

December __, 2002

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

E-mail address: rule-comments@sec.gov

Attention: Jonathan G. Katz, Secretary

**Re: File No. S7-45-02
Implementation of Standards of Professional Conduct for
Attorneys
Release No. 33-8150**

Ladies and Gentlemen:

The Business Law Section of the New York State Bar Association appreciates the Commission's invitation in Release No. 33-8150 (the "Release") to comment on proposed rules (the "Proposed Rules") to implement § 307 of the Sarbanes-Oxley Act of 2002 (the "Act").

The Business Law Section is composed of members of the New York Bar, and a principal part of the practice of many of its members is in securities regulation. The Section includes lawyers in private practice and in corporation law departments. A draft of this letter was circulated for comment among members of the Securities Regulation Committee, the Securities Litigation Committee and the Committee on Standards of Attorney Conduct and the views expressed in this letter are generally consistent with those of the majority of members who reviewed and commented on this letter in draft form. The views set forth in this letter, however, are those of the Section and do not necessarily reflect the views of the organizations with which its members are associated or the New York State Bar Association.

Summary

§ 307 of the Act is straightforward and simple. It requires lawyers who appear and practice before the Commission to report material violations of securities and other laws up the corporate ladder; if need be to the Board. We believe the Commission has gone well beyond what Congress intended of it, stretching the plain English of § 307 by the device of defining simple words and phrases to encompass conduct and actors in ways which were not contemplated and are unwarranted. We also believe that in seeking to mandate disclosure of misconduct to the Commission either by lawyers or by a specially identified committee of the Board, the Commission has, without justification, stepped far out in front of the national debate.

We urge the Commission to defer adoption of any rules containing “noisy withdrawal” requirements until there has been sufficient time for comment and full consideration of the potentially damaging effect of such a model on attorney-client relationships and privileges, especially since this concept was never authorized or contemplated by the Act.

Proposed “Noisy Withdrawal” Requirement

Lawyers have traditionally been able to provide their clients with dispassionate legal advice based on a full understanding of the relevant facts. Because of the evidentiary privilege that attaches to attorney-client communications, and the strict ethical obligations of confidentiality in effect in all 51 disciplinary jurisdictions in the United States, clients are allowed and encouraged to be completely candid with counsel. While, in some circumstances, protecting communications between lawyer and client may in an objective sense hinder the search for truth, society has made a judgment that this “impairment is outweighed by the social and moral values of confidential consultations. The attorney-client privilege provides a zone of privacy within which a client may more effectively exercise the full autonomy that the law and legal institutions allow.” American Law Institute, RESTATEMENT OF THE LAW GOVERNING LAWYERS, § 68 cmt. c, at 520 (2000).

The Proposed Rules threaten to undermine the stability of the attorney-client relationship by mandating conduct by lawyers that could lead to wholesale revelations of previously protected attorney-client communications and of legal advice ostensibly given in confidence. These requirements will undoubtedly have a chilling effect on attorney-client communications and on the willingness of securities issuers to seek and obtain effective legal advice at the time they need it most.

The Commission proposes to require a lawyer to effect a so-called “noisy withdrawal” when a client has refused or failed to rectify material violations of law. Proposed Rules § 205.3(d)(1). Regardless of whether the issuer has used the lawyer’s services in committing the wrongful acts in question, a lawyer who has discovered such acts and has not received an appropriate response will be required (if outside counsel) to terminate the representation and, more importantly, to reveal to the Commission that withdrawal was based on “professional considerations.” Proposed Rules § 205.3(d)(1)(i)(B). There can be little question that any such notice to the Commission, given the clear context of the regulatory scheme, will be justifiably

interpreted as a communication that the issuer has failed to rectify a situation believed by the lawyer to constitute a material violation as defined in the Proposed Rules, and will therefore implicitly communicate otherwise privileged information to the Commission. This revelation, even though compelled by administrative rule, may well open the door to disclosure of additional attorney-client communications in other contexts. Indeed, courts often hold that the partial disclosure of attorney-client communications on a particular issue constitutes a waiver of the privilege with respect to all communications concerning that subject matter. *See, e.g., In re Sealed Case*, 877 F.2d 976 (D.C. Cir. 1989) (waiver by subsequent disclosure of one document waives privilege as to all communications on same subject matter); *In re Martin Marietta Corp.*, 856 F.2d 619 (4th Cir. 1988), cert. denied, 490 U.S. 1011 (1989) (implied subject-matter waiver as a result of statements by corporation to government in negotiating settlement); *AMCA Int'l Corp. v. Phipard*, 107 F.R.D. 39 (D. Mass. 1985) (disclosure to adversary in pre-litigation negotiations of attorney-client correspondence waived privilege with respect to all related communications). In this regard, we have serious concerns that the statement in the Proposed Rules that such notification “does not breach the attorney-client privilege,” Proposed Rules § 205.3(d)(3), though presumably reflective of the Commission’s intent, will not be effective to preserve the privilege against, for example, challenge by a criminal prosecutor in a court of law. Setting into motion a chain of events that could well require disclosure of attorney-client communications would serve to deprive the issuer of the ability to have a full and open consultation with counsel at a critical time. This cannot be what Congress intended when enacting § 307 of the Act, which of course says nothing at all about lawyers being required to disclose any privileged or confidential information to parties other than the client.

We urge the Commission to restrict its rulemaking pursuant to § 307 of the Sarbanes-Oxley Act to regulations explicitly required of it by Congress. The private bar is far from having reached a consensus as to whether a lawyer should be permitted to disclose confidential client information to a third-party to prevent or rectify the consequences of crime or fraud in cases where it is reasonably certain to result, or has resulted, in substantial injury to the financial interests or property of another firm.¹

Given the need for consensus, the Commission should not step out in front of the debate and by fiat mandate that a segment of the private bar must, in practical effect, disclose confidential client information to the Commission.

While the private bar may reach the conclusion that disclosure to an appropriate third-party (which may or may not be the Commission) is required or permissible to protect against substantial financial injury, that conclusion needs to be considered by the private bar through its local and national bar associations.

¹ See Preliminary Report of the ABA Task Force on Corporate Responsibility, July 16, 2002 (the “Cheek Report”). We note that this report had limited circulation among members of the ABA and was never fully considered by the membership or submitted for final approval by any of its Sections or Committees. The Commission’s reliance on the Cheek Report as evidencing support for some of the statements in the Release is not appropriate, in our view.

The private bar and the Commission need to weigh the desirable goal of protecting society from the injurious impact of fraud and crime against the likelihood that mandated disclosure to a third-party, and in particular, a governmental enforcer, will corrode the attorney-client relationship in such a way that the lawyer will lose the client's trust, and in the process, the power to persuade a client to act lawfully.

Promoting effective, practical methods of reporting up the ladder, and not the threat of whistle-blowing to the Commission will protect investors. The emphasis of both the Commission and corporations and their counsel should be to identify structural devices that promote conscientious prevention and remediation of corporate misdeeds materially affecting the integrity of filings with the Commission.

Proposed Record Retention Requirements

The requirement that lawyers maintain contemporaneous records relating to possible material violations, Proposed Rule § 205.3(b)(2), poses a significant risk to the attorney-client privilege and ethical duties of confidentiality. In other contexts, courts have held that records that are maintained by an individual or entity as a result of a statutory or regulatory requirement are subject to disclosure even as against Fifth Amendment self-incrimination claims. *See Marchetti v. United States*, 390 U.S. 39, 55-56 (1968); *Grosso v. United States*, 390 U.S. 62, 67-68 (1968); *In re Grand Jury Subpoena Duces Tecum Served Upon Underhill*, 781 F.2d 64, 67-69 (6th Cir. 1986); *People v. Doe*, 59 N.Y.2d 655, 656-57 (1983). Regardless of the Commission's intent, there can be no guarantee that the "required records" doctrine would not be applied to bar claims of attorney-client privilege with respect to documents prepared and retained by a lawyer confronted with evidence of material violations of law by a client. We note that the Commission has expressed the view that "requiring such a contemporaneous record of the report may protect the attorney in any proceeding in which his or her compliance with this rule is at issue by demonstrating that the attorney acted properly under the circumstances." Clearly, it would be prudent for a lawyer to maintain such records, and lawyers should be encouraged to do so. Unfortunately, by mandating such records the Commission may well have rendered them, as well as their general subject matter, susceptible to full disclosure in subsequent legal proceedings. If the only reason for the contemporaneous record requirement is the protection of attorneys, we urge that the requirement — and the corresponding risk to the attorney-client privilege — be eliminated and that the matter be left to the sound discretion of the individual lawyers. If the Commission has included the retention requirement so that the records may be subject to production and inspection on request in future proceedings, we urge that the requirement be eliminated as well. To do otherwise would undermine the confidentiality surrounding the seeking and rendering of legal advice in highly sensitive circumstances. As a matter of fundamental policy, the Commission should encourage issuers to seek the advice of counsel when evidence of material violations emerges, not deterred by the spectre of subsequent disclosure of their communications with counsel.

Proposed Definitions

The definition of “appearing and practicing before the Commission” should be confined to attorneys who provide legal services related to an issuer’s compliance with the Securities laws

The definition of “appearing and practicing before the Commission” in §205.2(a) is vastly broader than the definition in existing Rule 102(f) of the Commission’s Rules of Practice and sweeps in, intentionally or unintentionally, all manner of persons whose connection to the Commission is tangential, at best, and well beyond the jurisdiction of the Commission, at worst. When read in conjunction with other provisions of the rules, the definition of “appearing and practicing” could sweep in a company’s patent attorney whose firm has been requested by securities counsel to review one section of a business description contained in a registration statement or periodic report because it has represented the company in areas of patent applications. [More examples?]

“Transacting business with the Commission” in clause (a)(1) is unduly expansive.

In clause (a)(1) of the definition, the term “transacting business with the Commission” includes “communications with . . . the Commission, or its staff.” Thus, a lawyer who has the temerity to represent a client in United States District Court in an action to which the Commission is a party, as plaintiff, defendant or intervener — or even an *amicus curiae* — involuntarily becomes an attorney “appearing and practicing” before the Commission because Court rules mandate that papers be served on the Commission and this can be construed as a “communication.” There is no reason for the Commission to attempt to assert jurisdiction in situations such as these.

Clauses (a)(2) and (3) are overbroad and adversely impact enforcement defense.

Clauses (2) and (3) of §205.2(a) would impose “noisy withdrawal” obligations on attorneys who are retained solely for the purpose of defending an issuer in a Commission investigation or administrative proceeding. The attorney’s responsibility is to zealously represent his or her client, *i.e.*, the issuer, within the bounds of the law. To undertake such a representation, a lawyer need not subjectively believe that he or she has the “better side of the argument” or that it is a position likely to prevail. The attorney is permitted to undertake the representation if he or she, after a reasonable investigation, believes that there is (or will be) evidentiary support for the position and that the assertions of law are nonfrivolous. *See, e.g.*, Rule 11, Federal Rules of Civil Procedure.

Read literally, a trial lawyer retained by an issuer to defend against an allegation that there was a material omission in an annual report on Form 10-K filed two years ago would have a duty to “report any evidence of a material violation. . . .” through “up-the-ladder” reporting and, if the Form 10-K were not amended, withdraw as counsel in a “noisy” manner. Thus, a “noisy withdrawal” would appear to be mandated even if the issuer’s defense counsel believed that the issuer’s position was defensible, though not a likely winner. Requiring an advocate to withdraw in such a circumstance undermines the adversary system which is at the heart of our

legal system. These provisions run counter to the Commission's reassurance to Congress and the public that the Commission's rules would not adversely impact the defense of enforcement actions.

It should be remembered that the Commission is an arm of the government. To take a person's property (in this case the property of an issuer) without affording it the right to be heard — a corporation, as a non-natural person, can only be represented by an attorney — would likely be a deprivation of due process of law. A rule that issuers can only be represented in litigation by lawyers who believe that the issuer will prevail in that litigation will place a premium on either a lack of integrity or lack of intelligence or both.

Clauses (a)(4) and (a)(5) are overbroad and could be erroneously construed to sweep in attorneys only tangentially related to an issuer's disclosure practices and the drafting process.

Clause (a)(4) could be construed to cover every lawyer in any way involved in the disclosure practices of an issuer, even in situations where that person is not functioning as an attorney; where the attorney's involvement is so remote the attorney has no involvement beyond furnishing information which may or may not be used; and where the attorney has no experience with or understanding of the securities laws or disclosure processes. In our view, this result would be inappropriate.

As an example, routinely, litigation attorneys, who may have a limited relationship with an issuer, are asked to respond to auditors' inquiries describing litigation or threats of litigation meeting certain minimum thresholds. The loosely written definition of "appearing and practicing . . ." could well sweep such individuals within the definition. The mere fact that the lawyer "has reason to believe" that the auditor and issuer may in some indirect way "incorporate" the information into a financial statement, which is, in turn, filed with the Commission could sweep that lawyer within the Rules. Similarly clause (a)(5) could be construed to include an attorney who advises a particular paragraph describing the technical aspects of a litigation need not be included whether or not that paragraph was material.

As another example, the proposed definition could also include attorneys who help draft material contracts or other agreements that are required under Regulation S-K to be filed as exhibits to registration statements or Exchange Act reports. For example, a real estate attorney who helps negotiate and draft an issuer's lease for new office space could be considered to be "appearing and practicing before the Commission" if he or she had reason to believe the lease would be filed as an exhibit to the issuer's filings or if the attorney advises that a particular paragraph need be included in a description to be so filed. Therefore, as it is now written, the rule might erroneously impose "up-the-ladder" reporting and "noisy withdrawal" obligations on attorneys who (a) do not practice securities law and therefore may not have a working understanding of materiality and other securities law concepts made use of by the proposed rule and (b) are not part of any disclosure process regarding the issuer at all or may see only a discrete portion of the overall disclosure document and drafting process, and therefore lack knowledge of the context necessary to make a materiality determination.

An actual knowledge standard should replace the “reason to believe” standard in §205.2(a)(4).

§205.2(a)(4) pulls in attorneys representing an issuer on non-securities law matters who participate, to any degree, in the “process of preparing” a statement that the attorney “has reason to believe” will be filed, or incorporated into a statement filed, with the Commission. Such attorneys may or may not have any working knowledge of securities law. Yet the “reason to believe” standard may require them to understand what, for example, Regulation S-K requires to be filed as an exhibit or incorporated by reference in a registration statement or report, as well as to monitor whether the statement is in fact filed and the content of the statement as it is ultimately filed.

Sub§ (a)(4) should be revised so that only preparation of a statement filed with an attorney’s consent means an attorney “appear[s] and practic[es] before the Commission.”

Under Rule 102(f) of the Commission’s Rules of Practice, an attorney only “appears and practices before the Commission” if she helps draft a statement that is filed with the Commission with the attorney’s permission. The definition in the proposed rule drops this limiting principle. The proposed definition should be revised to add back in this qualifier because it prevents attorneys who, for example, merely draft an agreement filed as an exhibit, or who only supply information about the issuer’s litigation to the issuer’s auditors, from being swept up in the definition of “appearing and practicing of the Commission.”

We urge the Commission to redefine subdivisions (a)(4) and (a)(5) so as to confine the definition of attorneys “appearing and practicing before the Commission” to persons who are acting as attorneys advising on the securities laws and required disclosure thereunder, rather than using the proposed definition which would cover virtually any attorney who is directly or indirectly involved in any subject matter relating, however tangentially, to the issuer’s disclosure.

The definition of “attorney” is overbroad

The definition of “attorney” should be clarified so that it applies only to a lawyer who is providing legal services related to the issuer’s compliance with the securities laws. As presently defined, a lawyer who is not advising the client but is simply providing factual information to be used in required disclosure, as is the case with a person advising on an environmental situation which may later be determined to be material, would be considered an “attorney” covered by §205.2(c). Furthermore, persons who happen to be lawyers working in a non-legal capacity, or who are otherwise providing services such that no attorney-client relationship exists, should not be subject to §2.05 obligations as proposed.

It is the responsibility of the attorneys and management drafting the disclosure to evaluate the accuracy, relevance and materiality of information supplied for possible use. Working within the attorney-client relationship they have the universe of all available information in which to make such judgments. A person who does not have the “total mix” of information should not become subject to §205.2 obligations simply because he or she is

admitted to the bar, any more than someone who is not an attorney. There are ample protections provided in the securities laws for someone improperly supplying information in these circumstances.

For example, as it is now written the definition of attorney could include a person employed in an issuer's accounting or marketing department who ceased practicing law ten years earlier (but remains licensed to practice) and was not hired as an attorney. In such a case, neither the issuer or such employee operates under the assumption that an attorney-client relationship between them exists. Such employee may not be more versed in current developments in securities laws than the ordinary "man on the street," particularly if the law he or she used to practice was something totally different, such as patent law. The issuer may justifiably disregard any "legal advice" (i.e., in reporting up the latter) that such employee may be required to give under the proposed rules, since a person who is not employed as an attorney is not expected to act in a legal capacity. Imposing up-the-ladder reporting requirements on that person creates an unnecessarily difficult personal situation (if he or she becomes aware of these requirements at all): should he or she give up her license now or leave open the possibility that he or she may some day encounter an "up-the-ladder" reporting requirement that may jeopardize his or her position in the capacity for which he or she is employed? This cannot be what the Commission intends and the definition should be revised to eliminate such situations.

The definition of "in the representation of an issuer" is overbroad and should specifically exclude counsel for financing sources (including underwriters)

For centuries there has been a well understood meaning of what it means for an attorney to represent a client, *i.e.*, to form an attorney-client relationship. Simply put, the relationship is formed when a person manifests the intent that the lawyer provide legal services and the lawyer manifests his or her consent to do so. See *Restatement of the Law (Third), The Law Governing Lawyers* §14 (American Law Institute 1998). The definition should be co-extensive with the attorney-client privilege. We do not believe that §307 of the Act was intended to change the time-tested concept of representation.

The proposed definition of "in the representation of an issuer" is "acting in any way on behalf, at the behest, or for the benefit of an issuer, whether or not employed or retained by the issuer." This broad definition is guaranteed to spawn decades of contentious litigation with the Commission. It may sweep into the category of those who have "up-the-latter" reporting and "noisy withdrawal" obligations with respect to the issuer attorneys who owe important duties, including client confidentiality, to persons other than the issuer.

The definition is so broadly worded that it can be read to include underwriters' counsel and counsel for other financing sources.

Although we do not believe it was the Commission's intent, the "in any way . . . at the behest, or for the benefit of" language could be construed to sweep in underwriters' counsel. For example, it is customary for counsel for the underwriters or initial purchasers in an offering to make blue sky filings "on behalf of" the issuer, or at least at the expense of the issuer.

Although in making such filings such counsel never holds himself or herself out to the state authorities as attorney for the issuer, he or she could be construed as acting “for the benefit of” or “on behalf of” the issuer. Yet all would agree that underwriters’ counsel has an attorney-client relationship only with the underwriters. It cannot be the Commission’s intent to impose “up-the-ladder” responsibilities with respect to the issuer on underwriters’ counsel.

It is also not uncommon for an issuer to “designate” underwriters’ counsel.² This usually occurs when the issuer desires counsel who represented the underwriters in a previous offering to represent the underwriters in a new offering, even if the underwriters have changed. The issuer may require, or strongly urge, the underwriters to engage such counsel, even if the underwriters do not customarily do so. In some cases, the underwriters’ counsel will even be named in the base prospectus for a shelf registration statement, long before the issuer has actually determined to have an offering, the type of offering (in the case of a universal shelf registration statement) or who the underwriters will be.

This common practice benefits the issuer, underwriters and investors. Designated counsel for the underwriters is already familiar with the issuer and, in connection with a new offering, needs only to update his or her due diligence conducted in connection with the prior offering instead of starting from scratch. Not only does this practice lower transaction expenses, it promotes the efficiency of the capital markets by allowing seasoned issuers to reach the capital markets quickly, when and as the opportunities arise, just as the option of shelf registration statements is intended to do. The benefit of shelf registrations would be illusory if seasoned issuers could not take advantage of ideal market conditions with rapid take-downs because due diligence by new underwriters’ counsel each time required too much time and effort of management, the underwriters and the underwriters’ counsel. The practice of designating underwriters’ counsel also increases the likelihood of better disclosure for investors. Designated underwriters’ counsel is often given the opportunity to review and comment on shelf registration statements (and, in some cases, Exchange Act filings) before they are filed. Further, by working on multiple offerings by an issuer over an extended period, designated underwriters’ counsel gains deeper understanding of the issuer and so can make a greater contribution to full and accurate disclosure.

² This analysis also applies to designated counsel for the initial purchasers in a Rule 144A/Regulation S offering. To a lesser extent, issuers in other private placements and borrowers under bank facilities may request the investor/lender to use counsel that represented the prior investor/lender to reduce transaction expenses. The definition of “in the representation of an issuer” should be revised to clearly exclude all these situations. The Commission should also make certain that there is no ambiguity or confusion under the rule as a result of customary fee arrangements. For example, the legal expenses of lenders for a bank facility are generally paid by the borrower; fees of investors’ counsel in a private placement are frequently paid by the issuer; the issuer in a rule 144A offering may, in certain cases, pay for all or part of the legal expenses of the initial purchasers; and the fees and expenses of counsel for the underwriters/initial purchasers in connection with blue sky filings are paid by the issuer. In all of these situations, it is clear that the duties of loyalty and confidentiality owed by the attorney run solely to the underwriter/initial purchasers/lender/investor the attorney represents, not to the issuer/borrower.

That a lawyer is designated by the issuer does not relieve him or her of the obligation to act as underwriters' counsel and to treat the underwriters as his or her only clients in the offering. The Commission cannot have intended to bring underwriters' counsel within the purview of the rules applicable to issuers' counsel (except to the extent applicable to the underwriter as an issuer itself). How can underwriters' counsel report "up-the-ladder" to the board or audit committee of an issuer? What could it possibly mean for underwriters' counsel to "withdraw" from the representation of the issuer?³

If designated underwriters' counsel were deemed to be representing the issuer (because of the "in any way . . . at the behest" language), the role of issuer's counsel and underwriters' counsel would be blurred, which would weaken, rather than strengthen, enforcement of the securities laws. To the extent underwriters have their own independent due diligence responsibilities, they are placed in a somewhat adversarial role relative to the issuer. The proposed definition improperly intermingles the two separate and distinct sets of duties.

The definition of "in the representation of an issuer" should be revised so as not to leave any ambiguity that counsel for financing sources, including underwriters, is not representing the issuer.

The broad definition may also mischaracterize the attorney-client relationship of counsel for an issuer's directors as a representation of the issuer.

The "in any way. . . at the behest of" and "for the benefit of" language also poses problems for a director's own personal counsel who does not represent the corporation but rather one or more individual directors. The representation of the director may occur "at the behest," and such representation may be "for the benefit of," the corporation (as in the case when a lawyer represents a special committee of the Board) but that lawyer in no sense represents the corporation, even if the corporation pays for the costs of representation. Indeed, the separateness of this representation ensures independent, tough-minded directors.

When lawyers who represent clients other than the issuer are swept into the term "in the representation of an issuer," chaos and conflict ensue. These lawyers owe duties of confidentiality and loyalty and fiduciary duties solely to persons other than the issuer. Those other persons, directors or underwriters, undoubtedly have certain duties which they must faithfully execute under the securities laws. But a lawyer who advises them in the faithful

³ Although the Commission seems to have contemplated the role of underwriters in formulating the definition, the Commission does not seem to have considered the issue discussed herein. The Release states that the definition of "in the representation of an issuer" is also "intended to reflect the duty of an attorney retained by an issuer to report to the issuer evidence of misconduct by an agent of the issuer (e.g., an underwriter)." This statement in the Release is, in our view, extraneous and not logical. The reporting duty does not arise under the concept of "in the representation of an issuer" but rather under the requirement elsewhere in the proposed rules that an attorney practicing before the Commission in the representation of an issuer report material violations by the issuer or "any officer, director, employee, or *agent* of the issuer," because an underwriter can be an agent of the issuer.

execution of those duties does not thereby become the issuer's lawyer. It is imperative that this definition be revised. The concept of "representation of the issuer" should be co-extensive with the attorney-client relationship with the issuer and not any broader.

The requirement that an attorney "act in the best interest of the issuer and its shareholders" is vague and impractical

§205.3(a) requires that an attorney appearing and practicing before the Commission in the representation of an issuer "act in the best interest of the issuer and its shareholders." The Release cites the Cheek Report's explanation of ABA Model Rule 1.13 to support the requirement that an attorney act in the best interest of the issuer and its shareholders. However, the Cheek Report merely explains that, where an attorney represents an organization, the attorney's duty runs to the organization rather than to the individuals serving as the organization's officers. Neither ABA Model Rule 1.13 nor the Cheek Report frame the "up-the-ladder" reporting obligations of 1.13(b) and (c) as broadly as a requirement to "act" in the organizational client's best interests. Thus, as now written, the rule goes beyond the scope of the ABA rule it claims is an equivalent.

A lawyer representing an issuer acts as counsel to the corporation and not to any constituent part of the corporation, such as directors, officers, creditors and/or shareholders. Clearly, there is not and should not be an attorney-client relationship between the corporation's attorney and the shareholders of the corporation, in their capacities as such. Corporations owe contractual duties to employees and creditors which shareholders do not. Corporations have legal obligations to governmental authorities such as to pay taxes and to obey environmental laws which shareholders do not. Melding the role of lawyer for the corporation and lawyer for the shareholders which corporate law and professional codes have kept separate undermines the role of an attorney. While shareholders may prefer that dividends be paid before interest is paid to bondholders, a lawyer whose sole client is the corporation knows that such course of conduct would place the corporation in breach of its obligations. Certainly, there is no attorney-client relationship or privilege which would protect communications between the corporation's attorney and the shareholders.⁴

§205.3(a) seeks to equate the fiduciary duty of directors⁵ with the obligations of attorneys in an attorney-client relationship. However, attorneys do not have the power to simply act in the best interests of the corporation and its shareholders as directors do; attorneys give legal advice,

⁴ The attorney-client privilege is co-extensive with the attorney-client relationship. Even to the extent that communications by a shareholder to a corporation's attorney came within the corporate attorney-client privilege, as a communication made in an "organizational capacity" by a constituent of the organization (*see* Comment to ABA Model Rule 1.13), such privilege belongs to the corporation to assert or waive, not to the shareholder.

⁵ Note that, even in attempting to mimic a fiduciary standard, the rule is incorrect; in some cases, the duty of directors expands to include creditors.

which may or may not be adhered to. As the Comment to ABA Model Rule 1.13 recognizes, “[w]hen constituents of an organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful.” Even the Cheek Report so generously quoted in the Release recognized that “it is the appropriate role of corporate officers and employees to make business decisions involving substantial degrees of risk . . . and certainly the lawyer is not expected to go over the head of individual with whom the lawyer is dealing”

A blanket requirement that issuers’ attorneys act in the best interest of the issuer and its shareholders is too vague. Rather, the rule should be explicit about what actions issuers’ attorneys must take to serve the best interests of the issuer. If it is the Commission’s view that a lawyer’s obligation to protect his corporate client from harm requires the attorney to report “up-the-ladder” wrongs of the organization’s constituents, §205.3(b) of the proposed rule already requires this, so that a requirement that an attorney “act in the best interest of the issuer and its shareholders” is unnecessary. Thus, the clause regarding best interests in §205.3(a) should be removed entirely, or clarified to refer to the distinction that, where the interests diverge, where an attorney represents an organization, the attorney’s duty runs to the organization rather than to the individuals serving as the organization’s officers, directors or shareholders in their individual capacities.

The Commission should not expand §205.3(a).

The Commission invited comment on whether §205.3(a) “should be expanded to address under what circumstances an attorney for an issuer may also represent officers, directors and employees” of the issuer, and on related questions of conflicts of interest and the waiver thereof. The Commission should not issue rules on these points because to do so would exceed the Commission’s authority under § 307 of the Act to promulgate “standards of professional conduct for attorneys appearing and practicing before the Commission . . . in the representation of issuers.” These are issues that arise generally in an attorney’s representation of any organizational client, not just in the representation of an issuer before the Commission, and are already extensively covered by state ethics rules. (See, e.g., ABA Model Rule 1.13(e) (“A lawyer representing an organization may also represent any of its directors, officers . . . or other constituents, subject to the provisions of Rule 1.7 [concurrent conflicts of interest]”)).

Qualified Legal Compliance Committees

Specific concerns are raised by the alternative reporting procedures set forth in § 205.3(c) and the definition of Qualified Legal Compliance Committee (“QLCC”) in § 205.2(f). We note that issues discussed elsewhere in this letter apply equally to a QLCC, including the definitions and the concepts of “noisy withdrawal” and “disaffirmance”. We group these specific concerns into four broad categories: (1) intrusion into state corporate governance models; (2) confidentiality; (3) failure to integrate the QLCC alternative with other portions of Part 205; and (4) liability issues.

Subject to addressing the specific concerns discussed below, we do not object to, and indeed support, the use of a QLCC as an appropriate and meaningful implementation of “up the ladder reporting” required by § 307 of the Act.

1. Intrusion into State corporate governance models

Under state law governance standards carefully crafted over a long period of time, the business and affairs of a corporation are generally managed by or under the direction of a board of directors. Committees of the board may be delegated any of the powers of the board to manage the affairs of the corporation, and a member of such a committee is fully protected in relying in good faith upon the records of the corporation and upon opinions and reports by any other person as to matters the committee member reasonably believes are within such other person’s professional or expert competence and who has been selected with reasonable care. This model has functioned well, particularly in the area of special litigation committees.

We believe the following departures from the governance model described above should be rectified.

- The requirement that the Committee “direct the issuer to adopt appropriate remedial measures” should be expanded to allow the QLCC in the alternative to “recommend to the full board” appropriate remedial action. In appropriate cases the QLCC may determine that the corporation will best be served by permitting all directors to participate in the determination of the remedial action to be taken thereby ensuring that the issuer benefits for the views of all board members. A requirement that final direction come from the QLCC paradoxically excludes from the formal decision-making process non-member directors whose views should be heard when considering the existence of securities law violations which, contrary to the Commission assertion in the Release, are usually not “well-understood” and usually involve difficult factual investigation and significant questions of judgment as to which reasonable and equally informed individuals can and do differ. Paradoxically, such formal exclusion of directors who are not QLCC members will cut short the “up the ladder” reporting to the full board which is the goal of § 307. We note that the Commission does not address, and acknowledges in the Release, that Congress did not explicitly direct the Commission to address, any action to be taken when an independent board has in good faith considered and resolved “evidence of a material violation.”
- Clause 5 of the definition of QLCC should be deleted in its entirety. An obligation upon each member of a QLCC (and the CLO and CEO) to notify the Commission of any failure to take a remedial measure directed by the QLCC and to “disaffirm” any document which the QLCC member individually believes is false or materially misleading eliminates the consensual basis for committee decision-making and requires, in substance, that committee resolutions be unanimous or that a signal be sent to the Commission. There is nothing in the Act that remotely suggest this outcome, especially as to non-attorney committee

members. Likewise, the notification and disaffirmance obligations should be removed from the CLO and CEO as the entire template of corporate governance is turned on its head if the CLO and CEO have a duty to report to the Commission determinations arrived at in good faith by a disinterested board committee.

- We suggest that the requirement in § 205.2(j)(1) that QLCC members not be employed, directly or indirectly, by the issuer is too narrow to achieve what we believe the Commission intends. We suggest that QLCC members also be required to be “disinterested” within the meaning of such term developed under state corporate law.

2. Confidentiality

§ 205.2(j)(3) requires that the QLCC have written procedures for the “confidential receipt, retention and consideration” of reports of evidence of material violations. The Commission does not address the issue of “confidentiality” from whom – other corporate officers and directors; plaintiffs in private litigation? The requirement should be altered to require the QLCC to make appropriate arrangements to encourage the reporting of material evidence of material violations including assurances against retaliation by corporate officers. There is nothing that a board committee can do to provide meaningful – i.e., judicially recognized – “confidentiality” in the sense of privilege against disclosure of “evidence” received by it or for its “consideration” in the context of private litigation. The time honored technique for achieving such a result involves engaging a law firm to prepare a report which is protected by the attorney-client privilege or work-product doctrine. The Commission should consider adding to § 205, or asking Congress to enact, if necessary, a provision creating a confidentiality privilege for records required to be kept pursuant to Part 205 in order to minimize the litigation risks associated with the rule.

3. Failure to integrate the QLCC alternative with other portions of Part 205

The Commission notes that the most important respect in which the QLCC alternative differs from §§ 205.3(b) and (d) is that § 205.3(c) “relieves” an attorney from any obligation to assess the issuer’s response and to withdraw and alert the Commission. This “relief” is illusory absent specific provisions to address the following (in the event that “noisy withdrawal” is adopted):

- The QLCC, which need not have any attorneys as members, will inevitably hire independent counsel to assist in consideration of the reported evidence and determination of appropriate remedial action. The independent counsel so retained will under the applicable definitions of Part 205 be subject to “noisy withdrawal” obligations under §§ 205.3 (b) and (d). The effect is to shift the “noisy withdrawal” obligations from the attorney originally reporting evidence to the QLCC to the attorneys retained by the QLCC to assist in consideration of the evidence. The attorneys engaged by the QLCC to assist the QLCC to consider

and resolve evidence which has been reported to the QLCC should be exempted from any obligation to make a “noisy withdrawal” under §§ 205.3(b) and (d)

- The Commission should exempt from the obligations of §§ 205.3(b) and (d) any QLCC member who is by coincidence an attorney. Presumably the Commission does not intend that such a member of the QLCC be under an independent obligation to report, keep records, noisily withdraw and disaffirm as a result of participation on the QLCC. This should be made express.

4. *Liability of QLCC members*

We believe that the liability issues raised by the QLCC proposal are so severe that, if not addressed by the Commission, no independent director could be advised to serve on a QLCC. The Commission has made clear its view in § 205.6 that a violation of proposed Part 205 will be treated as a violation of the Exchange Act for which the Commission may commence a civil action seeking equitable relief, as well as civil money penalties and cease and desist orders. In fairness the Commission should also refer to the numerous disqualifications from service or professional practice that flow from violation of the Exchange Act.

- The Commission uses the word “responsibility” three times in §§ 205.2(j) and 205.5(c). It would be disingenuous to suggest in the society in which we live that responsibility does not suggest “legal responsibility.” We believe it imperative that the Commission state in § 205 that no private right of action exists for violations of Part 205.
- Violation of the Exchange Act can have dire consequences for disinterested directors, precluding employment or board service in a wide variety of industries and in extreme cases destroying the viability of a law firm, accounting firm or business entity with which such director is associated. Pity the honest, competent and disinterested director who as a QLCC member has voiced his opinion, failed to persuade a majority of the QLCC and must now report the majority action to the Commission or remain silent and risk being found to have violated the Exchange Act and the dire consequences that can ensue while being subjected to private litigation for failure to perform his “responsibility.”
- QLCC members will not serve as a committee member in the absence of (a) insurance and (b) indemnification. The risks created by § 205.3(c), and in particular the individual subjective notification requirements of § 205.2(j)(5), will inevitably increase the costs of directors’ and officers’ liability insurance. More importantly, directors and officers will not serve without indemnification by the corporation for liabilities and expenses – in Delaware, for example, if the director acted in good faith and in a manner which he reasonably believed to be in or not opposed to the best interest of the corporation. In view of the Commission’s long held views about the unenforceability of indemnities for securities law violations, the Commission must clearly indicate that the indemnification permitted by state

corporate law is available in the context of litigation or administrative proceedings for violation of Part 205 if the applicable state standards are met.

Subsidiary Lawyers

We are concerned with the application of the proposed rules to lawyers representing subsidiaries of a public company. In part, our recommendation reflects our concern with the proposed rules' application to non-securities lawyers and foreign lawyers. Lawyers retained or employed by subsidiaries are likely to be specialists in an area other than securities law or generalists. It is not realistic to expect all such lawyers to be aware of the obligations that would be imposed by Part 205. Even if they are aware of the obligations, they are poorly equipped to determine whether facts available to them are evidence of a material violation of securities law. This is particularly true because of the standard of knowledge they are expected to meet which is totally divorced from the knowledge they actually have as to what is a material violation of a well developed and complex area of the law. As the Commission is well aware, experienced securities specialists can, in the best of faith, disagree as to whether a particular set of facts demonstrates a material violation of securities law.

Foreign lawyers representing foreign subsidiaries are even further removed from any reasonable basis for knowing they have such obligations, knowing whether they are aware of a material violation, and being able to meet the reasonable lawyer standard by which they are to be judged. Furthermore, they are more likely to find themselves in a bind between their obligations under the proposed rules and their ethical obligations in the jurisdiction where they are admitted.

We do not object to the fact that such lawyers might be disciplined under Rule 102(e). It is one thing to hold such lawyers accountable for what they knew they did; for example contributing a materially misleading description of a transaction used in a Commission filing. It is quite another to hold them accountable for inaction when they are unlikely in the future to be aware of their proposed obligations and in no position to evaluate the requirements if they are aware of the obligations.

While the foregoing concerns are shared with any similarly situated non-securities lawyer or foreign lawyer, there is an aspect of the proposed rules that is particularly troubling for lawyers retained or employed by a subsidiary of a public company. That is because they represent the subsidiary and not the public parent. Their obligations flowing from that are different from those of a lawyer representing the public company. Their attorney-client privilege and client confidences obligations run to the subsidiary, not the public company. See ABA Model Rule 1.7, Comment 34, ABA Model Rule 1.13, Comment 2, and New York Ethical Consideration 5-18. Under the ABA Model Rules, followed by many states, a shareholder is a "constituent" of the organizational client, not the client any more than an officer or a director. The public company's lawyer cannot tell a given shareholder client confidences without the consent of his or her client. Neither can the subsidiary's lawyer. The shareholder for each instance benefits from the fact that the lawyer for the organization must act in the best interest of the organization, but that does not make the shareholder the client.

Even if they were able to recognize their obligations under the proposed rules and were able to determine materiality under the securities laws, they cannot divulge client confidences to the parent's CLO, CEO, audit committee or board without their client's consent. Even more troubling would be their thinly veiled disclosure of such client confidences by advising the Commission that they had withdrawn for professional considerations. We therefore urge the Commission to limit this substantial change in a lawyer's obligations to those representing the public company. At the very least, we urge the Commission not to adopt these changes by a totally artificial January deadline when it deserves more time, thought and discussion.

Application of the Proposed Part 205 to Foreign Attorneys and Foreign Issuers

Application to foreign attorneys

Foreign attorneys are included within the scope of the definition of "attorney" in the Proposed Rules, and foreign attorneys employed or retained by issuers, domestic or foreign, who may be deemed to be "appearing and practicing" before the Commission, would be subject to the obligations imposed on attorneys under the Proposed Rules. As discussed elsewhere in this letter, the concept of "appearing and practicing" before the Commission in the Proposed Rules is extremely broad, and attorneys would fall within the scope of this definition even if they do not have any direct or indirect contact with the Commission; for example, if they prepare documents that are filed with or submitted to the Commission. As the Release notes, "Such attorneys may, for example, be involved in the preparation of documents for use in a foreign jurisdiction that might subsequently be used as the basis for other documents prepared by others for filing with the Commission, with or without the knowledge of the foreign attorneys who prepared the original documents."

For the reasons set forth below, we believe it would be inappropriate to subject foreign attorneys who are not admitted to practice under the laws of any jurisdiction within the United States to the obligations of attorneys under the Proposed Rules. Although certain of these considerations may apply equally as well to U.S. attorneys, we believe that the impact will be most strongly felt by foreign attorneys.

1. *The definition of "appearing and practicing" is too broad.* The Proposed Rules would impose extremely burdensome obligations on many foreign attorneys who are employed or retained by companies that are or may become issuers. In addition to those foreign attorneys who may be directly involved in the preparation and review of registration statements or annual reports filed with the Commission, the Proposed Rules would also deem to be "appearing and practicing" before the Commission attorneys who may prepare or review home country disclosure portions of which will later be reflected or included in documents filed with or submitted to the Commission. In addition, the foreign attorneys responsible for the preparation or review of the large number of documents an issuer may be required to furnish or summarize in an connection with issuer's filings with or submissions to the Commission would also be covered by the Proposed Rules. Among other things, these documents include employment agreements, agreements with customers and suppliers and regulatory filings. In many cases, the attorney preparing the document may not be aware of, or have any reason to know, whether or not the

document the attorney is preparing or reviewing is required to be included in a filing or submission to the Commission. In addition, certain disclosures required by foreign private issuers may subject foreign attorneys who prepare or review such disclosures to the Proposed Rules, even though similar disclosures by a domestic company may not be subject preparing or reviewing attorneys to such coverage. Because an issuer must submit to the Commission under cover of Form 6-K whatever information the issuer (i) makes or is required to make public pursuant to the law of the jurisdiction of its domicile or in which it is incorporated or organized, (ii) files or is required to file with a stock exchange on which its securities are traded and which was made public by that exchange, and (iii) distributes or is required to distribute to its securityholders, a great number of foreign attorneys would be subject to obligations under the Proposed Rules.

We believe the scope of the definition of “appearing and practicing” contained in the Proposed Rules is too broad. Although we understand that by proposing a broad definition, the Commission intended to include within scope of the rule the greatest number of attorneys having anything to do, directly or indirectly, with an issuer’s filings, we believe that, especially in the case of foreign attorneys, the extraordinary breadth is likely to lead to confusion as to who is subject to the obligations of the Rule, and to its sanctions in the event of noncompliance.

2. Foreign attorneys are not necessarily familiar with the violations which an attorney is required to detect under the Proposed Rules. An attorney subject to the Proposed Rules is obligated to determine if he or she has evidence of a material violation of the securities laws, material breach of fiduciary obligations or similar material violations. While many U.S. attorneys are not familiar with the U.S. securities laws, or laws relating to fiduciary duty, the information is at least generally accessible. This is not necessarily the case for foreign attorneys. Except those attorneys with an international practice, very few foreign attorneys have any knowledge of U.S. or state securities laws. In addition, because fiduciary obligations in many non-U.S. jurisdictions are governed by civil law rather than common law, attorneys practicing in jurisdictions other than in the jurisdiction where the issuer is organized may not necessarily be familiar with the standards applicable to determining breaches. Foreign attorneys who provide services for foreign subsidiaries of issuers are also affected by the Proposed Rules, insofar as the burden imposed on them would appear to require that they be obligated to respond to violations at levels above that of the entity for whom they provide services. Especially because the Proposed Rules appear to require that the attorney be the “eyes and ears” of violations of securities laws and fiduciary duties, many foreign attorneys do not believe they are adequately positioned to serve in this capacity.

3. The obligations imposed on the foreign attorney may violate obligations relating to confidences. A number of foreign jurisdictions treat the attorney-client privilege as a “professional secret,” and treat the violation as a matter of criminal law and professional ethics. [examples are Code Penal art 226-13 in France; § 203(1) No. 3 and § 356 Strafgesetzbuch in Germany.] Compliance by an attorney with the obligations imposed by the Proposed Rules could possibly result in sanctions against the attorney under the laws of the jurisdiction where the attorney is admitted to practice. Although the federal system of the United States may provide an arguable basis for the pre-emption of attorney-client and confidentiality obligations applicable to

U.S. attorneys, it is hard to understand the basis upon which the Commission can claim that the Proposed Rules would supervene obligations of attorneys admitted to practice outside the U.S.

4. *It is unrealistic to expect that foreign attorneys will necessarily be in a position to assess materiality of a violation, or the adequacy of a proposed response to disclosure of a violation.* Implicit in the Proposed Rules is the view that an attorney is in a position, even if he or she believes to have evidence of a violation, to determine its materiality. In the event a foreign attorney were to be performing work for a subsidiary of an issuer, or with respect to a single document or disclosure by that issuer, it may be unrealistic to expect that the attorney will be in the position to know whether a perceived misdeed would be material at the parent level. Too sensitive a trigger will result in the activation of significant corporate resources to the potential waste of resources by the issuer and detriment of the the reporting attorney. Moreover, most foreign attorneys are not in a position to assess whether the issuer has adopted an appropriate remedial response. An issuer's response may include assurances as to the appropriateness of disclosure or conduct under the applicable securities or other laws. Unless the foreign attorney is obligated, at the issuer's expense, to retain advisors to determine the appropriateness of the response, the attorney is placed in the position of being a judge without the professional capacity to determine whether the applicable standards have been met. It appears to us inappropriate to subject a person's professional career to such a diffuse obligation.

5. *Foreign attorneys' fears as to the scope and consequences of the Proposed Rules may cause foreign attorneys to advise clients not to list their securities in the United States of, if possible, to delist in the United States.* Often a foreign company considering issuing securities in the U.S. takes guidance from its foreign counsel as to the desirability of accessing the U.S. markets. We have significant concerns that by imposing greater obligations on such foreign attorneys, the Proposed Rules will lead such counsel both to advise clients as to the obligations as to the obligations associated with the rule, and perhaps to consider not listing in the U.S. if such listing does not significantly benefit the issuer.

6. *The Proposed Rules could be deemed to impose obligations on foreign issuers.* Even if an attorney does disclose to the proper corporate officers or board of a foreign private issuer evidence of a material violation, the officers or board may not believe that they are required to respond to the attorney in the manner contemplated by the statute. Among other things, the foreign private issuer may believe that its governance structure requires or suggests a different response. In the absence of an appropriate response, the counsel would, under the Proposed Rules, be required to disaffirm the affected filings and, if the person is an outside lawyer, make a noisy withdrawal and terminate all legal services. The implicit suggestion that rules governing attorneys will effectively require companies to respond to attorney notices in a manner that may be inconsistent with non-U.S. governance standards is an inappropriate means to impose governance obligations on issuers.

Application to law firms

A client often retains a law firm to provide legal services, rather than an individual attorney. Although the Proposed Rules appear at first blush to impose obligations only on

individual attorneys, the scope of the definitions, and the obligations imposed on attorneys under the Proposed Rules, suggest that in many cases the Proposed Rules would apply to an entire law firm, and that sanctions for violation could also effectively be imposed on an entire firm. Because the Release does not specifically address the implications for a law firm as a whole, we believe that the Proposed Rules are confusing and may lead to unintended consequences, both as to the obligations imposed on attorneys in a firm and the sanctions that may be imposed by the Commission. Among our concerns are the following:

1. It is not clear from the definition of “appearing and practicing” whether the Commission intends to include the individuals or groups of individuals at a law firm who are engaged in the types of conduct identified in the definition, or whether, if a firm rather than an individual is engaged to provide representation of the issuer before the Commission, the definition would be deemed to include the entire firm. We would note that even in the former case, the number of attorneys at a firm who participate in the types of conduct identified in the Proposed Rules on behalf of any issuer may comprise a substantial portion of the attorneys in practice at a firm. It would be extremely helpful for the Commission to identify whether the term “appearing and practicing” is intended to relate to individuals or an entire firm, and, if the latter is in fact the case, to describe how communications and responsibilities are to be appropriately coordinated within a firm structure. Because the purpose of the Act is to heighten the responsibility of individual attorneys to report material violations, we believe that the Proposed Rules should be clearly stated to apply only to individuals, rather than to a firm. To do otherwise would risk subjecting many attorneys at a firm to a series of obligations that may not have the capacity to undertake, without any commensurate benefit being achieved by public shareholders of an issuer.

2. Related to the comment above, the Proposed Rules provides that if a subordinate attorney appears and practices before the Commission on behalf of an issuer, that subordinate attorney’s supervisory attorneys also appear and practice before the Commission. Supervisory attorneys assume responsibility for compliance when an subordinate attorney reports evidence of a possible material violation. Because an attorney supervising, directing or having supervisory authority over another attorney is deemed by the Proposed Rules to be a supervisory attorney, would it be correct to conclude that every partner in a law firm is a supervisory attorney with respect to every associate, or is it intended that the definition be limited, for example, to a practice group or other departmental group of attorneys? The implication of this definition also appears to lead to the conclusion that responsibilities are not only individual but also firm-wide. We believe that only the supervisory attorney or attorneys to whom a subordinate attorney actually reports evidence of a material violation should be subject to the requirements of § 205.4. We would point out that, in the case of law firms having non-U.S. attorneys as partners, the implications of this rule would be more profound, because non-U.S. attorneys would be responsible for determining the adequacy of a disclosure or remediation under U.S. law.

3. We believe that it should be made clear in any final rule that information known to or in the possession of an attorney at a law firm should not be imputed to any other attorney. For example, knowledge of a potential violation of a fiduciary duty by an attorney practicing in the area of employee benefits (and who would not otherwise be deemed to be “appearing and

practicing” before the Commission) should not be attributed to another attorney at the firm who would be deemed to be “appearing and practicing” and who is familiar with the information contained in the issuer’s documents filed with the Commission (whether or not that attorney was involved in the preparation or review of the materials filed with the Commission). If such knowledge were to be attributed, each attorney at a law firm could be deemed to have an affirmative obligation to determine the information other attorneys may possess. We believe that imposing a burden of this sort on attorneys in a law firm would be excessive and unrealistic. We believe that the rule as adopted should clarify that attorneys who are partners of or are employed by a law firm should only be held responsible for information actually known by them.

4. It is unclear to us how an attorney employed by a law firm is required to act under the Proposed Rules where a law firm, rather than an individual, is retained by an issuer. As stated in the proposing release, where an issuer’s directors have responded inappropriately to evidence of a material violation that is ongoing or has yet to occur, and the violation is likely to result in substantial injury, an attorney retained by the issuer is required “to withdraw from representing the issuer, in all matters” forthwith, and to notify the issuer that he or she has withdrawn for professional reasons. It is not clear to us whether it is intended that, in the case where a client retains a law firm, rather than an individual, only the individual is required to resign from the account. We would ask how an attorney who had not been specifically engaged by a client would withdraw, and what the effect would be on the work being performed for the client by the law firm. If the entire firm were required to withdraw from all matters, the consequence could be draconian and may well result in significant prejudice not only to the issuer but also to its securityholders. Because a large law firm is typically engaged in a broad range of tasks for many of its public clients, the rule would require all attorneys working for that issuer to resign, including those not even tangentially involved in reporting the violation. In some cases, resignation may not be possible, as in the situation of a litigation where resignation will require leave of a court. In other cases, the forced termination by regulatory attorneys, intellectual property attorneys and others could result in significant disruption to the issuer’s ongoing business, and consequential harm and cost to the issuer and its securityholders.

We are concerned that, were the Proposed Rules to be adopted, considerations of risk associated with a mandated withdrawal on all matters by a law firm in the event of a difference of views may influence an issuer to assign legal work to many firms rather than to one principal counsel.

5. We are also concerned that if an entire firm were deemed to be subject to the Proposed Rules, a determination that an entire firm had violated the rule could potentially lead to the effective dissolution of a law firm, having a horrific effects both on the firm and on its clients. The recent experience of Arthur Andersen demonstrates that acts of a few can lead to the destruction of an entire firm. The finding of a violation by a law firm would significantly affect the firm’s ability to retain and continue to obtain clients in connection with securities law matters. Moreover, were a law firm to be disqualified from appearing and practicing before the Commission, the firm would need to cease its representation of public companies. Few firms could survive this result.

6. If the obligations of the Proposed Rules were imposed on entire firms, a law firm would legitimately fear that failure by one person within the firm to make a proper notification, or respond properly to a company's response, could lead to firm-wide sanctions. This could lead many law firms to determine not to represent smaller public companies. In those situations, the fee revenue generated from the client may not justify the risk that a mistake or an error of judgment could lead to censure or other penalty to the firm as a whole.

We believe that the consequences of imposing obligations under the Proposed Rules, directly or indirectly, on a law firm are profound. Because we are aware of the Commission's obligation to adopt attorney conduct rules within the timetable required by the Act, we recommend that the Commission limit the application of the final rules to individual attorneys and to individual supervisory attorneys. Any extension of the rules to law firms should be based upon a more thorough assessment of the implications of such a proposal than the current timetable permits.

Material Violation

The Proposed Rules require attorneys who appear or practice before the Commission in the representation of an issuer to report evidence of a "material violation." We are concerned that the definition of materiality and the scope of the violations encompassed by the proposed rules are unduly broad and not well defined. We are also concerned that the reasonableness standard contained in the rules, which imposes a reporting obligation on attorneys who may not understand the significance of information they receive from an issuer, is unfair.

Materiality

In the Release, the Commission states that the definition for the term "material" is derived from Supreme Court precedent, and § 205.2(h) of the Proposed Rules states that "[m]aterial refers to conduct or information about which a reasonable investor would want to be informed before making a decision." This definition differs from, and may be less stringent than, the classic definition of materiality under the federal securities laws, which provides that information is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)). We recommend that the Commission use this traditional standard for materiality. While even the traditional standard is not free from ambiguity, it is the subject of a body of interpretive law that provides practitioners with a useful frame of reference.

Violations

The Proposed Rules define "material violation" as "a material violation of the securities laws, a material breach of fiduciary duty, or a similar material violation." Each type of violation is defined in an excessively broad manner.

- The Release states that the term “violation of securities law” should be understood to cover not just violations of the federal securities laws, but violations of securities laws in each of the 50 states.
- § 205.2(d) defines breach of fiduciary duty as “*any* breach of fiduciary duty, recognized at common law, including, but not limited to, misfeasance, nonfeasance, abdication of duty, abuse of trust, and approval of unlawful transactions.” While the Release states that “[t]his definition is intended to identify typical common-law breaches of fiduciary duty,” it does not identify which duties are covered by the rule, so it is not clear what this limitation means.
- The Commission does not attempt to define what “similar violations” means, stating only that its meaning should be “determined or interpreted according to Commission decisions,” and that it is “intended to extend beyond a breach of fiduciary duty or a violation of the securities laws.” § 205.2(i).

These definitions are extremely broad and create an unacceptable level of ambiguity. At a minimum, the final rules should be restricted to violations that are likely to have both a direct effect on investors of the relevant public company and a direct impact on the Commission’s internal processes, a standard that is suggested by the Commission’s decision in *In the Matter of William R. Carter, Charles J. Johnson Jr.*, 1981 SEC LEXIS 1940, 47 SEC 471.

The Trigger For Reporting

The Proposed Rules state that an attorney has “evidence of a material violation” that triggers the reporting requirement when he or she has “information that would lead an attorney reasonably to believe that a material violation has occurred, is occurring, or is about to occur.” 205.2(e). The Release notes that this is an objective standard that is triggered by something more than “mere suspicion,” but notes that an obligation exists even where the attorney “does not personally believe that a material violation has occurred, is occurring, or is about to occur.”

We are concerned that this objective standard would permit the Commission to discipline attorneys even if they did not recognize the significance of the evidence before them. This concern is magnified by the broad scope of violations that are subject to the reporting requirement, and by the fact that the Proposed Rules apply to all lawyers working for an issuer, not just those doing securities related work. The objective standard the Commission proposes may be unfair to attorneys with different training, experience, position and seniority, some who lack years of experience in the field, or a background in accounting, or in the issuer’s industry. The rule has the potential to be unduly harsh with respect to relatively new or inexperienced lawyers, or with respect to lawyers who do not regularly practice securities law.

These issues would be mitigated if the test were subjective, and the reporting obligation triggered when an attorney had actual knowledge that a violation exists, or is about to occur. This is consistent with Rule 1.13 of the ABA’s Model Rules of Professional Conduct, which contains a reporting requirement for attorneys representing an organization that applies only

when an attorney “knows” that a violation is occurring or is about to occur and is likely to result in substantial injury to the organization. Similarly in *In the Matter of William R. Carter, Charles J. Johnson Jr.*, 1981 SEC LEXIS 1940, 47 SEC 471 at 512, the Commission adopted an actual knowledge standard before a duty to report arose.

The Release also states that an attorney’s reporting obligation is only triggered when the evidence of a material violation applies to “clearly illegal” conduct that the issuer has decided it will actually pursue. This limitation should be made explicit in the rules.

[In the text of the Release accompanying footnotes 20 and 21, the Commission makes reference to the speech made by its then General Counsel to the New York County Lawyers Association in January 1982. A portion of that speech that is specifically noted in the Release (“...[General Counsel] indicated that the Commission generally should not institute Rule 102(e) proceedings against attorneys absent a *judicial* determination that the lawyer has violated the federal securities laws...”)(emphasis added) has in the intervening 20 years become a fundamental premise of the Commission’s relation to attorneys practicing before it; it is not an exaggeration to state that each succeeding set of Commissioners has considered and accepted that premise, subject of course to exceptions in particular circumstances. The Proposed Rule abandons that premise without so much as an acknowledgement of abandonment, without an inquiry as to its continuing utility in accomplishing the Commission’s investor protection aims, without a request for comments on whether or how that premise could properly be incorporated into proposed Part 205.

The desirability of exercise by attorneys of professional judgment in counseling compliance with the federal securities laws and rules administered by the Commission is nowhere questioned in the Release. In fact, encouragement of appropriate exercise of that judgment could be said to be at the very heart of the intentions of the legislative sponsors of Section 307 and of the Commission in proposing Part 205. For purposes of Section 307, equally with Section 602, the Commission would undercut its own objectives if it were seen to intend to enforce the proposed Rule by acting at once in capacities analogous to those of prosecutor, grand jury and trial (or appellate) court. A stated intention by the Commission “generally” to obtain a judicial determination under Exchange Act Section 21(d) of attorneys’ violation of the provisions of Part 205 or of attorneys’ participation in an issuer’s violation of substantive regulatory requirements, prior to and as a basis for disciplining those attorneys, would, as it has in the past 20 years, avoid the twin evils perceived by the then General Counsel and by each succeeding set of Commissioners: “hav[ing] a serious chilling effect on zealous representation and be[ing] a harbinger of prosecutorial abuse....” We therefore urge the Commission deliberately to make a statement of that intention and to insert that statement into any release published in connection with adoption of Part 205.]

Liability

The final rules should clearly state that there is no private right of action for violations of Part 205. In addition, Part 205 should contain a safe harbor provision protecting lawyers from

lawsuits based on statements contained in notices required by the rule, similar to that for auditors under § 10A(3)(c) of the Exchange Act, 15 U.S.C. 78j-1.

In addition to establishing a standard of professional conduct for attorneys that is enforceable by the Commission, the Proposed Rule also gives rise to the possibilities of civil liability on the part of attorneys (a) to their issuer clients, for compliance with the Rule, and (b) to the securityholders of their issuer clients, for failure to comply with the Rule.

To the extent required to be made public in discharge of attorneys' "noisy withdrawal" obligations under proposed Part 205.3(d), the disclosures accompanying and justifying withdrawal from representation and the disaffirmance of issuer client reports and other filings could be expected frequently to be adduced as the basis for claims of defamation, breach of contract and even malpractice against the attorneys by their issuer client or its successors-in-interest (e.g., a receiver by whatever official title). In a closely analogous context (Section 10A of the Exchange Act), Congress recognized the likelihood of such claims and specifically afforded insulation from liability to auditors reporting to the Commission on the auditors' detection of presumed illegal acts having a material effect on financial statements. We urge the Commission to provide a similar explicit protection in Part 205.

Although the Supreme Court has made clear, in the line of decisions from *Cort v. Ash* to *Merrill Lynch, Pierce Fenner & Smith Inc. v. Curran*, that implication of a private right of action for failure to comply with a statutory provision will depend on affirmative expression of a legislative intent to create implied rights, and although the Release denies any intention by the legislative sponsors or by the Commission to create implied rights under Part 205, the Commission's proposed language in Part 205.3(a), (c) and (d) -- which alone, without the Release, will appear in the Code of Federal Regulations if and when adopted by the Commission -- could be read to suggest the necessity of implied rights to enforce the minimum standards that are the purpose of the Rule (see Part 205.1). We urge the Commission to repeat the text of the Release accompanying and following footnote 81 as a separate subpart of Part 205.

We hope the Commission finds these comments helpful. We would be pleased to discuss them with the Staff.

Respectfully submitted,

By _____
Guy P. Lander, Chairman
Business Law §

By _____
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