

December 23, 2002

VIA EMAIL

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549-0609

Re: Section 307 of the Sarbanes-Oxley Act of 2002: Implementation of Standards of Professional Conduct for Attorneys, File No. 33-8150

Dear Mr. Katz:

On November 21, 2002, the Securities and Exchange Commission gave notice of its proposal to add a new Part 205 to the Code of Federal Regulations which would establish standards of professional conduct for attorneys who appear and practice before the Commission in the representation of issuers¹. Comments are due by December 18, 2002.

Given the short comment period, we urge the Commission to reconsider adopting that part of the proposed regulations that would require lawyers to notify the SEC of their withdrawal as counsel to an issuer and to disaffirm filed documents.

This proposal directly contradicts the clear intention of Congress. In drafting Section 307 of the Sarbanes-Oxley Act of 2002, Senators Sarbanes, Edwards and Enzi unequivocally rejected notification to the SEC² and they made that clear in their discussion of the Section reported in the Congressional Record.

¹ New Part 205 would be added to Title 17 -- Commodity and Security Exchanges, Chapter II of the Code of Federal Regulations.

² Senator Enzi stated, "The amendment [Section 307] I am supporting would not require the attorneys to report violations to the SEC, only to corporate legal counsel or the CEO, and ultimately, to the board of directors." 148 CONG. REC. S6555 (daily ed. July 10, 2002).

Later, the Congressional Record reports that Senator Sarbanes directed a question to Senator Edwards. He said: "It is my understanding that this amendment, which places responsibility upon the lawyer for the corporation to report up the ladder, only involves going up within the corporate structure. He doesn't go outside of the corporate structure. So the lawyer would first go to the chief legal officer, or the chief executive officer, and if he didn't get an appropriate response, he would go to the board of directors. Is that correct?" Senator Edwards responded "Mr. President, my response to the question is the only obligation that this amendment creates is the obligation to report to the client, which begins with the chief legal officer, and, if that is unsuccessful, then to the board of the corporation. There is no obligation to report anything outside the client - the corporation."

We believe that Congress got it right. There is no consensus that reporting to the SEC is either appropriate or wise. Some think it corrosive: it presumes that corporate issuers are entirely corrupt at the highest levels and that the Congressional remedy of reporting up the corporate ladder will fail. We believe the Commission should give the American Bar Association time to consider the preliminary report of its Task Force on Corporate Responsibility³ and time to develop an approach that has the endorsement of the private bar.

Dechert is submitting this comment letter because, as a firm, we consider the rulemaking proposal to be of far reaching impact to the role of lawyers and their relationship to corporations. Dechert is an international law firm with offices in 13 locations. Some 25 of our 750 lawyers previously have been members of the Staff of the SEC. We have great respect for the role the agency and its Staff has played over the years in formulating and enforcing the nation's securities laws.

Our comments are divided between those relating to that portion of the proposed regulations which, pursuant to Section 307 of the Sarbanes-Oxley Act of 2002, must be addressed by January 26, 2003 and that portion of the proposed regulations which have not been mandated by Congress, and, indeed, was considered and rejected by Congress.

Reporting Up the Corporate Ladder

Congress has specifically required the Commission to issue rules by January 26, 2003, including a rule that would require:

- an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or equivalent thereof); and
- if the counsel or officer does not appropriately respond to the evidence (adopting, if necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another

Senator Sarbanes then concluded "I think this is an important point. I simply asked the question in order to stress that this is the way this amendment works. This has been a very carefully worked out amendment. I engaged in an exchange with the distinguished Senator from North Carolina [Edwards] and the Senator from Wyoming, Mr. Enzi, the co-sponsors of this amendment. I know how careful they have been in trying to craft the amendment and in bringing it here." 148 Cong. Rec. S6557 (daily ed. July 10, 2002).

³ Preliminary Report of the ABA Task Force on Corporate Responsibility, July 16, 2002, *available at* http://www.abanet.org/buslaw/corporateresponsibility/preliminary_report.pdf. [hereinafter Preliminary Report].

committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

Congress, no doubt, thought this formulation was straightforward. However, the sweep of the proposed regulations, including the broad scope of the proposed definitions, introduce significant uncertainty as to just who will be subject to reporting up the ladder and go beyond what the Congressional sponsors intended.⁴

Interpretive Issues

The entire thrust of paragraph (b) of proposed Section 205.3 turns upon the interplay of a number of interlocking definitions, including definitions of the following words and phrases: “attorney,” “appearing and practicing before the Commission,” “evidence of a material violation,” “in the representation of an issuer,” “breach of fiduciary duty,” “material violation,” “reasonably believes,” and “reasonable or reasonably.”

The definition of “appearing and practicing before the Commission” matters because the proposed sanctions for violation of the proposed regulations, as is required by Section 307 of the Sarbanes-Oxley Act, can extend only to attorneys who are said to be those who appear and practice before the Commission. Congress did not seek to require all lawyers hired or retained by an issuer to report misconduct up the ladder (although they clearly could have done so had they so wished). In the proposing release, the SEC makes clear that these sanctions include bringing civil actions seeking injunctive and other appropriate equitable relief, as well as civil money damages under Section 21(d) of the Securities Exchange Act of 1934 or, in the alternative a cease-and-desist proceeding pursuant to Section 21(c) of the Exchange Act⁵.

⁴ As Senator Edwards states in the Congressional Record:

“This amendment is about making sure that those lawyers, in addition to the accountants and executives in the company, don’t violate the law and, in fact, more importantly, ensure that the law is being followed. *** If you find out that the managers are breaking the law, you must tell them to stop. If they won’t stop, you go to the board of directors, which represents the shareholders, and tell them what is going on. If they won’t act responsibly and in compliance with the law, then you go to the board and say something has to be done; there is a violation of the law occurring. It is basically going up the ladder, up the chain of command. ***This amendment acts in a very simple way. It basically instructs the SEC to start doing exactly what they were doing 20 years ago, to start enforcing this up-the-ladder principle.” 148 CONG. REC. S6552 (daily ed. July 10, 2002).

The Congressional Record reports that Senator Enzi also said Section 307 was intended to apply solely to lawyers practicing before the Commission, “not all attorneys, just attorneys appearing and practicing before the Commission; that is, those who are dealing with documents that deal with companies listed by the Securities and Exchange Commission.” 148 CONG. REC. S6555 (daily ed. July 10, 2002).

⁵ The SEC also contended that criminal sanctions under Section 32 would not be available.

For that reason, we urge the Commission to reexamine the Congressional intent behind Section 307. We believe it is clear that Congress wanted the SEC to require persons who are lawyers and who know that they appear and practice before the Commission to undertake to report material violations of securities law, material breaches of fiduciary duty and material similar acts up the corporate ladder.

While U.S. securities lawyers clearly know and understand that they appear and practice before the Commission, foreign lawyers, as well as those caught up on the broad sweep of the interlocking definitions of “attorney” and “appearing and practicing” may easily fail to appreciate that Section 307 of the Sarbanes-Oxley Act may be interpreted by the SEC to subject them to Exchange Act sanctions. For example, if such lawyers are found to have had a hand in the drafting of some portion of a document ultimately filed with the Commission, they may fail to understand that this tangential involvement makes them generally subject to the mandated reporting of any material violations, including those which are not related to the filed document

Moreover, the very expansive reading that the proposed rule would give to the definition of “attorney” and the definition of “appearing and practicing before the Commission” would apply to many lawyers (and non-lawyers) who give commonly used words and phrases their common meanings and will not appreciate that they have been made subject to the regulations by SEC interpretation. The circular nature of Paragraph (b) of Section 205.4, which would confer the status of an attorney appearing and practicing before the Commission on every subordinate of a supervisory attorney who is, in fact, appearing and practicing before the Commission and, conversely, would confer the status of an attorney appearing and practicing before the Commission on every supervisory attorney who supervises an attorney who is, in fact, appearing and practicing before the Commission, will mean that, as a practical matter, virtually any attorney employed by an issuer is susceptible of being subject to the substantive reporting provisions of the proposed regulations⁶. Given the risk of being sanctioned for a failure to supervise, supervisory attorneys, will be likely to treat all internal attorneys⁷ as subject to the requirements of the proposed regulations. Moreover, proposing release commentary on Section 205.5 would make those within the ambit of the regulations even broader, expressly stating that the status of a subordinate attorney can be conferred on an attorney supervised by a non-lawyer⁸.

Paragraph (b) of Section 205.4 is also unclear as to whether a supervisory attorney, which is said to automatically include the issuer’s chief legal officer, can be said to be supervising outside counsel. We believe the Commission should make it clear that this

⁶ The practical effect of Paragraph (b) of Section 205 is to constitute almost all, if not all, lawyers, be they supervisory or subordinate attorneys, as attorneys deemed to be appearing and practicing before the Commission, since the status of either one as so appearing is attributed to the other.

⁷ Including, if identifiable, those non-lawyers who are holding themselves out as lawyers and others who fall within the definition of attorney or may be thought to fit within the broad definition of appearing and practicing before the Commission.

⁸ And if this is so, then presumably a non-lawyer supervised by a non-lawyer may also be a subordinate attorney and a non-lawyer directing a non-lawyer may also be a supervisory attorney.

cannot be the case, given the duties imposed upon supervisory attorneys. Clarifying this point makes sense, but even more sense needs to be made: Assume an outside law firm with patent expertise is engaged by Issuer X to provide advice with respect to a patent application. The supervisory attorney at the law firm does not, even as most broadly read, appear and practice before the Commission on behalf of the issuer, nor does any subordinate attorney in the firm so appear and practice. As we read the proposed language, no one at the law firm would be subject to the reporting material violations of securities law, etc. The answer appears to be different if the outside law firm were also engaged to provide general corporate and securities advice to the issuer⁹. The answer also appears to be different if the patent firm's partner consults a fellow partner about the securities law implications of a failure to obtain the patent, as opposed to directing a securities associate to do research on this issue¹⁰.

In raising these issues, we are seeking to illustrate that the very broadly drafted definitional language is replete with serious ambiguities, that, by the nature of the Sarbanes-Oxley legislation, will be interpreted only in an administrative or civil proceeding brought by the SEC. We believe that the SEC will more than adequately fulfill the desire of Congress to cause lawyers to report misconduct up the corporate ladder if it focuses on that group of lawyers who meet the common sense meaning of lawyers who practice before the Commission without extending the reporting obligation to more tangential individuals.

Finally, attorneys appearing and practicing before the Commission, however broadly defined need to have a clear understanding of what is meant by "evidence of a material violation." The proposed definition of "material" should explicitly track the language of *Basic, Inc. v. Levinson*¹¹. Lawyers would then have a firm basis, informed by voluminous case law, upon which to determine whether they are confronted with a violation that is material. The phraseology, "conduct or information about which a reasonable investor would want to be informed" materially departs from the *Basic, Inc. v. Levinson* formulation, substituting a lower, vaguer standard.¹²

⁹ In this case, as expansively described in the proposing release, at least one securities partner at the firm would likely fit the definition of a supervisory attorney and, that supervisory attorney might quite possibly, as suggested in the proposing release, confer the status of subordinated attorneys on every associate in the firm.

¹⁰ Here, it would be hard to say that either partner supervises the other, while the associate would clearly be supervised and, since a question of disclosure on a filing has now surfaced, the patent partner would become a supervisory attorney appearing and practicing before the Commission.

¹¹ 485 U.S. 224 (1988).

¹² There is further slippage from the Supreme Court standard in the proposing release. For example, under Part VII, Costs and Benefits, the Commission states:

"Part 205 will affect all attorneys who appear and practice before this Commission in the representation of an issuer and who learns of evidence that tends to show that a material violation of the federal securities laws, a material violation of fiduciary duty, or a similar material violation by the issuer or an officer director, agent, or employee of the issuer has or may have occurred or may occur."

We also believe the phrases, “reasonable or reasonably,” and “reasonably believes” should follow the approach that has been taken by some members of The ABA Task Force on Corporate Responsibility: i.e., evidence of the material violation should mean evidence such that the violation would be obvious to a lawyer of reasonable prudence and competence given the facts actually known to the lawyer¹³. If the *Basic, Inc. v. Levinson* standard of materiality is made explicit and the definitions of reasonability we have suggested are adopted, then there is some reason to believe that attorneys who are not skilled securities lawyers (but who are subject to the proposed rule), as well as skilled securities lawyers, can fairly understand and pursue their obligation to report misconduct up the corporate ladder.

Tightening this definition would go a long way to establishing reasonable parameters as to what constitutes a material violation of securities laws, a material breach of fiduciary duty or a similar material violation because in every instance the violation would have to be such that “there must be a substantial likelihood”¹⁴ that the disclosure of the material violation “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available” if not disclosed.¹⁵

Enhancing the Effectiveness of Reporting up the Corporate Ladder; Qualified Legal Compliance Committee.

Reporting up the corporate ladder will, we believe, work powerfully if internal structures are instituted by issuers that make the process widely understood and accepted within a corporation’s culture. The ABA Task Force on Corporate Responsibility has focused very usefully on suggesting ways of making the reporting mechanism workable by proposing the adoption of internal reporting protocols that are promulgated at the highest corporate levels. One of the problems with informal reporting up the ladder recognized by the ABA Task Force is the expectation that may be held by senior management that the lawyers they work most closely with and trust the very most - the general counsel or outside corporate counsel - owe a duty of loyalty to them personally. Clearly delineated lines of communication recognizing that the duty of loyalty is owed the corporation would dispel that very human assumption in a neutral and healthy way, empowering a lawyer to report over the head of senior management.

And in the same Part VII, the Commission also asserts, “Part 205 would implement an ‘up the ladder’ reporting requirement upon attorneys representing an issuer before the Commission who became aware of potential misconduct of which a reasonable prudent investor in the issuer would want to be informed.” The underscored language that we have quoted illustrates the dangerous paraphrases of the language of the proposed regulation, which in itself, departs from the *Basic, Inc. v. Levinson* formulation of materiality. This matters because lawyers and courts look to the language of proposing and adopting releases in interpreting regulations.

¹³ Preliminary Report, *supra* note 3 at 35.

¹⁴ *Basic*, 485 U.S. at 232 (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

¹⁵ *Id.*

Section 307 in effect, mandates the adoption of healthy reporting protocols. In order to maximize a sense of corporate buy-in, and not just rote compliance, regulations adopted under Sarbanes-Oxley might require that the Boards of Directors adopt Codes of Conduct that clearly delineate the lines of communication within the corporation that are established to aid in compliance with Section 307, as well as delineating the purposes of the reporting protocol. We strongly urge the Commission to work creatively to bolster the effectiveness of the Sarbanes-Oxley Act internal reporting mandate before considering regulations that would mandate that lawyers must report to the Commission.

Finally, the idea of the establishment of a Qualified Legal Compliance Committee is a good alternative, whether or not the Commission insists that without such a committee, outside counsel may be required to make a noisy withdrawal to the SEC.

Reporting to the SEC

We urge the Commission to exercise its regulatory powers carefully, wisely and within the scope of the mandate Congress gave the agency¹⁶. The SEC's thoughtful approach to the role of the securities lawyer as enforcer of the securities laws set forth in the opinion it delivered in the *Carter, Johnson*¹⁷ case struck a fine balance that should not be repudiated.

We believe it would be a profound mistake for the Commission unilaterally to impose an obligation on attorneys to notify the SEC of their withdrawal and then to disaffirm any document filed with the Commission believed to be materially false or misleading. Due process is required, consensus among those who will be subject to the rule is essential. The difficult and conflicting policy considerations that underlie requiring or permitting lawyers to make noisy withdrawals to an appropriate third party to remedy or prevent financial injury require more than a 30-day written debate between one government agency and the securities law bar.

If the Commission determines to go ahead with mandating noisy withdrawal, then at minimum it must address the following issues:

1. Must an entire law firm withdraw from representing an issuer or just those lawyers who are directly involved in the matter which they believe has not been adequately dealt with by the issuer?

Corporations with great regularity engage a firm to both represent it in a counseling role and to litigate on its behalf. Should a law firm that is engaged in a litigation have to

¹⁶ See *supra* text accompanying note 2 (discussion of Congressional intent).

¹⁷ In the Matter of William R. Carter, Charles J. Johnson, Jr. 1981 SEC LEXIS 1940; 47 SEC 471 (1981). Prior to that decision, the SEC had advanced the view that securities lawyers had an obligation to report securities laws violations of their clients to the SEC. In determining that securities lawyers should first seek to persuade and then either withdraw or report up the corporate ladder to the Board, the SEC put an end to a decade and more of heated debate over its desire to enlist lawyers as whistleblowers.

withdraw from this representation as well as from its securities law representation? If a firm must withdraw from all engagements, is that in the best interest of the issuer and its investors? If firms fear that they must withdraw across the board or fear that the entire firm may be disbarred from practice before the Commission if the SEC determines that they should have withdrawn, but did not do so, will law firms undertake to represent and grapple with difficult clients whose investors are in the greatest need of forthright lawyering?

2. Can the Commission pre-empt state or foreign law? The Commission asserts that despite the clear intent of Congress, its unilateral mandate that the withdrawing counsel notify the SEC and disaffirm documents filed with the SEC, overrides state law codes of professional conduct to the extent that these codes would prevent a lawyer from notifying the SEC of its withdrawal. This assertion will, no doubt, be tested, especially with respect to lawyers and law firms that practice in states and foreign countries that would prohibit this form of noisy withdrawal. And, until there is a clear answer as to both state law, and, then, each relevant foreign jurisdiction, law firms and their lawyers will be caught in the crossfire.

* * *

We appreciate the opportunity to comment on the rules proposed to be adopted by the Commission pursuant to Section 307. If we can be of any further assistance in this regard, please do not hesitate to contact Margaret A. Bancroft (212) 698-3590, Herbert F. Goodrich, Jr. (215) 994-2905, John V. O'Hanlon (617) 728-7111, Arthur Newbold (215) 994-2624, Jack W. Murphy (202) 261-3303 or Bruce B. Wood (212)698-3531.

Sincerely yours,

Dechert

cc: Hon. Harvey L. Pitt, Chairman
Hon. Paul S. Atkins, Commissioner
Hon. Roel C. Campos, Commissioner
Hon. Cynthia A. Glassman, Commissioner
Hon. Harvey J. Goldschmid, Commissioner

Giovanni P. Prezioso, General Counsel