laws and state ethics rules. The Commission has recognized – and sought to strengthen – the obligations of lawyers to bring compliance issues to the attention of senior officials charged with making decisions for the organization. See, e.g., 17 C.F.R. 205.3. The essence of this obligation resides in the candid exchange of privileged information and impartial advice between lawyer and client – an exchange that will be substantially impaired if lawyers face the Hobson’s choice, when their advice is rejected, of assuming supervisory liability or resigning from their firm. In addition, treating lawyers as supervisors based merely on their ability to provide management with legal and compliance advice will inevitably invite regulatory inquiry into the quality of that advice – a professional oversight role that falls outside the Commission’s mandate and that it has long eschewed.

Accordingly, the Commission should reject the Initial Decision's holding that Mr. Urban was a "supervisor" and clarify the standard for supervisory liability, based on the explicit requirements of the Exchange Act and appropriate Commission precedent. This standard should recognize that an individual will be viewed as a supervisor only when the individual knew or should have known that he or she has been granted supervisory "control" over another person. Although there may not be a specific list delineating all of the powers that define the necessary degree of "control," those powers must go well beyond the mere ability to provide advice and recommendations: the authority to "hire or fire, to reward or punish" ordinarily should be among them – and in their absence only very compelling evidence of actual authority to control an individual's conduct should suffice. Adoption of a clear and appropriate standard is essential to providing legal and compliance professionals with the guidance necessary to enable them to perform their roles effectively – and to play an active part in all of a broker-dealer's activities – without fear that they will become liable in cases where an employee's actual supervisors remain free to reject or ignore their advice.

ARGUMENT

- I. CONSISTENT WITH SETTLED INDUSTRY UNDERSTANDING AND PRACTICE, MR. URBAN ACTED AS AN ADVISOR AND DID NOT HAVE SUFFICIENT AUTHORITY OR CONTROL TO BE A "SUPERVISOR"**
 - A. Legal And Compliance Professionals Do Not, For Beneficial Policy Reasons, Ordinarily Have Supervisory Authority Over Personnel Outside Their Departments**
 - 1. Legal and compliance professionals play a critical role in detecting, analyzing and advising on potential misconduct, distinct from the role of business personnel**

As long recognized by the regulatory community and the securities industry, investors and markets greatly benefit from the creation of effective legal and compliance departments at broker-dealers. See Mary L. Schapiro, Chairman, SEC, Remarks at the CCO Outreach National

Seminar, dated Jan. 26, 2010 (“The role of compliance professionals is critical to the protection of investors and the functioning of our markets”). Lawyers and compliance professionals play a number of important roles at regulated firms, including among others developing policies and procedures, assisting in education and training, handling internal inquiries and fostering strong relationships with regulators. See generally White Paper. One of the most important of these roles is advising senior management regarding how to address potential legal or compliance concerns, including in the context of supervisory decisions. See id. at 10 (“The role of the Compliance Department is to advise businesses on how to comply with applicable laws and regulations, and to monitor business activity and employee conduct to identify violations (or potential violations) . . .”).

As a matter of good practice, broker-dealers generally seek to establish clearly delineated reporting lines for legal and compliance professionals that do not run to revenue-generating business units. See id. at 10.² This structure permits those professionals to maintain independence from a firm’s business units, even while allowing the Legal and Compliance Departments to “maintain close ties to senior management, who are accountable for a firm’s overall compliance efforts.” Id. at 2.

² The recent financial reform legislation also has recognized the importance of strengthening the independence of compliance personnel from business units. For example, Section 764(a) of the Dodd-Frank Wall Street Transparency and Accountability Act of 2010 mandates that security-based swap dealers and major swap participants must have a “Chief Compliance Officer” and that he or she should “report directly to the board or to the senior officer of the security-based swap dealer or major security-based swap participant[.]” Section 932(a) of the Dodd-Frank Investor Protection and Securities Reform Act of 2010 requires that the “compensation of each compliance officer appointed under paragraph (1) shall not be linked to the financial performance of the nationally recognized statistical rating organization and shall be arranged so as to ensure the independence of the officer’s judgment.”

Similarly, SEC Rule 270.38a-1(a)(4) mandates that a mutual fund’s chief compliance officer report directly to the fund’s board of directors.

To perform their functions effectively, lawyers and compliance personnel generally are encouraged to become involved in, and thereby potentially to affect, all significant matters in which the organization is engaged – a policy which substantially enhances overall compliance by broker-dealers. Close contact with ongoing business activities and developments better enables these professionals to identify areas of potential compliance concern, to develop and update policies and procedures, and to provide education, training and guidance on key legal and regulatory issues. Similarly, it assists them in identifying, and bringing to management’s attention, evidence of misconduct when it does occur.

At the most senior level of an organization, the General Counsel ordinarily is expected to have an especially broad understanding of a firm’s activities and extensive involvement as an important legal adviser to management on a wide range of issues. Consistent with the Commission’s rules governing lawyers at public companies, the General Counsel of a broker-dealer is generally expected to initiate appropriate inquiries and investigations into potential violations of law, as well as to ensure that senior management is informed and properly advised as it assesses how to respond appropriately to evidence uncovered in these investigations. See 17 C.F.R. 205.3, 205.4.

It is also common for senior legal and compliance professionals, particularly lawyers serving as General Counsel, to participate as members of firm committees and boards. This participation allows them to “voice [their] views to management and also keeps [them] apprised of important business activities.” White Paper at 13, n.62. As committee members, they “may also provide an important advisory role to [other] committee members in making decisions addressing compliance issues.” Id.

At every stage of their involvement in the firm's activities – prevention, detection and reporting, as well as board and committee participation – the role of legal and compliance professionals is not to supplant the role of business units and senior management, but to provide them with sound advice and recommendations to promote a strong compliance culture. See FINRA, Rule 3130 (“A chief compliance officer is a primary *advisor* to the member on its overall compliance scheme and the particularized rules, policies and procedures that the member adopts” (emphasis added)).

2. **Legal and compliance professionals ordinarily do not have decision-making or supervisory authority outside their departments**

Regulators and the securities industry have specifically acknowledged the distinct role of legal and compliance professionals, separate from a broker-dealer's business units, in the supervisory context. While these professionals can advise and assist in developing policies and procedures, only the firm's senior business management can decide whether and how to implement and enforce them. See NASD Notice to Members (NTM) 04-71 at 838 n.5 (Oct. 2004) (“The responsibility for discharging compliance policies and written supervisory procedures rests with the firm's business line supervisors. These supervisors are the persons responsible for executing the supervisory policies and procedures that Rule 3010 requires firms to establish and adopt”).³ Similarly, legal and compliance departments monitor business activity, investigate and report instances of misconduct and offer recommendations for remediation efforts, but it is the firm's business management who must implement such recommendations. White Paper at 9-10.

³ See also FINRA, Rule 3130, Supp. Mat. 07, Effect of Certification on Business Line Responsibility (“The FINRA Board of Governors recognizes that supervisors with business line responsibility are accountable for the discharge of a member's compliance policies and written supervisory procedures”).

Thus, while legal and compliance professionals “play[] . . . important advisory and monitoring role[s] within a firm’s overall compliance system, [they do] not have supervisory authority.” Id. at 10. Absent special circumstances, these individuals do not have the ability to control the conduct of registered representatives that revenue-generating business personnel have. See Expert Report of David A. DeMuro ¶ 29 (Feb. 11, 2010). Rather, a legal or compliance department may only direct business activities in the very rare circumstance when the firm has expressly designated that power and authority and the legal or compliance department knowingly agrees to undertake that responsibility. See id. ¶ 24.

Maintenance of the distinctions between advisory and supervisory personnel is crucial to the legal and compliance departments’ ability to retain their independence and objectivity in assessing and advising on legal and compliance matters. Management benefits greatly in its supervisory decisions by obtaining balanced, impartial and informed advice from professionals who do not individually stand to gain or lose depending on the decision’s outcome. At the same time, senior managers and line supervisors generally are also better situated than lawyers and compliance professionals to assess fully the impact of supervisory decisions on a firm’s business operations, competitiveness and effectiveness as an organization.

B. Mr. Urban’s Role As General Counsel Conformed To The Ordinary Role Of Legal Professionals And Was Not Supervisory

Mr. Urban’s role at FBW was wholly consistent with the ordinary role of legal and compliance professionals in the securities industry. He was FBW’s General Counsel and headed three of the firm’s control departments: Compliance (which was viewed along with Legal as one function), Human Resources and Internal Audit. Initial Decision at 2. Like many senior legal and compliance personnel, Mr. Urban also participated on the Board of Directors, as well as the Executive Committee and the Credit Committee. See id. at 3, 10. In this capacity, he frequently

advised the Credit Committee about legal and compliance issues, brought instances of potential misconduct to the Committee's attention and handled communications with outside parties at the direction, and on behalf, of the Committee. See id. at 10 (citing Tr. 1974).

Other tasks performed by Mr. Urban, or by Compliance personnel at his direction, mirrored the typical legal and compliance functions under industry practice. See generally White Paper. His work included directing preparation of firm policies and procedures, see Initial Decision at 35, regularly monitoring employee activity, id. at 14 (citing Div. Ex. 55), and flagging certain accounts for attention, id. at 7-8. Mr. Urban also directed Compliance personnel to investigate various issues and activity. Id. at 11, 24-25 and 42.

Mr. Urban and his staff regularly provided advice and recommendations to FBW's business personnel regarding potential misconduct. See id. at 36 (citing Urban Ex. 565 at Bates 8615) (describing an FBW PowerPoint presentation dated November 8, 2005, which stated that the firm's Legal and Compliance Department "[r]ecommends appropriate remedial action whenever deviations from the policies and procedures are detected" (emphasis added)). For example, in response to concerns about Mr. Glantz, including whether he was being adequately supervised, the Compliance Department prepared a memo that was presented to the Credit Committee and advised that "[t]he Compliance Department believes that *the Firm needs to address* the potential issues and *arrive at some decisions* regarding the concerns noted." Id. at 12 (citing Tr. 486; Div. Ex. 27 at 1, 3) (emphasis added). Further, when it became clear that Mr. Glantz would not cease his misconduct, Mr. Urban recommended to those responsible for Mr. Glantz's supervision that he be terminated. See id. at 25-26 (citing Tr. 830, 968, 971, 2831-34, 823-23, 969, 2833, 2834-37; Div. Ex. 135-37).

The Initial Decision contains ample evidence that, consistent with industry practice, Mr. Urban solely provided advice and recommendations and was not viewed as a “supervisor.” FBW employed a traditional supervisory structure with clear identification of supervisory authority. See id. at 44 (citing Tr. 2978). As is common among securities firms, revenue-generating employees held supervisory authority and dominated the management of FBW.⁴

II. THE STANDARD APPLIED IN THE INITIAL DECISION IS IMPROPER: THE ABILITY TO PROVIDE LEGAL AND COMPLIANCE ADVICE AND RECOMMENDATIONS AND TO PARTICIPATE IN CREDIT AND SIMILAR COMMITTEES DOES NOT CONSTITUTE SUPERVISORY CONTROL

Chief Judge Murray determined that “[t]he overwhelming evidence is that Mr. Urban was not responsible and had no authority for hiring, assessing performance, assigning activities, promoting, or terminating employment of anyone, outside of the people in the departments he directly supervised.” Initial Decision at 35 (citing Tr. 230, 586, 589, 1599).⁵ Indeed, she concluded that “[Mr.] Urban did not have any of the traditional powers associated with a person supervising brokers.” Id. at 52. Nor did he believe he was Mr. Glantz’s supervisor. Id. at 35 (citing Tr. 2845; Answer at 2). Specifically with respect to dealing with the conduct of Mr. Glantz, the Initial Decision found that Mr. Urban “did not direct FBW’s response.” Id. at 52.

⁴ Chief Judge Murray noted that Retail Sales had the responsibility “to supervise and to address problems with retail brokers,” Initial Decision at 5 (citing Tr. 1878, 2621-23, 2632-33), and that branch managers were charged with the direct supervision of traders. Id. at 6 (citing Tr. 2369; Div. Ex. 197 at 17402). She also found that Louis Akers, head of Retail Sales, was the most powerful person at the firm, holding “unquestioned overall authority over Retail Sales,” even refusing orders from FBW’s CEO. See id. at 5 (citing Tr. 1878, 2621-23, 2632-33).

⁵ Although Mr. Urban was listed in FBW’s procedure manual as the supervisor of “[a]ll [e]mployees,” FBW’s Chief Compliance Officer Patricia Centeno, who drafted the procedures, testified that this was intended to indicate that Mr. Urban “was in charge of *providing legal advice* to all employees, not that he supervised all employees.” Initial Decision at 35 (citing Tr. 591) (emphasis added).

Nevertheless, the Initial Decision held that Mr. Urban was Mr. Glantz's supervisor for purposes of Section 15(b)(4)(E). Id.

The conclusion that Mr. Urban was a supervisor was not grounded in the text or legislative history of Section 15(b)(4)(E) or any precedent of the Commission or a court in litigation. Rather, the decision was based on a broad reading of the language in the Section 21(a) report issued by the Commission in Gutfreund, which can be read literally to suggest that any legal or compliance professional who becomes "involved" in a matter is a supervisor if he or she has the "requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue." Gutfreund, 1992 WL 362753, at *15. Despite an express recognition that the facts and circumstances of Mr. Urban's case were not analogous to those addressed in Gutfreund, the Initial Decision concluded that Mr. Urban was a supervisor based solely on the fact that Mr. Urban's "opinions on legal and compliance issues were viewed as authoritative," "his recommendations were generally followed by people in FBW's business units"⁶ and he "dealt with Glantz on behalf of the [Credit] committee." Initial Decision at 52.

For the reasons discussed below, the overbroad standard applied in this matter was erroneous and should be rejected by the Commission. It is inconsistent with the text and legislative history of the statute, binding Commission precedent and traditional notions of fair notice and due process.

⁶ However, the Initial Decision acknowledges that the people in Retail Sales, the business unit in which Glantz worked, did not generally follow Mr. Urban's recommendations. Id. at 52.

A. The Standard Applied In The Initial Decision Is Overbroad and Inconsistent With Applicable Law

1. The text and legislative history of Section 15(b)(4)(E) of the Exchange Act reflect an express determination to limit an individual's responsibility to another "person subject to his supervision"

Section 15(b)(4)(E) of the Exchange Act states in relevant part that one is liable if he or she "has failed reasonably to supervise, with a view to preventing violations of the [securities laws], another person who commits such a violation, if such other person is *subject to his supervision*." 15 U.S.C. § 78o(b)(4)(E) (emphasis added).⁷ One cannot be "subject to" the supervision of another if the latter has no authority or ability to control the actions of the former.

Both the House and Senate legislative reports confirm that the phrase "person subject to his supervision" was intended to limit the imposition of supervisory liability. See S. Rep. No. 379, 88th Cong., 1st Sess. 775-76 (1963); H.R. Rep. No. 1418, 88th Cong., 2nd Sess. 21 (1964). The original draft of Section 15(b)(4)(E), in contrast to the statute as ultimately enacted, imposed liability in any case in which an entity or individual "failed reasonably to supervise, with a view to preventing [securities] violations . . . another person who commits such a violation." See Memorandum of the SEC With Respect to Changes in H.R. 6789 Between its Submission to the Industry Liaison Committee and its Introduction to Congress ("H.R. 6789 Memorandum") and Comparative Print of the Initial Draft Bill First Proposed to the Industry Liaison Committee and the Draft Submitted by the Commission and Introduced as H.R. 6789 and H.R. 6793, reprinted in Investor Protection: Hearings on H.R. 6789, H.R. 6793 and S. 1642 before a Subcomm. of the House Comm. on Interstate and Foreign Commerce, 88th Cong., 1st Sess., pt. 1 at 651–52, 654,

⁷ The supervisory standard for broker-dealers in Section 15(b)(4)(E) is made applicable to individuals who are "associated persons" under Section 15(b)(6); for ease of reference we generally cite only to the former herein.

656, 661–62 (discussion of the Commission’s development of a legislative request in response to the recommendations of the Special Study).

Congress subsequently revised the draft, however, in response to comments from the securities industry, to require that an individual can only be subject to liability under the section if the person committing the violation “is subject to his supervision.”⁸ The addition of the language “subject to his supervision” plainly must be read as a limiting clause – fully consistent with the notion that there should be some awareness on the part of the “supervisor” as to who is within his or her supervisory authority and some concreteness to the supervisory relationship.⁹

2. No reasonable construction of the term “subject to his supervision” in Section 15(b)(4)(E) can encompass Mr. Urban’s relationship with Mr. Glantz

Here, Mr. Glantz was not subject to Mr. Urban’s supervision under any reasonable interpretation of the language in the statute. First, Mr. Urban was not designated as Mr. Glantz’s supervisor. See Initial Decision at 7. He did not believe that he was Mr. Glantz’s supervisor. Id. at 35 (citing Tr. 2845; Answer at 2). Nor did anyone tell him that he was to supervise Mr. Glantz. See generally id. And, Mr. Glantz neither understood Mr. Urban to be his supervisor, nor believed that Mr. Urban exercised supervisory authority over him. Id. at 7 (“Glantz considered Akers to be his supervisor When anyone questioned Glantz, he would refer them to Akers who would take care of it.”). Second, as the Initial Decision found, Mr. Urban did not

⁸ In comments, the securities industry requested greater clarity regarding the scope of the supervisory liability. See H.R. 6789 Memorandum; see also In the Matter of Arthur James Huff (“Huff”), Exchange Act Release No. 29017, 48 SEC Docket 767, 1991 WL 296561, at *6 (Mar. 28, 1991) (Lochner, Schapiro, Commissioners, concurring).

⁹ See also Huff, 1991 WL 296561, at *6 (Lochner, Schapiro, Commissioners, concurring) (“[A] supervisory person would be responsible *only if* the employee who violated [the securities] laws was subject to his *supervisory jurisdiction*” (emphasis added)); (if the phrase “subject to his supervision” is to have any meaning, there must be “some limiting effect on the individuals whom the Commission can sanction”).

have the traditional powers of a person supervising Mr. Glantz, including the ability to hire, discipline or fire Mr. Glantz. Id. at 51, 52.

Rather, Mr. Urban served a typical role played by legal and compliance professionals throughout the securities industry and across the business world. While he did get “involved” in matters concerning Mr. Glantz’s conduct in his role as General Counsel and as a member of the Credit Committee and other committees, he provided advice and made recommendations on legal and compliance issues to the decision-makers within the firm. The ability to provide advice and recommendations on legal and compliance issues, including in the context of credit and similar committees, is inherent in the function of all legal and compliance professionals and does not, standing alone, confer “supervisory” authority or control over employees, even if the advice and recommendations are “generally followed.”

The facts unambiguously show the limitations of Mr. Urban’s authority and lack of supervisory control. Tellingly, Mr. Urban’s recommendation that Mr. Glantz be terminated was rejected by business management. Id. at 25, 27. Furthermore, management repeatedly failed to heed other parts of Mr. Urban’s advice with respect to addressing Mr. Glantz’s conduct. See id. at 18, n.34; 25; 28-29. For example, management initially did not transfer Mr. Glantz to Baltimore (to make it easier to supervise him) and management did not contact Mr. Glantz’s clients to determine if Mr. Glantz’s trades were compatible with their desired investment objectives. Id. The evidence amply demonstrates that Mr. Urban played an advisory rather than a supervisory role, a role that is insufficient to support the determination that Mr. Glantz was “subject to” Mr. Urban’s supervision.

3. **The standard applied in the Initial Decision is inconsistent with Commission precedent**

Longstanding Commission precedent generally has assigned “supervisor” status only to those whose authority included a significant measure of “control” beyond the ability to provide advice and recommendations. See In the Matter of Michael E. Tennenbaum, Exchange Act Release No. 18429, SEC Docket 676, 1982 WL 312984 (Jan. 19, 1982) (holding options department head to be a supervisor where he had authority to permit and withhold authority for traders to trade in discretionary accounts).¹⁰ To the extent the Gutfreund Section 21(a) report was construed to the contrary by Chief Judge Murray, the Initial Decision was in error.

In reaching the conclusion that Mr. Urban was a supervisor, the Initial Decision sought to apply language in Gutfreund which states that the determination of supervisory status “depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue.” Gutfreund, 1992 WL 362753, at *15. The Gutfreund report, in addressing the conduct of a firm’s Chief Legal Officer, noted that legal and compliance personnel of broker-dealers have been considered supervisors under Section 15(b)(4)(E) “under certain circumstances.” Id. In applying the Gutfreund test to the instant case, however, the Initial

¹⁰ See also In the Matter of Robert J. Check, Exchange Act Release No. 26367, 42 SEC Docket 651, 1988 WL 902613, at *4 (Dec. 16, 1988) (holding sales manager to be supervisor where he rejected sales persons’ trades and had “power and obligation” to ensure customers received breakpoint benefits); In the Matter of First Albany Corporation, John T. Batal and Michael R. Lindburg (“First Albany”), Exchange Act Release No. 30515, 51 SEC Docket 87, 1992 WL 64040, at *6 (Mar. 25, 1992) (holding compliance professional to be supervisor where he possessed “the power to take disciplinary action against a registered representative who violated firm policy by removing commissions and imposing small fines”); In the Matter of James J. Pasztor, Exchange Act Release No. 42008, 1999 SEC Docket 2193, 1999 SEC LEXIS 2193 (Oct. 14, 1999) (holding compliance professional to be supervisor where he had the ability to hire and fire business employees); In the Matter of Kirk Montgomery, Exchange Act Release No. 45161, 76 SEC Docket 1173, 2001 WL 1618266 (Dec. 18, 2001) (holding compliance professional to be supervisor where he had the ability to impose fines and cancel trades).

Decision failed adequately to recognize that, in every circumstance, the “requisite” degree of authority to “affect” the conduct of an employee must include actual supervisory authority over the employee, consistent with the requirements of the statute as construed under relevant Commission precedent.

Gutfreund itself makes this point. Citing the concurring opinion in In the Matter of Arthur James Huff (“Huff”), Exchange Act Release No. 29017, 48 SEC Docket 767, 1991 WL 296561, at *6 (Mar. 28, 1991) (Lochner, Schapiro, Commissioners, concurring), the report explains that “in each situation a person’s actual responsibilities and authority . . . will determine whether he or she is a ‘supervisor’” Gutfreund, 1992 WL 362753, at *17, n.24. The Huff concurring opinion – expressly described in the Gutfreund report as “consistent” with the principle it is applying, id. – makes clear an individual should be deemed a supervisor only if “in light of all relevant facts and circumstances, he knew or should have known that he had the authority and responsibility within the administrative structure . . . to exercise such control . . . that he could have prevented [the employee’s] violations.” Huff, 1991 WL 296561, at *9 (Lochner, Schapiro, Commissioners, concurring). The opinion also underscored that the “most probative factor that would indicate whether a person is responsible for the actions of another is whether that person has the power to control the other’s conduct” Id. at *7. Indeed, all of the Commission’s cases involving supervisory liability, including Gutfreund, “display a consistent emphasis on authority, responsibility, *and control*, as the hallmarks of a ‘supervisor.’” See Mary L. Schapiro, Commissioner, SEC, Remarks at the SIA Compliance and Legal Seminar, dated Mar. 24, 1993 (“Schapiro Speech”) at 16 (emphasis added).¹¹

¹¹ See also First Albany, 1992 WL 64040; Pasztor, SEC LEXIS 2193; Montgomery, 2001 WL 1618266. Although the Commission’s decision in In the Matter of George J. Kolar, Exchange Act Release No. 46127, 77 SEC Docket 2944, 2002 WL 1393652 (June 26, 2002)

In other words, contrary to the conclusion reached in the Initial Decision, neither Gutfreund nor other Commission precedent supports the imposition of supervisory liability on legal and compliance personnel absent a demonstration that they have been granted actual supervisory responsibility and authority – much less based solely on their ability to provide advice and recommendations or to participate on firm committees. Gutfreund itself states that “[e]mployees of brokerage firms who have legal or compliance responsibilities do not become ‘supervisors’ for purposes of Section 15(b)(4)(E) . . . solely because they occupy those positions.” Gutfreund, 1992 WL 362753, at *15.

B. The Standard Applied In The Initial Decision Does Not Satisfy Minimum Requirements Of Fair Notice And Due Process

As a practical matter, the Gutfreund standard as applied in the Initial Decision is far too broad and vague to permit in-house legal and compliance staff to determine whether their actions would impute supervisory status over the employees with whom they work. Fundamental notions of fairness, notice and due process should dictate that a person be made aware of his supervisory responsibility and authority to control another’s conduct before supervisory liability is imposed upon him. This is implicit in the text of the statute, which expressly states that the person must be “subject to his supervision,” and made express in Commission precedent construing the statute. See Huff, 1991 WL 296561, at *9 (Lochner, Schapiro, Commissioners, concurring) (“In light of the statutory language and history, and the Commission’s prior decisions, we believe that a supervisor ought to be defined . . . as a person . . . who has been given (*and knows or reasonably should know he has been given*) the authority and the responsibility for exercising such control (emphasis added)); see also In the Matter of

seems to suggest that “control” is not mandatory, the suggestion is mere *dicta* in the context of a holding that “control” in fact existed. See id. at *5. Additionally, the decision cites no precedent where supervisory responsibility was assigned without such control. Id.

Patricia Ann Bellows, Exchange Act Release No. 40411, 67 SEC Docket 1426, 1998 WL 409445 (July 23, 1998), at *8 (quoting Huff, 1991 WL 296561, at *9 (Lochner, Schapiro, Commissioners, concurring)).

Chief Judge Murray’s standard creates an untenable situation for legal and compliance professionals who, in simply carrying out their ordinary responsibilities, cannot know for certain when they are acting as “supervisors” and who is subject to their supervision, and thus, cannot know when they are subject to liability. Such a result is not only unfair, it also cannot be squared with the intent of Congress in enacting Section 15(b)(4)(E), longstanding precedent, see Checkosky v. SEC, 139 F.3d 221, 225 (D.C. Cir. 1998) (dismissing disciplinary action where SEC failed to provide “clear and coherent standard” for violations of its rule governing improper professional conduct in violation of Administrative Procedure Act) or the requirements of due process. See Valicenti Advisory Servs, Inc. v. SEC, 198 F.3d 62, 67 (2d Cir. 1999) (“Due process requires . . . that ‘laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited’” (citing Grayned v. City of Rockford, 408 U.S. 104, 108 (1972))).

C. The Standard Is At Odds With The Appropriate Discharge Of The Professional Responsibilities Of In-House Lawyers

- 1. Lawyers’ ability to serve as effective and independent counselors will be compromised by assigning supervisory liability based merely on their ability to provide advice and recommendations**

The standard set forth in the Initial Decision also cannot be reconciled with the effective discharge by in-house counsel of their professional obligations to their client. By potentially subjecting virtually all legal and compliance personnel to supervisory liability under Section 15(b)(4)(E), it imposes obligations wholly inconsistent with the traditional and appropriate roles of these professionals.

Lawyers, when serving as counselors, have an obligation to “exercise independent professional judgment and render candid advice.” ABA Model Rules of Professional Conduct, 2.1 (2004). Yet this independence will inevitably tend to be compromised if they risk liability for that advice whenever it is not followed. In related contexts, the Commission has explicitly recognized this concern, stating that:

[I]n the course of rendering securities law advice, the lawyer is called upon to make difficult judgments, often under great pressure and in areas where the legal signposts are far apart and only faintly discernible . . . *to the extent lawyers exercising their professional judgment are excessively motivated by ‘fear of legal liability or loss of the ability to practice before the Commission’ clients may well decide not to consult lawyers on difficult issues.*

In the Matter of Scott G. Monson, Exchange Act Release No. 28323, 93 SEC Docket 1898, 2008 WL 2574441, at *4 (June 30, 2008) (quoting In the Matter of William R. Carter and Charles J. Johnson, Jr. (“Carter”), Exchange Act Release No. 1981, WL 384414, at *25 (Feb. 28, 1991) (emphasis added)). See also Carter, 1981 WL 384414, at *25 (“Concern about [a lawyer’s] own liability may alter the balance of his judgment in one direction as surely as an unseemly obeisance to the wishes of his client can do so in the other”).

In addition, as Monson points out, “the Commission, as a matter of policy, generally refrains from using its administrative forum to conduct *de novo* determinations of the professional obligations of attorneys.” 2008 WL 2574441, at *5 (quoting Disciplinary Proceedings Involving Professionals Appearing or Practicing Before the Commission, 53 Fed. Reg. at 26, 431 (July 15, 1988)). But if legal and compliance personnel fulfilling a strictly advisory role are deemed to be supervisors under Section 15(b)(4)(E), the Commission will be forced to engage in precisely the type of hindsight evaluation of non-public legal advice that it has previously disavowed. See, e.g., Initial Decision at 54-55 (considering and rejecting the

Division's contention that Mr. Urban's legal judgment that a Suspicious Transaction Report did not need to be filed in a given instance was unreasonable).

2. The Commission has recognized that the appropriate role of lawyers is to bring evidence of misconduct to relevant decision-makers in an organization, not to supplant the role of those decision-makers

Legal professionals, as described above, do not typically have any authority to supervise business employees unless such authority is expressly delegated to them. See supra Section I.A.2. That is by design. In-house counsel serve particular functions within securities firms – they provide legal advice to business personnel, monitor legal developments, investigate potential misconduct and make recommendations to business management on the appropriate response to the misconduct. They necessarily become involved in many of the firm's business activities to perform these functions and, for well-known policy reasons, the Commission and other regulators strongly encourage such involvement. In-house counsel's involvement in these activities does not, however, transform these lawyers *per se* into the decision-makers, nor supervisors. It is business management that decides whether to accept the advice of in-house counsel and implement counsel's recommendations.

The distinction between acting as a counselor and acting as a decision-maker has critical professional consequences for a lawyer. Most notably, as counselors, lawyers may provide advice that is protected fully by the attorney-client privilege, which also seeks to promote candid consultation by clients with counsel. In contrast, when lawyers go beyond this role of providing legal advice – and assume business or other responsibilities outside the lawyer's sphere – the privilege may no longer attach to their activities. See In re Lindsey, 158 F.3d 1263, 1270 (D.C. Cir. 1998) (“[W]here one consults an attorney not as a lawyer but as a friend or as a business adviser or banker, or negotiator ... the consultation is not professional nor the statement

privileged” (quoting McCormick on Evidence § 88, at 322-24 (4th ed.1992)) (footnotes omitted)); In re Sealed Case, 737 F.2d 94, 99 (D.C. Cir. 1984).

Further, in implementing the attorney conduct provisions of the Sarbanes-Oxley Act, the Commission itself has acknowledged that the appropriate role of lawyers is to bring evidence of misconduct to relevant decision-makers in an organization, not to supplant the role of those decision-makers. See Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities and Exchange Commission, 17 C.F.R. pt. 205, Exchange Act Release No. 47276, Section 205.3 (Jan. 29, 2003) (“the Commission recognizes that it is the client issuer, acting through its management, who chooses the objectives the lawyer must pursue, even when unwise, so long as they are not illegal or unethical. . . .” but that “when an individual associated with the organization is violating a legal duty, and the behavior ‘is likely to result in substantial injury’ to the organization . . . it is . . . appropriate for counsel to act in the best interests of the issuer by *reporting up-the-ladder*.”) (emphasis added).

3. In-house counsel cannot, as the Commission has recognized in its rulemaking, serve their functions effectively if required to resign when their recommendations are not followed

In cases where management rejects the advice of counsel – as in the instant case – lawyers have no ability to overrule management’s decision. Not only does this inability confirm their lack of “supervisory authority” under any reasonable definition of the term, it also places them in an untenable position under the standard adopted in the Initial Decision: if management rejects their advice and recommendations, they must risk liability as supervisors or resign.

The Commission has expressly recognized the inappropriateness of this result. In promulgating proposed “noisy withdrawal” rules under Section 307 of the Sarbanes-Oxley Act, it took special care to distinguish between in-house and external counsel – exempting the former

from the duty to resign because “[r]equiring an in-house attorney . . . to resign when that attorney receives an inappropriate response to the attorney’s reported evidence of an ongoing or impending material violation appears to be unreasonably harsh.” Proposed Rule:

Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. pt. 205, Exchange Act Release Nos. 8150, 46868 (Nov. 21, 2002).¹²

III. FAILURE TO ADOPT A CLEAR AND APPROPRIATE STANDARD FOR IMPOSING SUPERVISORY LIABILITY WILL HAVE SIGNIFICANT ADVERSE POLICY CONSEQUENCES

A. Adoption Of The Standard Set Forth In The Initial Decision Will Discourage Involvement Of Legal And Compliance Personnel In Ongoing Broker-Dealer Activities

The Commission and its staff have repeatedly underscored the policy benefits of broad involvement by legal and compliance personnel in the full range of a broker-dealer’s business activities. The Commission’s Director of Inspections, Compliance and Examinations reiterated this point in a recent speech:

[T]o be effective, compliance and ethics programs cannot exist in silos. Instead, I believe they need to be ingrained in the DNA of the organization and the decision-making framework of the organization. They need to be imbedded in the business process and at the table when strategic decisions are being made and new products are being developed.

Carlo V. diFlorio, Director, Office of Compliance Inspections and Examinations, SEC, Remarks at the CCO Outreach National Seminar (Jan. 26, 2010).

Adoption of the erroneous standard applied in the Initial Decision would substantially undermine this goal. Instead of encouraging lawyers and compliance professionals to become

¹² See also Press Release, SEC, SEC Proposes Rules to Implement Sarbanes-Oxley Act Provisions Concerning Standards of Professional Conduct for Attorneys, No. 2002-158 (Nov. 2, 2002) (exempting in-house attorneys “because attorneys employed by an issuer face greater potential obstacles to compliance, and because the personal cost of compliance to an attorney employed by the issuer is greater”). It is worth noting that the Commission has not established any mandatory “noisy withdrawal” provisions for in-house or other lawyers.

active participants in the firm's business, it would send a strong message to the contrary, telling lawyers: if you get "involved" in a matter and give advice or make recommendations on "legal and compliance issues," you will be held to account as a supervisor – even though management ignored your advice and you had no authority to alter their decision. It is hard to envision a greater incentive to become "involved" in as few matters as possible.

Worse, even assuming that legal and compliance professionals remain "involved" in many of a firm's activities, an overbroad standard – by potentially impairing these professionals' ability to offer balanced and impartial advice – will deter business personnel from seeking their counsel. Concerns regarding personal liability will be difficult to set aside if every matter becomes a source of potential supervisory exposure. Managers, who can be expected to recognize the potential for overly conservative advice from legal and compliance professionals worried about the risk of personal liability, may well decide to exclude those professionals from key aspects of their firm's business and, at a minimum, to solicit their views less frequently.

B. Adoption Of The Standard Set Forth In The Initial Decision Will Tend To Reduce The Individual Responsibility Of Those With Actual Supervisory Authority

The standard set forth in the Initial Decision, if adopted by the Commission, would also tend to reduce the sense of individual responsibility among those with actual supervisory authority and control. Diffusion of responsibility is especially likely to occur where supervisory responsibility is not clearly defined and those involved believe that, in the event of failure, they can share responsibility with several others. The more individuals that potentially fall into an ambiguous group of potential supervisors, the less likely that any one individual will act in the case of potential misconduct.

The standard would also enable and encourage those with actual supervisory authority to "pass the buck" for their failure to take appropriate supervisory action with respect to compliance

and legal personnel. Indeed, that is precisely what occurred in the instant case. Although senior management at FBW continuously lied to Mr. Urban and ignored his advice, they nonetheless targeted Mr. Urban – one of the only individuals at the firm attempting to resolve the problems with Mr. Glantz – as a scapegoat when Mr. Glantz’s violations came to light. See Initial Decision at 38.

C. The Commission Should Adopt A Clear Standard Assigning Supervisory Responsibility Only To Those Who Know Or Should Know That They Possess Sufficient Supervisory Control Over Another Person’s Activities

The adoption of policies establishing clear lines of authority – so that both supervisors and the supervised fully understand their responsibilities – constitutes a key component of a broker-dealer’s regulatory obligations. FINRA expressly mandates, as a minimum component of a firm’s supervisory systems, the “designation, where applicable, of an appropriately registered principal(s) *with authority to carry out the supervisory responsibilities* of the member.” NASD Rule 3010(a)(2) (emphasis added); see also FINRA, Supervisory Control Procedures FAQs (“Firms must designate the principal(s) and his or her supervisory control responsibilities in their SCPs.”).

Industry best practices – properly seeking to maintain the independence of legal and compliance professionals – contemplate that those professionals should not be designated as supervisors for employees outside of their departments. See White Paper at 2-3. Further, in light of the obligation to have written supervisory procedures, this is well understood by everyone associated with the broker-dealer. In other words, brokers (such as Mr. Glantz) are explicitly told that lawyers (including the General Counsel) do not have supervisory authority over them, and all in management share this knowledge.

As the Commission has recognized, there may be cases in which individuals who are not traditional “line supervisors,” including legal and compliance personnel, are vested with

supervisory authority. Yet in those unusual cases, it must be clear to the individual that he or she was responsible and empowered to take effective action. See Huff, 1991 WL 296561 at *6 (Lochner, Schapiro, Commissioners, concurring) (a supervisory relationship “can only be found in those circumstances when, among other things, *it should have been clear* to the individual in question that he was responsible for the action of another and that he could take effective action to fulfill that responsibility” (emphasis added)); see also Schapiro Speech at 11-12 (“a non-line employee may be a ‘supervisor’ of a particular employee when he or she has the authority and responsibility to exercise some degree of control over the salesperson’s conduct, *knows or should know that she is vested with this authority*, and in fact could have influenced the violative behavior if she had exercised her control.” (emphasis added)).

The need for clarity in the assignment of supervisory authority to a non-line supervisor is particularly important in the context of individuals – such as a General Counsel and other legal and compliance professionals – who are expressly excluded from the supervisory chain under a broker-dealer’s written supervisory procedures. These professionals – and those outside their departments – rightly will presume that they do not have supervisory authority over brokers and other business personnel, absent an unambiguous manifestation that management has determined to override the express provisions of those written procedures.

The language of the Gutfreund Section 21(a) report, rather than provide this clarity, has created doubt about the degree of authority that must be granted to render a General Counsel a “supervisor.” In particular, it is extremely difficult to understand the scope or the limits of the comment in the report that a supervisor is a person “who has a requisite degree of responsibility, ability or authority to affect the conduct of the employee.” The word “affect” is inherently vague and potentially encompasses many relationships that do not approach the degree of authority that

properly should be viewed as making someone “subject to [the] supervision” of another. Indeed, as evidenced in the instant case, the mere ability to provide advice and recommendations could be misconstrued to constitute a supervisory relationship under this language – despite the Commission’s effort, discussed in Section II.A.3 above, to clarify the consistency of the Gutfreund standard with the “control” test articulated in earlier precedent. This vagueness is compounded by the circularity implicit in the word “requisite,” which begs the very question at issue: what is the degree of authority necessary (i.e., “requisite”) to become a supervisor?

In light of the substantial ambiguity and potential for confusion inherent in the Gutfreund report, the Commission should reconfirm and clarify the crucial point embedded in the statute and in many of its decisions: no one should be held liable as a supervisor if they have not been expressly granted clear authority that affords them actual supervisory responsibility and control over an individual. Although there may not be a specific list delineating all of the powers that define the necessary authority, the ability to “hire or fire, to reward or punish” ordinarily should be among them – and in their absence only very compelling evidence of actual authority to control an individual’s conduct should suffice. Moreover, the Commission should explicitly recognize that neither the ability of legal and compliance professionals to provide advice and recommendations, nor their participation in firm credit and similar committees, constitutes sufficient authority to make them “supervisors” of employees outside their departments.

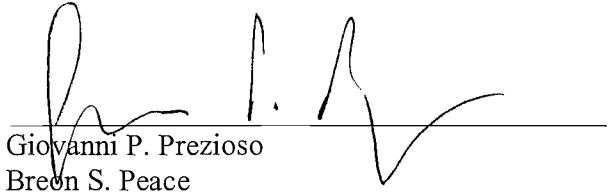
CONCLUSION

For the foregoing reasons, the Commission should vacate the determination of supervisory status in the Initial Decision and issue a final decision holding that Mr. Urban was not a “supervisor” within the meaning of Section 15(b)(4)(E) of the Exchange Act.

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Respectfully submitted,

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