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

December 17, 2002

File No. 33-8150.wp

Re: Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, 17 CFR 205: Comments of Susan P. Koniak, Roger C. Cramton and George M. Cohen (with List of Academics Who Are in General Agreement)

Dear Mr. Katz:

We are writing to provide comments on the proposed rules issued by the Commission to implement § 307 of the Sarbanes-Oxley Act. We are law professors who have spoken, taught and written on the professional responsibilities of lawyers in client fraud situations for many years. With Geoffrey Hazard, we are coauthors of the forthcoming fourth edition of *The Law and Ethics of Lawyering* (Foundation Press), one of the leading teaching books on the subject. Professor Koniak testified before the Senate Judiciary Committee earlier this year at a hearing on lawyer conduct in the Enron affair. Professor Cramton has recently published an article on the same subject ("Enron and the Corporate Lawyer: A Primer on the Legal and Ethical Issues, 58 *The Business Lawyer* 143 (Nov. 2002.) Professor Cohen has participated in a number of recent CLE programs dealing with the role of lawyers in the numerous corporate frauds and failures that have damaged investor trust in the integrity of securities markets.

We have circulated a draft of these comments to a number of academic colleagues, inviting them to endorse the comments or to submit comments of their own to the Commission. At the end of these comments, we list the names and affiliations of those who are in general agreement with our comments and recommendations. Because time did not permit consideration of each individual's suggestions, they are not responsible for our language or the details of each comment or recommendation. They have, however, authorized us to attach their names and to say that they agree generally with the substance and tone of this letter.

We have organized our comments under headings to facilitate the Commission's work. We begin by providing an overview of the issues we address. The body of our comments discusses each issue in turn and offers language that we believe would improve the effectiveness of the rules and clarify their meaning. The text of changes we propose are included in each comment, following our discussion of the need for the change.

OVERVIEW

1. Standards that Trigger the Attorney's Duties

Our most important recommendation concerns the one issue that more than any other will determine whether the Commission's regulations will achieve the objectives for which § 307 of Sarbanes-Oxley was enacted: the standards that trigger the attorney's report duties required by the statute.

The language and history of § 307 requires an objective standard at each of the reporting stages within the corporation, as the Commission recognizes in its Comments. Section 307 also requires standards that turn on the existence of "evidence" of a material violation rather that on the existence of a material violation. The purpose of § 307 was to ensure that "evidence" of law violations, indicating that the company faces legal risks, should be known and considered by higher authority in the company, not brushed off by lower-level managers. Requiring more than what the statute requires – "evidence" – will cripple the effectiveness of the report rule and runs counter to the language of the statute.

Notwithstanding the language concerning an objective standard in the Comments, the "reasonably believes" standard will not achieve that result because its usage in all other areas of the law and its plain language means that the particular lawyer must "believe" something *and* that the belief be "reasonable." Tort law, criminal law and the law of professional responsibility all use the phrase reasonably believe, as we have just described and no amount of redefinition in the Comments here will avoid the confusion and misleading nature of the words the Commission has chosen. Trying to redefine this phrase even in the text of the rule would be a mistake and would not forestall confusion. When confronting a commonly used legal phrase, such as "reasonably believes," most lawyers would not bother to look for a unique interpretation of those words in the definition section of a rule or statute, no less in the Comments. See also Part X, below, on access to the Comments to these rules.

The natural and usual use of the "reasonably believes" standard is when the law is trying to *deter* particular conduct, e.g., the law of self defense in tort and criminal law. In those situations the law wants to impose a heavy burden on an actor: action should not be taken unless the actor believes the action is necessary and, in addition, that the actor's belief is reasonable. Here Congress intended that attorneys be *required* to communicate evidence of a material violation up the corporate ladder, so that higher authority in the company would learn about the major risks involved and handle them appropriately. Using a standard designed to deter action undermines the purpose of § 307.

We agree with the graduated approach included in the Commission's proposal, using less demanding triggers for reporting within the corporate client and more demanding standards for required notification of withdrawal to the Commission and disaffirmance of documents (the "noisy withdrawal provision of § 305.3(d)), and for permissive disclosure of confidential information (§ 205.3(e)). Our proposal keeps that graduated approach.

We propose new objective standards to govern an attorney's duty to report and a higher standard to govern the duty to make a noisy withdrawal.

2. Enforcement Policy (Sanctions)

We urge the Commission to remove discussion of enforcement policy from the text of § 205.6(b)(2) . At most, enforcement policy should be mentioned in a comment and the comment should be clear that the policy does not change the terms of the rule itself, particularly that it does not alter the triggering standards for action. We also propose some new language to the Sanction section.

3. "Noisy Withdrawal" and Discretion to Report to the Commission

We support the Commission's narrowly circumscribed rule requiring lawyers to make a noisy withdrawal by notifying the Commission in circumstances that will, as the Commission rightly notes, be rare. What the Commission proposes is largely consistent with the rules of professional ethics of most states: first, withdrawal is required in all states when continued representation would assist a client's crime or fraud; second, notification of that withdrawal along with disaffirmance of documents or representations that are tainted by the ongoing or prospective violation, i.e., a noisy withdrawal, is permissible in virtually all states.

The existence of the alternative reporting procedures of § 205.3(c), involving a qualified legal compliance committee of the board (QLCC), means that the instances in which noisy withdrawal is required may turn out to be limited. It seems highly likely that many or most companies will establish a QLCC, with important effects on the reporting and other obligations of inside and outside lawyers. First, an attorney would satisfy the initial report obligation by reporting the material violation to the QLCC. Second, the reporting attorney would no longer have a duty to make a "noisy withdrawal" to the Commission under § 205(c). Third, a CLO who receives a report of a material violation may refer the report to the QLCC, shifting the responsibility to conduct an inquiry to the QLCC. Fourth, once a material violation has been reported to the QLCC, the obligation to notify the Commission of the material violation, when it has not been appropriately addressed by the board, shifts from the reporting attorney to the individual members of the QLCC, who would be acting in a business capacity.

However rarely noisy withdrawal will have to be used, it is nonetheless an important part of the entire regulatory structure and, as we explain, completely consistent with § 307. If the recent scandals and those of the past have taught us anything, it is that the boards of some companies are either kept in the dark by management or are reluctant to oppose management actions that are or may be illegal. In those situations, illegal conduct will be stopped or rectified if everyone knows that the company's attorneys will have to exit noisily. On the other hand, if everyone knows that all an attorney can do, if the board persists, is to exit quietly without any signal to anyone, the illegal conduct may continue indefinitely and cause irreparable harm to the company, its shareholders and investors.

We also support the "permissive disclosure" allowed by § 205.3(e) and urge the Commission to be clear that nothing it says in this provision or elsewhere is designed to weaken duties imposed on attorneys by the states that may require or allow disclosure in more situations than contemplated by these regulations. We also discuss this matter in the next topic, preemption.

4. Preemption of State Ethics Rules

We then explain why it is necessary and proper that the Commission's rules preempt state ethics rules that may prohibit what the Commission's rules require or permit. At the same time, we believe it is important that, with one exception, the rule not preempt any state ethics rule that require or allow more reporting or more action on the part of the lawyer to prevent or rectify client fraud than the Commission rule requires. The exception to which we refer concerns in-house counsel (see 7, below). The comments throughout should be reviewed to eliminate any suggestion that more rigorous state disclosure rules, mandatory or permissive, are nullified by these rules, apart from the one exception noted.

5. Foreign Lawyers

We support the approach of including foreign lawyers within the ambit of the rule and explain why excluding them would adversely interfere with the market for legal services and undermine the Commission's rules and the purposes of § 307.

6. "Appearing and Practicing" Before the Commission

We discuss how important it is that the definition of "appearing and practicing"include those who advise that information need not be disclosed to the Commission in any particular filing or writing as well as those who advise against the need for any particular filing or writing. Further, we believe it is important that those who advise on the legality of statements by management to particular individuals or institutions be included within the rules' purview.

On the other hand, we believe that the Commission's approach to lawyers acting as advocates, instead of advisors, should be clarified to ensure no diminution in appropriate and aggressive advocacy due clients in adversary proceedings. We suggest clarifying language.

We criticize the rule for failing to address clearly whether a law firm "appears and practices" before the Commission and, if so, when. We elaborate on this problem in the next Part.

7. Law Firms, Imputation and Subordinates and their Supervisors

The proposed rules suffer from the failure to address the important questions of imputation of knowledge within a law firm and of law firm censure and discipline. We suggest language to address those related issues. One consequence of failing to address imputation is that it renders the definition of "practicing and appearing" confusing. An even more troubling consequence is that this failure may encourage the decentralization of legal work within law firms, undermining the Commission rules, the purposes of § 307, and the provision of quality legal services.

The Commission's rules should also address the need for discipline of law firms. Specialized corporate and securities practice involves the participation of a team of lawyers who bring differing skills and knowledge. Responsibility for decisions is often divided up or shared in ways that are uncertain or shifting. The diffusion of responsibility and knowledge leads to the argument that no one attorney can be held responsible for what was done. The Commission should add a rule permitting the censure or reprimand of a law firm and assessment of monetary penalties when the firm, which is clearly responsible for the representation, has failed to conform to responsibilities required by the Commission.

The Commission is correct in assuring in-house counsel that they do not need to resign their employment when notifying the Commission that a reported violation has not been appropriately addressed by their employer. That approach is consistent with, and perhaps required by, the whistle-blower protections that are part of the Sarbanes-Oxley regime (see § 806). The proposed rule, however, should make it clear that inside attorneys may not continue to participate in the reported matter. Continuation in most, if not all, instances would run afoul of ethics rules in every state that demand that lawyers not assist an ongoing crime or fraud. Relieving in-house lawyers from the duty to withdraw combined with the prohibition against firing in-house lawyers for having acted in accordance with these rules may otherwise be read to counteract ethics rules or decisions that rightly state that all lawyers, including in-house counsel, cannot assist unlawful conduct.

8. Successor Counsel

We applaud the Commission for attempting to deal with the problem of successor counsel lacking the knowledge necessary to ensure that the withdrawal of predecessor counsel was not in vain. We do not, however, think the Commission's proposed solution is by itself adequate to the task and we suggest adding a requirement that successor counsel inquire into past reports filed under these rules.

9. Professional Duty of Confidentiality and the Attorney-Client Privilege

The Commission's duty under § 307 to establish "minimum standards of professional conduct" authorizes the Commission to define the scope of and exceptions to the professional duty of confidentiality applicable to lawyers appearing and practicing before the Commission. Section 205.3(e) of the Commission's proposed rules, which permits an attorney under certain circumstances to disclose confidential information to the Commission, establishes an exception to the professional duty of confidentiality. The rule should be described as such in the Comments.

On the other hand, we do not believe that the Commission has authority to modify the evidence rules applied in federal and state courts under the rubric of "attorney-client privilege." Nor is it necessary or wise to venture into an area of law that is primarily the province of judges in federal courts and judges and state legislatures in state courts. Nor should the Commission attempt to resolve controverted issues of privilege such as waiver, other than to indicate how various actions, such as attorney disclosure or company report, will be treated in the Commission's own proceedings and activities.

10. Miscellaneous Matters

A final part discusses several other matters that did not fit neatly under the above headings.

That concludes our overview. We now proceed to a discussion of these matters and our proposal of specific recommendations that will improve the effectiveness and clarity of the rules.

DISCUSSION AND PROPOSED CHANGES

I. The Standards that Trigger the Lawyer's Duties

To avoid repetition in our recommendations, the substitute language to the rules that we propose in this part is collected below under heading D. We first discuss our problems with the current language and the reasons for our revisions.

Section 307 dictates that the Commission adopt a rule that requires lawyers to report "evidence of a material violation of securities law" to the CLO or the CEO (we adopt the Commission's abbreviations throughout our comments) and in some circumstances further up the corporate chain of command. Two things are obvious from the use of the word "evidence" and the lack of any reference to the lawyer's subjective state of mind: Congress intended the Commission to use an objective standard, not a subjective one; and it intended the rule to require the reporting of “evidence of violations,” not just the reporting of “violations.”

The proposed rule muddies both matters, running the risk that it will be read by lawyers to require reporting only of “violations” of law that the lawyer “believes” exist and then only when the lawyer is sure that his “belief” is “reasonable.” Indeed, we believe the rule encourages that reading and thus undermines the legislation the rule is designed to implement.

A. “Reasonably Believes” Is the Wrong Standard

The “reasonably believes” standard, defined in § 205.2(l), pervades the Commission’s proposed rule. The standard repeatedly occurs, not only directly in the various substantive provisions of the rule, but indirectly as part of the definitions of “appropriate response” in § 205.2(b) and “evidence of a material violation” in § 205.2(e). The reasonably believes standard is inappropriate and should be replaced in all but one of the situations in which it is used (see Part I.C.4, below).

As a preliminary matter, we note that the Commission asked for comment on whether the rule should be “subjective” or “objective.” We see no plausible reading of § 307 that would support the adoption of a “subjective” standard. Congress said lawyers should report “evidence.” While it is surely true that deciding what is “evidence” requires thought, the law generally treats the determination of what constitutes “evidence” as an objective matter, not a function of a particular person’s point of view. Those who drafted this amendment were well aware that one approach was to require lawyers to “know” or “believe” something as the trigger for their duty to report. That approach was rejected by the drafters, the full Senate, the conferees (to whom the ABA made clear its views and provided numerous options for less rigorous standards than those incorporated into § 307), and the House before final passage of this legislation.

We understand that the Commission thought it was adopting an objective standard. The Commission tried mightily in § 205.2(l) and its Comments to stress that “reasonably believes” is objective. We note that the Commission’s Comments state, for example, that its definition was based on that included in “the ABA’s Model Rules of Professional Conduct, *modified to eliminate any implied subjective element.*” (Emphasis added.) The problem is that the attempted modification will not work.

Strive as the Commission might, the plain meaning of words counts, as it should, and the manner in which the law generally employs the phrase “reasonably believes” also counts. And the plain meaning of the words “reasonably believes” is that the lawyer must subjectively “believe” something before the duty to act is triggered. As, or more, important, the phrase “reasonably believes” is a longstanding one in the law, and in every other instance in which the law employs that phrase, e.g., in criminal and tort law (at least any area of law in which any of the three of us is aware, and that covers a wide body of law as we teach various and diverse legal subjects), the phrase describes a mental state that has a subjective as well as an objective component. The Model Rules use the phrase as it is used elsewhere in the law. Any attempt to modify a legal term of long usage is unfair in that it fails to give notice to those required to live by the term or risk punishment.

Moreover, the natural and usual use of the "reasonably believes" standard is when the law is trying to *deter* particular conduct. Consider one example: the law of self defense of criminal and tort law. It is a defense to a homicide charge that one killed another because one "reasonably believed" one's life to be in danger. In every jurisdiction that means that one is excused for having acted (killed) in self-defense only when one *actually* believed one's life was in danger and then only if, in addition, that subjective belief was objectively reasonable. By setting up two hurdles, the law expresses its desire to curb action. The same thing is generally true when the "reasonably believes" standard is used in the ethics rules, for example in the Model Rules' general provision on conflicts of interest. The fear is that the lawyer, acting on subjective belief alone, will be too quick to undertake a representation resulting in a conflict. The additional "reasonableness" hurdle is thus added as a check on action.

Here, by contrast, the Commission is not trying to deter lawyers from reporting within the corporation to higher levels of authority. Quite the opposite: it is trying to mandate that lawyers, who too often have been reluctant to do so, notify a higher authority if an appropriate response does not take place at a lower level. "Reasonably believes" would be inappropriate even if all the Commission was supposed to do was to *encourage* internal reporting, but the Commission is trying (and is required by § 307) to do more than provide "encouragement."

Beginning with a "deterrence" standard – words and legal usage that do not match the Commission's purpose – and then trying to fix all that through Comments and a line or two of "redefinition" is unsound and won't work. Put simply, no amount of commentary and certainly not one definition in a list of definitions, is sufficient to stop the confusion that the Commission's novel definition, at war with the plain meaning of the words, will create. Not only will the "reasonably believes" test create confusion, it will increase the costs of enforcing this rule by encouraging defenses, litigation and appeals, and it will decrease the benefits of the reporting regime Congress mandated. These increased costs and diminished benefits are particularly unjustified when there are ready substitutes for "reasonably believes" that more clearly express the Commission's and Congress's intent. The "reasonably believes" language must be dropped. The only exception is § 205.3(b)(5), which we discuss in Part I.C.4 below, for which we argue that the Commission should retain the "reasonably believes" standard, but substitute the traditional definition for the Commission's novel one. We also urge the Commission to comb the Comments to remove any hint that the lawyer, before being required to report, must "believe" that all elements of a material violation are established.

A variation on the "reasonably believes" standard occurs in the definitions of "appropriate response" in § 205.2(b) and "evidence of a material violation" in § 205.2(e). "Appropriate response" is defined as a response that "provides a basis for an attorney reasonably to believe" that appropriate action has been or will be taken by the issuer. "Evidence of a material violation" is defined as information "that would lead an attorney reasonably to believe that a material violation has occurred, is occurring, or is about to occur." The language "reasonably to believe" is an improvement over "reasonably believes," as the former is less likely to be read by lawyers or courts as including a subjective component. But the "subjective plus" interpretation remains possible. Even if "reasonably to believe" is interpreted as containing only an objective standard, the very appearance of the more objective "reasonably to believe" in these definitions, in contrast to the normally subjective and objective "reasonably believe" test of § 205.2(l), only heightens the probability that "reasonably believes" will be misread, increasing costs and decreasing benefits from this rule.

For clarity of presentation we set out our proposed alternatives under heading D below, which allows us to address first other aspects of the standards which our alternatives also modify.

B. The Ambiguity on Whether "Evidence" or "Violation" Triggers the Reporting Requirements

The definition of "evidence of a material violation" in § 205.2(e), which the proposed rule also uses extensively, presents another serious problem. The problem is that § 307 of Sarbanes-Oxley explicitly uses "evidence" as the trigger for action, but the Commission's definition at best renders the word "evidence" ambiguous, and at worst reads the word out of the rule entirely. The key language in § 205.2(e) is the statement that the evidence required to trigger action is "information that would lead an attorney reasonably to believe that a material *violation has occurred, is occurring or is about to occur.*" (Emphasis added.)

In every state, as a matter of the ethics rules and substantive law forbidding aiding and abetting of a tort or crime, a lawyer may not assist a client in conduct the lawyer "knows" to be illegal when continuing the representation would further the illegality. Moreover, all state ethics rules require that the lawyer withdraw when he or she "knows" of the client's illegal use of his services. As any reader of reported decisions knows, that law has not proved as effective as one would have hoped in deterring lawyers from recklessly or carelessly aiding client fraud. Why? Because any lawyer worth his salt knows that assessing whether the law is actually being violated is no simple task. One extra fact, one nuance, one affirmative defense, one creative ambiguity, and a judgment of "illegality" morphs into something more benign.

Unfortunately, as lawyer behavior in the S & L scandal and countless other financial debacles demonstrates, the inevitable "grayness" or uncertainty of all law – a characteristic of all just legal regimes and not a flaw – has become an excuse for ignoring evidence of illegality, no matter how substantial the evidence or harm being wrought has been. That reality is precisely why § 307 speaks of "evidence" and not "illegality" or established "violations" of law, and it is why it is essential that the Commission eliminate any and all language in this rule and its accompanying Comments that departs from the evidence standard. The language in the proposed rule that requires lawyers to think in terms of known, clear, established, obvious or objective "violations" of law should be abandoned. Not only is the shift away from "evidence" to "violation" inconsistent with the plain language of § 307, it undercuts the rule itself, significantly decreasing the benefits that this rule would otherwise produce.

C. The Different Standards for Different Courses of Conduct

The Commission uses several differing triggers for lawyer action for the three different reporting stages. The proposals suggest a graduated approach, i.e., a higher standard is required to justify reporting as the receiver of the report (or the noise) changes. We approve of a graduated approach, but piled on top of the "reasonably believes" and "lead an attorney to reasonably believe" and the shift (at some points) from "evidence" to "violation," the separate triggers proposed by the Commission add only more confusion. Our proposal, see Part D, below, preserves the graduated approach while clearing up the confusion.

We consider in turn the Commission's standards for the initial duty to report, the determination of whether there has been an appropriate response to the initial report, and the requirement of a noisy withdrawal.

1. Initial report to the CLO or CEO [§205.3(b)(1)]

Section 205.3(b) describes the standard for the initial report to the CLO and CEO this way: an attorney's duty is triggered if the "attorney *becomes aware* of evidence of a material violation." The same standard appears in the rule regarding the reporting obligations of subordinate lawyers, § 205.5(c). Adding yet another term to describe an attorney's state of mind, "becomes aware" introduces another level of uncertainty and again invites confusion on what level of "knowledge" of evidence the Commission has in mind. We thus eliminate that term from our proposal.

If "becomes aware" is intended to be no different than "reasonably believes," why use different words? If "becomes aware" is intended to equal "reasonably believes" then the latter term should have been used in both places. We reject that idea, however, for the reasons stated above explaining the problems with trying to modify what "reasonably believes" means elsewhere in the law and the term's natural function of deterring action. In addition, the plain meaning of "becomes aware" seems at war with "should have known," which we view as crucial to any true objective standard.

The Commission's proposal also tries to avoid the ambiguity of "becomes aware" by building the "reasonably believes" standard into the definition of "evidence of a material violation," saying that such evidence is "information that would lead an attorney reasonably to believe" that a material violation "has occurred, is occurring, or is about to occur." We have already stated our objection to the use of a variation on the "reasonably believe" standard and the shift from "evidence" to "violation" in the definition of "evidence of a material violation." Here our point about that definition is somewhat different: it is possible and far preferable to replace "becomes aware" with language that would make it unnecessary for lawyers to refer to the definition of "evidence" to discover some description of the requisite mental state. The definition of "evidence" is not where lawyers would expect to find the triggering standard of knowledge requiring action.

2. Report to a Qualified Legal Compliance Committee (QLCC) [§ 205.2(j)(5),§ 205.3(c)]

Section 205.2(j)5) uses the "reasonably believes" trigger, and § 205.3(c) uses the "becomes aware" trigger for the alternative reporting system involving a QLCC of a company's board of directors or the entire board. We have already commented on the problems with those triggers and those criticisms carry over here. The point we want to stress now is that the alternative reporting procedures authorized by § 205.3(c) should include the same triggering language that is applicable to reports to the CLO and CEO under § 205.3(b). That is especially the case because many public companies are likely to adopt the QLCC procedure for reporting evidence of material violations because the use of this procedure satisfies the report obligation of a reporting attorney, relieves that attorney of the duty to effect a "noisy withdrawal," and relieves the CLO of the duty to conduct his own inquiry. Having a higher standard for the QLCC procedure would not be faithful to the statutory text and legislative history of § 307 of Sarbanes-Oxley. See Part III below, discussing further how limited in scope the "noisy withdrawal" provision is. In short, a graduated approach to state of mind at this stage is not appropriate.

3. What constitutes a "response" sufficient to relieve a lawyer of obligations to take further action? [§ 205.2(b), § 205.3(b)(4), §205.2(b)(7), §205.2(b)(8)]

The next standard used by the Commission occurs in § 205.2(b), which defines "appropriate response" as "a response to evidence of a material violation . . . that provides a basis for an attorney reasonably to believe" that no further action is necessary. This definition is critical because an "appropriate response" to a report relieves the attorney of further steps under § 205.3(b)(7), whereas a failure to provide an appropriate response by the CLO or CEO under § 205.3(b)(4), or by the issuer under § 205.3(b)(8), triggers further required action. A new word is introduced as part of the standard here, "basis," which again creates uncertainty about the degree of knowledge necessary to activate the trigger.

We recommend modifying the definition of "appropriate response" to eliminate the "reasonably believes" problem and to emphasize again the objective nature of the "appropriate response" judgment. Our substitute definition can be found in Part D, below.

We also recommend two modifications to the Comment to § 205.2(b). First, we recommend deleting the following sentence from the Comments: "The Commission's intent is to permit attorneys to exercise their judgment . . . so long as their determination of what is an 'appropriate response' is objectively reasonable." The Commission has no choice but to "permit" lawyers to "exercise their judgment" – that is what lawyers are paid to do. Given that reality, this sentence runs the risk of conveying a comforting enforcement message to the effect that the Commission will be loathe to second guess a lawyer's "judgment" that a response is "appropriate." The Comment to § 205.2(b) may be taken as suggesting that the Commission will be doing precious little enforcement of any duty imposed on lawyers beyond the initial duty to report. Later, we will discuss the problems we have with the enforcement agenda detailed in the Commission's proposed § 205.6(b). Here we are simply pointing out that the Commission's enforcement policy should be in one place, preferably not in these rules, and wherever it is, it should not be diluted or muddled by Comments that suggest subtle or not-so-subtle modifications of that policy.

Second, while we applaud the use of examples in the Comment to § 203.2(b) and encourage the Commission to keep them in the final publication of the rule, we recommend that the Commission eliminate references that rely on the "reasonable belief" standard, e.g., "a lawyer could *reasonably believe* that the issuer's response was appropriate . . . ." Here (as elsewhere in the Comments) we urge the Commission to substitute for the language quoted above a formulation that emphasizes the objective nature of the rule. The language we substitute for "reasonably believes" in our revisions, designed to clarify the objectivity of the standards, should be used throughout the Comments, except for the Comment to § 205.3(b)(5) for the reasons discussed above in Part A, above.

To demonstrate the approach we have in mind for most of the Comment, consider the Comment to § 205.2(b) that deals with reliance on an outside law firm's detailed and reasonable report as constituting an "appropriate response" satisfying the attorney's report obligation. The Comment, instead of turning on the lawyer's "reasonable belief" that the legal opinion was adequate, should employ language similar to the language we propose for § 205.3(b)(1) in Part D, below.

We also recommend that the Comment's discussion of that example should specify that among the factors that would be considered by the Commission in assessing whether an outside law firm's response constitutes an appropriate response are the following: the description in the report of the scope of the investigation undertaken by the law firm; and the relationship between the investigating firm and the issuer or CLO, particularly whether the firm had done any work on the transactions or filings that had concerned the reporting lawyer or on any similar transactions or related filings. The Comment should also make clear that the greater or more credible the evidence triggering the report to the CLO, the more detailed and independent the investigation into the matters must be to permit a reasonable lawyer to conclude that no further action is required.

4. Bypassing the CLO and CEO [§ 205.3(b)(5)]

Section 205.3(b)(5) provides that if an attorney has a duty to report under §205.3(b)(1), the attorney may bypass reporting to the CLO and CEO, and report directly to the board or relevant board committee as described in §205.3(b)(4), if the attorney "reasonably believes that it would be futile to report evidence of a material violation" to the CLO and CEO. In this one instance, we agree with the Commission that "reasonably believes" is the appropriate standard, and we support retaining the language of §205.3(b)(5) as written. As we argued in Part A, above, the "reasonably believes" standard makes sense when we want to deter conduct that a lawyer may be overly eager to engage in. It is plausible to assume that lawyers might be too willing to bypass the CLO and CEO and report directly to the board. The "reasonably believes" standard here would emphasize to the attorney that his subjective belief that reporting to the CLO and CEO would be "futile" is a necessary, but not sufficient, basis for bypassing these officers. For the "reasonably believes" standard to serve this purpose, the traditional definition should be stated in the Comment. We suggest the definition from the Model Rules.

5. Notification to the Commission ("noisy withdrawal") [§ 205.3(d)]

Yet another reporting standard governs the controversial requirement that an attorney or members of the QLCC notify the Commission of an ongoing or prospective material violation under certain circumstances. (We take up the issue of whether "noisy withdrawal" should remain in these rules in part III, below.) Section 205.3(d) of the proposed rule requires notice of withdrawal to the Commission and disaffirmance of tainted documents (together constituting "noisy withdrawal") only when "the attorney reasonably believes that a material violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interest or property of the issuer or of investors." We support, as we have said, the Commission's graduated approach, requiring more to trigger notification to the Commission without the company's consent than to trigger internal reporting to the CLO or to the board.

We thus support the inclusion of the "substantial injury" clause. But, as we explained above in detail, we oppose the "reasonably believes" standard as well as the shift from "evidence" to "violations." We propose an alternative to this section that preserves the Commission's graduated approach incorporating the "substantial injury" clause and increases the "evidence" trigger for the "noisy withdrawal" step without moving to a "violations" standard.

6. Permissive Disclosure [§§ 205.3(d)(2), 205.5(d)]

Two rules proposed by the Commission that permit, but do not require, action by the lawyer raise a somewhat different trigger issue. Section 205.3(d)(2) permits the lawyer to make a noisy withdrawal in response to past wrongdoing if the lawyer "reasonably believes that a material violation has occurred and is likely to have resulted in substantial injury to the financial interest or property of the issuer or of investors but is not ongoing." Section 205.5(d) permits a subordinate lawyer to bypass a supervising attorney and make disclosures to the client if the subordinate attorney "reasonably believes that a supervisory attorney to whom he or she has reported evidence of a material violation under §205.3(b) has failed to comply with §205.3." In both cases, we believe lawyers would be reluctant to act in the permissive way, so we conclude, consistent with our argument in Part A, that "reasonably believes" is not the appropriate standard, and we advocate substituting the objective standard that we set forth in Part D. But that does not mean that permissive disclosure rules should be framed exactly as mandatory disclosure rules are. With mandatory disclosure rules, the Commission must be concerned not to define too broadly the situations in which the prohibition applies. With permissive disclosure rules, by contrast, the Commission's concern should be the opposite: to avoid *constraining* the lawyer's discretion too much, for example by suggesting that there is only one possible conclusion that a reasonable attorney would reach. (In fact, restricting the lawyer's discretion too much under permissive rules may be just another way of expanding the prohibition of conduct that is *not* permitted. For a further discussion of the permissive disclosure rules and this problem, see Part III.C. below) Thus, in our proposed revisions in Part D., we apply the objective standard to what an attorney "would" conclude for mandatory disclosure rules, but apply the objective standard of what an attorney "could" conclude for the permissive disclosure rules in §§ 205.3(d)(2) and 205.5(d). The "could" standard makes it less likely that lawyers choosing to exercise their discretion to make the permissive disclosure will be second-guessed.

D. Our Proposed Alternative Standards

We suggest alternative language to describe the trigger of a lawyer's initial obligation to report to the CLO or CEO, and, more broadly, we propose changes to other parts of this rule that suggest an unauthorized shift from an "evidence" standard to a "violations" standard. We do not here provide rewrites for all the places in the rules where we believe "reasonably believes"should be changed. Instead we provide exemplars, concentrating on key sections of the rule and trust that they will suffice to make it clear how all similar provisions should be changed.

Our recommended revision of § 205.3(b)(1), *Duty to report evidence of a material violation*, reads as follows:

> (1) If, in appearing and practicing before the Commission in the representation of an issuer, an attorney, confronted with information that a prudent and competent attorney, acting reasonably under the same circumstances, would conclude was credible evidence of a material violation by the issuer . . . [remainder of subsection follows unchanged].

The Comments to the rule should state that the standard is a totally objective one that is governed by a new definition of "prudent and competent attorney" that substitutes in the definitions section as a replacement for the current definition of "reasonably believes," which should be deleted. The new definition, repositioned alphabetically with later definitions re-labeled, would read as follows:

> *Prudent and competent attorney* means an attorney who possesses the skill, knowledge and prudence of attorneys who, acting in a reasonable manner, provide the specialized legal services in question.

Comments to the new definition should emphasize that the attorney is not viewed as an ordinary general practitioner, but as an attorney who has experience and knowledge of the same practice specialty or specialties which are involved in the particular matter. Any action or non-action by attorneys covered by these rules will be assessed by asking what a reasonable lawyer, exercising the skill, knowledge and prudence characteristic of attorneys performing the same activities, would have decided to do in light of the information available to the particular lawyer involved. If such a lawyer would have refused to perform an assignment for a client without access to a particular piece of information, the attorney's conduct will be assessed as if he had the information required for his job. Otherwise, there is the chance that corporate managers, intent on wrongdoing, would deny an attorney access to information to avoid these rules. The scope of the lawyer's assignment from the client will be relevant insofar as it affects the information an attorney has or should have, but it will not otherwise excuse an attorney from the operation of these rules. That is necessary to avoid the problem of limiting assignments to circumvent the Commission's rules.

An attorney's conduct will be assessed, not in hindsight, but by asking what a prudent and competent lawyer would have done at the time, with the information he had or would have demanded either to complete the assignment competently or to follow up on facts or circumstances about which a prudent and competent attorney would have inquired further before proceeding with his assignment. For guidance on what information the Commission will consider as known to an attorney, attorneys should be referred to the American Law Institute's *Restatement (Second) of Agency* § 9(l), which defines notice as follows:

> A person has notice of a fact if he knows the fact, has reason to know it, should know it, or has been given notification of it.

The decisional law employing that common law standard should be consulted by lawyers seeking guidance. We encourage the Commission to consider incorporating the Agency Restatement's standard just quoted in the body of these rules.

We recommend changing § 205.5(c) to conform to the standard we advocate for §205.3(b)(1), as follows:

> A subordinate attorney complies with § 205.3 if the subordinate attorney, in the course of appearing and practicing before the Commission, is confronted with information that a prudent and competent attorney, acting reasonably under the same circumstances, would conclude was credible evidence of a material violation by the issuer, and reports this evidence to his or her supervising attorney under § 205.3(b).

We recommend substituting the word "credible" in front of "evidence" everywhere it appears in this rule.

We would eliminate § 205.2(e) and substitute in the right alphabetical order:

[Applying to the duty to report evidence of a material violation to the CLO, CEO or QLCC:]

> *Credible evidence* means information that a prudent and competent attorney would consider sufficient to constitute probable cause that a material violation may have occurred, may be occurring, or may be about to occur. When a lawyer is hired to advocate in connection with past conduct in which that lawyer's, or his law firm's, services were not used, credible evidence does not include evidence of past wrongdoing that occurred before the lawyer's representation and did not involve the use of the lawyer's services.

[Applying to the duty to report to notify the Commission of a noisy withdrawal:]

> *Credible and substantial evidence* means information that a prudent and competent attorney would consider sufficient to make it more likely than not that a material violation may have occurred, may be occurring, or may be about to occur. When a lawyer is hired to advocate in connection with past conduct in which that lawyer's, or his law firm's, services were not used, credible and substantial evidence does not include evidence of past wrongdoing that occurred before the lawyer's representation and did not involve the use of the lawyer's services.

The last sentence of these two definitions is intended to preserve the lawyer's advocacy role. See Part VI.B.

The Comments to both sections should emphasize that the first standard is intended to be less rigorous than the second. Some may encourage the Commission to adopt "more likely than not" for reporting to the CLO and QLCC. We think that is too high a standard. A prudent and competent attorney should inform the client's managing agents and entities when he or she concludes that there is probable cause that material violations of law are occurring, have occurred or will occur. As we explained above, we think the CLO report stage and QLCC report stage should have the same standard.

Some may encourage the Commission to use "clear and convincing evidence" for the "noisy withdrawal" stage. That standard is too high, given the likely adoption of the QLCC reporting procedures by many companies and the fact that this stage only applies to violations likely to cause *substantial* injury. Noisy withdrawal is an option likely to be exercised in very narrow circumstances. See Part III, below, explaining how narrow the "noisy withdrawal" provision is likely to be in practice.

Our recommended revision of § 205.3(c)(1), consistent with our proposed revision to § 205.3(b)(1), reads as follows:

> (1) If, in appearing and practicing before the Commission in the representation of an issuer, an attorney, confronted with information that a prudent and competent attorney, acting reasonably under the same circumstances, would conclude was credible evidence of a material violation by the issuer . . . [remainder of subsection follows unchanged].

The Comments explaining the standard for triggering a duty to report would track the same issues discussed in connection with the identical language in § 205.3(b)(1).

Our recommended revision of § 205.2(b) reads as follows:

> *Appropriate response* means a response to credible evidence of a material violation reported to appropriate officers or directors of an issuer that would provide a prudent and competent attorney with a reasonable basis to believe:

Our recommended revision of § 205.3(d)(1) reads as follows:

> (1) Where an attorney who has reported evidence of a material violation [to a CLO or CEO and does not receive an appropriate response]. . . , and a prudent and competent attorney would conclude that there is credible and substantial evidence that a material violation of law is ongoing or is likely to occur and is now causing or is likely to cause substantial injury to the financial interest or property of the issuer or of investors: . . . .

Our recommended revision of § 205.3(d)(2) reads as follows:

> Where an attorney who has reported [evidence of a material violation to a CLO or CEO and does not receive an appropriate response] . . . , and a prudent and competent attorney could conclude that there is credible and substantial evidence that a material violation of law has occurred and is likely to have resulted in substantial injury to the financial interest or property of the issuer or of investors but is not ongoing: [the attorney may make a 'noisy withdrawal']. . . .

It is important that the Commission make clear throughout the proposed rules that "ongoing" injury does not require current activity by the issuer. For example, if the issuer prepared and submitted in the past a prospectus upon which current investors are relying to make investment decisions, every day that the prospectus is extant and investors rely on it is a day in which new frauds are occurring. That is what ongoing fraud has always meant in the law and what it should mean here. For example, perjury or the presentation of false documents constitute ongoing fraud on the tribunal until the proceedings are complete because the court and the jury are relying on that material to assess other evidence until that time. For purposes of the Commission's rules, ongoing material violations should include past material violations that invite continuing and new reliance and which thus involve the issuer in new acts of fraud. Our revision of § 205.3(d)(1), above, reflects that understanding of "ongoing" and that understanding should be uniform throughout the rules and their Comments.

This sense of "ongoing" should be familiar to securities lawyers given the substance of the law of securities fraud, and these rules should reflect that substantive law, not contradict it. Moreover, this understanding of the ongoing effects of past wrong should be familiar to all lawyers. It arises whenever a crime, such as the possession of stolen property, is formulated as continuing until the stolen property is returned to the its rightful owner or when a fugitive from justice remains at large. As alluded to above, trial lawyers encounter a continuing obligation when they have presented evidence that they later come to know is false. See ABA Model Rule 3.3(a)(3) (requiring a lawyer to take reasonable remedial measures, including disclosure to the tribunal, to correct prior submission of false evidence). The latter rule includes a very high triggering standard, i.e., that the lawyer comes to "know" that the evidence is false, but the rule operates only in the advocacy setting, not when lawyers are acting as advisors (see part VI.A, below, on the difference between the two roles).

Finally, our recommended revision of § 205.5(d) reads as follows:

> A subordinate attorney may take the steps . . . if a prudent and competent subordinate attorney could conclude that a supervisory attorney to whom he or she has reported evidence of a material violation under § 205.3(b) has failed to comply with §205.3.

II. Enforcement Policy (Sanctions)

Section 205.6 is entitled Sanctions. Section (b) of that provision is not about sanctions. Rather, it is a restatement of the SEC's current enforcement policy. As long as the SEC's enforcement policy remains unchanged, there is no need to restate it here. If it does change, as the Comments to this rule remind people it might, the Commission would have to revise § 205.6, which would create unnecessary paperwork and be a waste of staff, time and resources. Moreover, unless the Commission intends to revise all its rules to include an enforcement section, it signals a unique attitude toward this rule to include an enforcement statement here.

In general, neither laws nor regulations include provisions detailing the vigor with which the state will enforce the substantive legal provision laid out in the law or regulation. And for good reasons. First, enforcement policies often change, not rule by rule, but over a broad range of rules. Second, few laws or rules are enforced to their full extent; resource limitations as well as policy considerations dictate that. Nonetheless, including a rule a statement that only "highly unreasonable" violations will be the subject of SEC proceedings confuses and undercuts any higher standard of conduct articulated in the body of the rule. To say throughout these rules that a lawyer is required to do "x" when some objective test of reasonableness has been met and to end with a rule that seems to require something, not of lawyers but of the Commission, namely, to require toleration of single instances of unreasonable conduct, is to suggest that the earlier provisions of the rule do not mean what they say.

In addition, we believe the Commission should revisit its enforcement policy in light of § 307 and these new rules. The policy may not be appropriate in this particular regulatory context nor for that matter in related contexts, given the Sarbanes-Oxley legislation and the revelations of the last year. The Commission, as its Commissioners and staff know all too well, has limited resources. Enforcing rules designed to deter violations of the securities laws, like the rules mandated by § 307, may be one of the most cost effective means for your agency to carry out its broader responsibilities. Indeed, we believe that is so. At the least, however, the Commission should take the time to review its enforcement policies in this post-Enron world. The Commission's enforcement policy, we repeat, is a matter of record. It needs no repeating here, particularly given the costs of doing so, not the least of which is to muddy the meaning of the standards articulated elsewhere in these rules.

One issue relevant to sanctions and enforcement policy – the desirability of a rule authorizing disciplinary proceedings against a law firm as distinct from individual attorneys – is discussed in Part VII, below.

We therefore urge the Commission to eliminate all of the language of proposed § 205.6(b)(2). The following should be substituted in its place:

> (b) Nothing in this rule limits the Commission's authority to proceed against attorneys under any other law, regulation or enforcement authority. No other Commission action is necessary as a prerequisite of action under the provisions of § 205. Nor is action under this rule necessary as a prerequisite for any other form of enforcement authorized by any other Commission authority or law.

We recommend you adopt the above new paragraph (b) along with explanatory comments to make it clear that the provision of disciplinary proceedings brought under the rules implementing § 307 of Sarbanes-Oxley not be taken as restricting the Commission's authority to proceed against attorneys for the violation of other SEC regulations, e.g., an aiding and abetting proceeding or an injunction proceeding. The creation of new sanctions should not affect, or be a predicate to, the use of other enforcement power of the Commission. Alternatively, this could be expressed in a new paragraph (d) of § 205.6 stating: "Nothing in this part alters or affects the Commission's authority to proceed against attorneys or other agents of issuers under other regulations, law or authority." We believe that paragraph (c) of § 205.6 should remain unchanged.

III. Noisy Withdrawal and Discretion to Disclose Confidences to the SEC

Several major issues are raised in connection with "noisy withdrawal" and disclosure of confidential information without the company's consent. First, what standard should trigger an attorney's required withdrawal, require the attorney to signal the withdrawal by a statement to the Commission that the withdrawal was for professional considerations, and permit the attorney to disclose confidential information to the Commission or to third parties? Second, should the Commission's rule deal with each of these actions or be limited to "noisy withdrawal" (withdrawal accompanied by a notice to the Commission that withdrawal was for professional considerations and disaffirmance of any tainted filings or documents)? Third, should the attorney's action be permissive or mandatory? And fourth, what effect should the Commission's rule have on state ethics rules which require withdrawal in the relevant circumstance, but either permit, require or forbid further action that may or does have the effect of revealing client confidential information?

We dealt in the prior section of these comments with the standard triggering a lawyer's duty to take action without a client's consent that may have the collateral effect of signaling or disclosing confidential information. We deal here with the second and third issues and in the next part with the fourth issue, preemption of state ethics rules.

A. Noisy Withdrawal [§ 205.3(d)]

Section 205.3(d) requires a reporting attorney who has not received an appropriate response in a reasonable time and who concludes that the reported violation is either ongoing or is about to occur and is likely to result in substantial injury to the company or investors, to take three actions: (1) withdraw from the representation (if the attorney is not an inside lawyer); (2) notify the SEC, within one business day, that the withdrawal is based on professional considerations; and (3) disaffirm any false or materially misleading submission to the SEC that the attorney has participated in preparing. If the violation has previously occurred, but has no ongoing effect, a reporting attorney would be permitted, but not required, to withdraw, notify the SEC and disaffirm tainted filings under § 205.3(d)(2).

We support the proposed rules' narrowly-circumscribed rule requiring outside lawyers to make noisy withdrawal to the Commission in circumstances that will, as the Commission rightly notes, be rare.

1. History of withdrawal and disclosure in client fraud situations

Noisy withdrawal is permitted under the ethics rules of almost every state. The comments by the Commission mention the ABA's Canons of Professional Ethics (1908-1969), which required lawyers to disclose ongoing client fraud, at least when the lawyer's services had been used to perpetrate the fraud. That continued to be the ABA's position after 1969, when the ABA's next rendition of model ethics rules was adopted. The ABA's Model Code of Professional Responsibility, DR 7-102(B)(1), as originally drafted and adopted by the ABA in 1969, not only allowed, it required, lawyers to disclose their clients' frauds in which the lawyers' services had been used. Moreover, that provision with its requirement of disclosure was the law in almost every state in the country until 1974 and in all but about a dozen or so states until the late 1980s.

In 1974, the ABA amended DR 7-102(B)(1) to add the words "except if privileged" to the end of the rule and proceeded in short order to interpret the word "privilege" to include all confidential information, not just material covered by the attorney-client privilege. See ABA Formal Op. 341 (1975). The combination of the amendment and the opinion interpreting it rendered DR 7-102(B)(1) a rule whose meaning was at war with its text. A "shall disclose" rule was transformed in this circuitous manner to a "shall not disclose" provision. The history is important because the transformation by the ABA of DR 7-102(B)(1) was motivated by the bar's resistance to the SEC's actions in the *National Student Marketing* case, 457 F. Supp. 682 (D.D.C.1978), in which the Commission's enforcement division argued that the securities laws demanded precisely what the ethics rules of most states and the ABA required: disclosure of client fraud when efforts to get the client to rectify ongoing fraud failed. The ABA was apparently comfortable with DR 7-102(B)(1)'s required disclosure as long as no one in authority sought to sanction lawyers who did not do what the rule insisted they must do. When the Commission demanded, in effect, that lawyers live up to the principles articulated in ABA rules and in state law, the ABA abandoned the principle it had long articulated.

But the states were not quick to follow the ABA's departure from the traditional understanding. Of the over 40 states that had adopted DR 7-102(B)(1) in its original form, only 14 were persuaded by the ABA to change to a "shall not disclose" rule. The ABA, however, fought on in 1983, adopting Model Rule 1.6 in 1983, which is a "shall not disclose" rule insofar as client fraud is concerned. This despite the fact that the states had overwhelmingly rejected the ABA's rewriting of DR 7-102(B)(1) to the same effect. The ABA should not have been surprised that most states rejected its new position on client fraud: silent withdrawal as the only permitted response to client fraud situations, softened by the "noisy withdrawal" comment. The high courts of the states, charged with primary responsibility for the maintenance of an independent, vigorous and trustworthy legal profession, could not be persuaded by arguments that the bar should abandon its longstanding position that a lawyer should disclose confidential information to prevent or rectify a client's ongoing or prospective fraud.

The Commission's proposed rules do not *require* disclosure of confidential information to the Commission or to third parties. "Noisy withdrawal" is required only in limited circumstances; and neither the ABA nor the Commission treat notice of withdrawal and disaffirmance of tainted documents as a disclosure of confidential information. The Commission's rule do not go as far as the ABA itself went for most of that organization's history. Nothing in the ABA's own Model Rules prohibits lawyers from complying with the Commission's rule. Indeed, the Comment to Model Rule 1.6, adopted by the ABA House of Delegates in 1984 and still in force, either requires or permit lawyers to withdraw noisily in more situations than those contemplated by the SEC's proposed rule. Comment [14] to Rule 1.6 of the ABA Model Rules as amended in February 2002 provides:

> If the lawyer's services will be used by the client in materially furthering a course of criminal or fraudulent conduct, the lawyer must withdraw, as stated in Rule 1.16(a)(1). After withdrawal the lawyer is required to refrain from making disclosures of the client's confidences, except as otherwise permitted in Rule 1.6. Neither this Rule nor Rule 1.8(b) nor Rule 1.16(d) prevents the lawyer from giving notice of the fact of withdrawal, and the lawyer may also withdraw or disaffirm any opinion, document, affirmation or the like. . . .

See also ABA Formal Op. 92-366 (1992) (amplifying and explaining the ABA's "noisy withdrawal" comment and justifying notice of withdrawal and disaffirmance as implied from the lawyer's duty to avoid assisting a client's crime or fraud, prohibited by Rule 1.2(d)).

The Commission's noisy withdrawal provision, like the ABA view of its Model Rules, kicks in after the lawyer has been *required* to resign in an ongoing or prospective client fraud situation. The Commission's rule goes further in only one respect: the proposed Commission rule is explicit in requiring all of the actions in question – withdrawal, notice of withdrawal, and disaffirmance of any filing or document tainted by the client's prior filings or representations – actions that the ABA ethics opinion says are sometimes required to avoid a violation of Rule 1.2(d).

2. Noisy withdrawal is consistent with § 307

The noisy withdrawal provision does not overstep the SEC's legislative mandate. Section 301 *requires* the Commission to "issue rules setting forth the minimum standards of professional conduct for attorneys" *including* a rule requiring lawyers to report illegal conduct up the corporate chain of command. Yes, Congress could have required noisy withdrawal to the Commission or disclosure, but it is significant that the statute does not remove disclosure to the Commission, no less noisy withdrawal, from the regulatory options open to the SEC. Congress surely understood that § 307 gave the agency discretion to expand on the up-the-ladder rule: the conferees were lobbied on these matters by the ABA.

Some have argued that at least one of the sponsors of § 307 said that "disclosure" to the Commission was not his aim. Whatever their aim, the amendment passed by both houses of Congress does nothing to prevent the Commission from requiring outright disclosure to it of client fraud, and the Commission has stopped far short of that by only requiring notification to the Commission of the fact that the attorney has withdrawn, an action that is not treated as a disclosure of confidences.

3. Why noisy withdrawal is necessary for the proper working of the up-the-ladder requirement

Some take the position that mandating noisy withdrawal is not necessary and that silent withdrawal without any signal to the Commission should suffice, at least for those lawyers who have not been in recent contact with the agency. We disagree. We believe the "noisy withdrawal" provision is an important, necessary, and well-advised proposal. In those rare instances when the highest authority with power to act on behalf of a client insists on continuing an ongoing fraud or pursuing plans to commit a fraud in the future, requiring nothing more than the resignation of the lawyer who has tried in vain to stop this activity does nothing to protect shareholders and investors. The fraud-doing company is free to continue bilking investors until the next lawyer has to withdraw silently and then the game begins again. In contrast, imposing a duty on the first lawyer to make noisy withdrawal to the Commission gives the fraud-doing client-board every incentive to comply with the law to avoid the noise. In the hands of lawyers dedicated to following the law, including, of course the regulations of this agency, we find it difficult to imagine a circumstance in which a board would choose noise over voluntary compliance.

4. Why all the controversy?

Given how rarely noisy withdrawal would even need to be threatened, no less used, it is worth addressing just what has gotten the ABA and many securities lawyers so exercised. Arguments are made that the noisy withdrawal requirement (or the minimum report-within-the-organization rule mandated by Congress) will come between lawyers and clients, making it less likely that clients will confide in securities lawyers. These arguments are unpersuasive. The ethics rules of most states permit (and four require) lawyers to disclose confidential information to prevent or rectify a client's fraud. No lawyer is arguing that the existence of this option has ruined lawyer-client communication or that the attorney-client relationship has been destroyed in the four states, including Florida, New Jersey and Virginia, that *require disclosure*, not mere noisy withdrawal, in these client fraud situations. The attorney-client privilege in every jurisdiction provides that conversations between clients and lawyers (including communications between boards of directors and corporate counsel) are not protected by the privilege when the client (or its agents, the board) is using the lawyer to commit a crime or fraud. If lawyer-client communications can withstand all of that, the argument that they will be destroyed or seriously impaired by the SEC's very limited noisy withdrawal provision is nothing more than hyperbole.

The Commission's graduated approach, requiring more evidence to trigger noisy withdrawal than internal reporting by the lawyer, shows just how moderate the Commission's approach is in this rule. The Commission could have gone further. We are not sure, however, that going further is necessary: only time will tell. That the Commission has begun so conservatively demonstrates just how much care the agency is taking to be sensitive to the exaggerated concerns of some members of the securities bar and the ABA. Lawyers who oppose this provision purport to be acting in their clients' best interest, out of loyalty and in keeping with the highest traditions of the bar. We respectfully remind our colleagues of the bar that our highest traditions required us to expose clients who use our services to break the law. Managers and directors are not the clients of corporate entities; their shareholders and investor organizations are not complaining about the noisy withdrawal rule. The clients are companies like Enron, Adelphia, Global Crossing, Tyco, etc., whose lawyers' made no noise and did not withdraw. Those clients are now bankrupt and the shareholders' investment largely worthless.

B. Use of the Alternative Reporting Procedures (QLCC) Is Likely to Limit the Number of Situations in Which Attorneys Will Be Required to Make a "Noisy Withdrawal" [§ 205.3(c)]

The heated reaction of some members of the bar to the noisy withdrawal provision of § 205.3(d) has ignored the practical reality that many or most large public companies will adopt the alternative reporting procedures provided in § 205.3(c). The latter section permits a company to establish a qualified legal compliance committee (QLCC) composed of at least one member of the company's audit committee and two or more independent directors to investigate reports of material violations.

The creation of a QLCC has important effects on the reporting and other obligations of inside and outside lawyers. First, an attorney satisfies the initial report obligation by reporting the material violation to the QLCC. Second, the reporting attorney no longer has a duty to make a "noisy withdrawal" under § 205.3(c). Third, a CLO who receives a report of a material violation may refer the report to the QLCC, shifting the responsibility to conduct an inquiry to the QLCC. Fourth, once a material violation has been reported to the QLCC, the obligation to notify the Commission of the material violation, when it has not been appropriately addressed by the board, shifts to the members of the QLCC; the reporting lawyer (other than the CLO) no longer has an obligation to report up the ladder or to make a noisy withdrawal. Although a member of the QLCC may be a practicing attorney, he or she would be acting in a business capacity as a corporate director in making the required notification and not as a lawyer.

It is difficult to estimate at this time whether some, many or most public companies will adopt the alternative reporting procedures, but many experienced practitioners believe it will be adopted by many or most large companies. To the extent that companies do follow this course, a lawyer employed or retained by the company would not have an obligation to notify the Commission that the reported violation has not been appropriately addressed. The obligations of that lawyer would continue to be determined by the applicable state's ethics rules. Because at least four-fifths of the states now permit or require such disclosure, the effects of § 205.3(e)(2) would be primarily in the minority of states that may or do prohibit any action by a lawyer in client fraud situations other than silent withdrawal. Despite the uncertainty about the law on this subject in some jurisdictions, we do now that forty states either permit (and four of them require) disclosure of confidential information to prevent or rectify an ongoing or prospective client criminal fraud in which the lawyer's services have been used. And an uncertain number of additional jurisdictions permit noisy withdrawal in those situations.

Section 205.3(d)(2) of the Commission's rules would in some circumstances permit (but not require) the lawyer to disclose confidential information necessary to prevent an ongoing crime or fraud. That is hardly a major interference with existing state rules nor a substantial change in the current responsibilities of most lawyers. If, as some practitioners expect, many companies adopt the alternative reporting procedures, the frequency of notification required of attorneys by Commission rule will be dramatically reduced.

Securities lawyers and public companies are given new options under § 205.3(c). If an attorney or a law firm wants to avoid the potential obligation of reporting to the SEC, it can condition acceptance of employment or representation on the company's willingness to establish a QLCC. On the other hand, if a company prefers to retain attorneys who are subject to all possible obligations arising under the Commission's implementation of § 307 of Sarbanes-Oxley, the company will hire and retain attorneys who are comfortable with those responsibilities. Some companies may prefer to have the ultimate judgments of whether there is a "material violation" and, if so, whether it has been appropriately addressed, made by lawyers; others may reasonably take the contrary view that the QLCC, a special committee of the board, should make those decisions. The provision of choice on the part of both lawyer and client, with the solution flowing from their agreement on where the ultimate responsibility should be placed, strikes us as a desirable innovation of the type has been urged by Richard Painter. See Painter, Rules Lawyers Play By, 76 N.Y.U. L. Rev.716-722 (2001) (urging SEC rules that would allow issuers to direct up-the-ladder reporting by attorneys to an independent compliance committee instead of to the full board of directors, providing the company's choice is disclosed to shareholders). Section 205.3(c) is a promising development that may provide a laboratory for determining whether giving lawyers and clients an opportunity to agree on the allocation of legal responsibilities offers greater promise than the usual "one size fits all" regulatory approach.

The large role that QLCCs may play requires that the rule permitting them incorporate sound principles. We think that is generally the case under the proposed rule, but that some improvements are necessary. First, the rule should make it clear that all QLCC members, including the one from the audit committee, must be independent members of the board. Second, the establishment of the QLCC should be an independent choice that is made in advance of a report of a material violation. Thus the rule should provide that the QLCC must be in place before a material violation has been reported rather than after the events in question have become known to the CEO and the board. Third, the Commission should require that an issuer notify shareholders of the establishment of a QLCC by including that disclosure requirement in one of the Commission's disclosure rules, such as Regulation S-K.

C. Discretion to Disclose Confidences [§ 205.3(e)]

As we have just said, we believe the Commission could have mandated that lawyers make disclosures to it when the highest authority that can act for the entity client insists on continuing fraud or pursuing future illegal conduct. Indeed, the ABA's Kutak Commission, which drafted the ABA Model Rules of Professional Conduct of 1983, as well as the Ethics 2000 Commission's report in 2002, recommended rules that would have given lawyers discretion to make that kind of disclosure, a provision rejected on those and another occasion by the ABA House of Delegates. More recently, the Preliminary Report of the ABA Task Force on Corporate Responsibility, 58 Bus.Law. 189 (Nov. 2002), has gone further than the Ethics 2000 Commission, recommending that disclosure under Model Rule 1.6 be

> *mandatory, rather than permissive*, in order to prevent client conduct known to the lawyer to involve a crime, including violations of federal securities laws and regulation, in furtherance of which the client has used or is using the lawyer's services, and which is reasonably certain to result in substantial injury to the financial interests or property of another. [Id., at 206 (emphasis added).]

The Commission's disclosure proposal, § 205.3(e), is modeled on the Task Force's preliminary recommendation and, because it is permissive rather than mandatory, even less of a threat to lawyer-client communication.

The use of a "may" formulation in the Commission's rules does, however, raise a potentially serious problem. A rule prescribing when a lawyer "may" disclose could naturally be read to prescribe when a lawyer "may not" disclose. The problem is that the vast majority of state ethics rules have permissive disclosure provision and there is no legitimate reason for this Commission to narrow extant ethics rules that may be more protective of investors. But that is how a "may" rule with its pregnant "may not" may well be read. Moreover, the implicit "may not" could also be read as superceding rules in those few states that require disclosure, rules that again are more protective of investors and which this Commission, in our opinion, has no legitimate reason or authority to override, as we explain further in Part IV below.

We do not think the Commission intended to override more rigorous state ethics rules, and the Commission needs to make that absolutely clear. Unlike the ethics rules, which purport to cover all lawyer behavior, the Commission has chosen (wisely in our view) to limit its regulatory rule to a narrow subset of lawyer conduct that was the particular concern of Congress. A "may" formulation makes sense, as it appears in state ethics rules, as an exception to the duty of confidentiality that those rules set forth. The Commission is not setting forth and should not set forth any overarching definition of lawyer confidentiality and thus the "may" disclose formulation is not well-suited to the structure of the Commission's rule.

To avoid this problem, we believe it is wiser for the Commission to avoid describing what a lawyer "may" disclose. Instead, the Commission should formulate the "discretionary" part of this rule as preempting any state ethics rule to the contrary. And, we believe the Commission rightly limits that preemption to a carefully described set of circumstances. In short, we believe that the Commission should rewrite § 205.3(e) to state that any state ethics rule to the contrary notwithstanding, an attorney may make the disclosures permitted by the section. We take up the broader question of preemption in Part IV, which follows.

IV. Preemption of State Ethics Rules

The federal government's power to regulate the securities industry under the Commerce Clause is indisputable, as is its power to do so through the SEC. In pursuit of that legitimate goal, the Commission's authority to regulate, for example, accountants and analysts engaged in securities work, is also, one would think, beyond cavil. Yet, although the Commission has long asserted and exercised the power to regulate lawyers practicing and appearing before the commission, the ABA, segments of the securities bar and now, we understand, a group of state court judges, maintain that the Commission should slow down, rethink many or all of these rules (§ 307's mandate notwithstanding), and write rules that acknowledge their subordinate status to state ethics rules.

A. Federalism Arguments Do Not Trump the Federal Mandate

Federalism, a principle that most of us revere as a bulwark of freedom and a pillar of our constitutional structure, is not violated, offended or even weakened by § 307 or the SEC's proposed rules. First, we note that the amendment that became § 307 passed the Senate, evenly divided between the two major political parties, *unanimously* and was accepted by the leadership of the House, by House and Senate conferees, and then by the House of Representatives before being signed by the President. Sometimes all that may happen without anyone considering serious problems with a bill, but that is not what happened here.

Prior to the Senate vote on § 307, the Senate considered the question of preemption because it was raised by opponents of the amendment. The arguments were rejected. While the bill was in conference, the ABA sent a letter to the conferees arguing, inter alia, that federalism either mandated or counseled the legislators to declare that any Commission rules issued under § 307 would yield to state ethics codes. The conferees rejected the ABA's pleas. Now, the same arguments are being presented to the Commission, which has no authority to rewrite, ignore or modify § 307's mandate. Moreover, the arguments are not meritorious. In the past, even before the Commission had a specific legislative mandate to regulate the conduct of lawyers appearing or practicing before it, similar arguments against the Commission's discipline of lawyers were rejected by federal courts.

As long as the federal government has authority under the Constitution to regulate in a particular area, the Supremacy Clause of the Constitution makes it clear that state law that conflicts or interferes with federal regulation must yield. We have already asserted that the general power of the federal government to regulate securities is indisputable, so the question is whether there is something about lawyer regulation that forces a different conclusion.

Anti-preemption arguments emphasize the traditional role of the states in the regulation of the bar. It is true that lawyer regulation has traditionally been the province of the states, but so has the regulation of corporations and accountants. Yet, in furtherance of the regulation of securities that trade in interstate commerce, the Commission regulates some aspects of corporate governance and the accounting profession and no one would seriously argue that state law in conflict with those regulations should somehow trump those regulatory efforts because "traditionally" states, not the federal government, have been the primary regulators of those groups.

Anti-preemption arguments emphasize the important role an independent bar plays in our constitutional system. We agree, but rhetoric about lawyer independence is no substitute for reasoned argument. If the federal government's power under the Interstate Commerce Clause to regulate lawyers (and thus, the Commission's power) is more limited than its power to regulate other groups traditionally regulated by the states that are involved in the issuance and trading of securities, it can only be due to some other language in the Constitution that provides that singular status for lawyers. The Sixth Amendment is often invoked for that purpose, but the Supreme Court has long held that the Sixth Amendment's guarantee of counsel does not generally extend beyond criminal prosecutions. The Supreme Court has never held that the Sixth Amendment extends to the provision of legal advice to companies relating to compliance with the securities laws or to regulating the conduct of attorneys in administrative proceedings before the SEC. And no court, of which we are aware, has suggested that any other clause of the Constitution, including the Due Process Clauses of the Fifth and Fourteenth Amendments, performs the function that some try to attribute to the Sixth Amendment.

Assertions that the Commission is going where no arm of the federal government has gone before, and that the federal regulation of any lawyer is some novel, alien and dangerous concept are false. The IRS regulates tax lawyers in some respects, the Patent Office regulates patent and copyright lawyers, federal bankruptcy judges regulate bankruptcy lawyers (with rules, by the way, that conflict with the conflict of interest rules in virtually every state), to provide three prominent examples. The federal government rightly exercises the right to regulate lawyers in those areas because all involve areas where the government's power to legislate and regulate are beyond question, just as it is in the area of securities law. There is no argument for singling out the securities bar, among all lawyers engaged in federal practice areas, as being entitled to immunity from federal regulation.

B. Effective Regulation Is the Issue

Why do many lawyers argue for state regulation of the securities bar, an approach that would involve differing standards and multiple regulatory bodies – an outcome that would be a nightmare for multi-state and multi-national law firms? To speak plainly, bar organizations are not arguing for state or self-regulation in lieu of federal rules because those are not the choices. They are arguing for no effective regulation of corporate lawyers handling complex securities-related matters versus effective regulation. Viewed in that light, the pleas of some segments of the bar are understandable. Everyone would prefer being free of the law's grasp, although that argument is fraught with irony in the mouths of lawyers and distressing in demonstrating how little faith in law those dedicated to it are willing to display.

We say the choices are no regulation versus regulation for two reasons. First, the ABA and other voluntary associations of lawyers have no power to regulate anyone. Notwithstanding complaints about the bar's independence from the government, it is the states through rules, procedures and proceedings promulgated or supervised by the highest court in each state that are empowered to regulate the bar (with some state legislative participation in a few states). Second, the states have never made any effort to regulate the securities bar and are unlikely to do so in the future. This is not because they are unconcerned with lawyer misconduct or the securities laws but because bar counsel's offices lack (and will continue to lack) the expertise, resources and political clout to take on a major law firm for misconduct connected to that firms' securities practice. We are experts in this field and none of us knows of a single instance in which bar counsel has successfully prosecuted (or even brought charges against) a major law firm relating to securities law practice.

This absence of state enforcement cannot be attributed to an absence of evidence of serious misconduct by securities lawyers in major law firms. Published cases detail, in many cases through the internal memoranda and testimony of lawyers within a firm, what can only be described as compelling evidence of misconduct connected to securities work at a substantial number of successful and venerable law firms. The bulk of lawyers in those firms and elsewhere are decent, dedicated and highly competent people. Nevertheless, solid evidence exists that lawyers within many firms at one time or another did things that in any effective regulatory regime would, at a minimum, justify the filing of charges. But there is nothing in the way of formal state proceedings.

We are not blaming the states. Bar counsel's offices do not usually pay enough to attract and keep lawyers with securities expertise and lawyers are unwilling to support the increases in bar dues that would finance higher pay and larger staffs. Moreover, unlike the SEC, which needs more funds to attract and retain top-notch securities lawyers, bar counsel employment does not offer as promising a route to a prestigious career in private practice following government service. Lawyers with considerable expertise in securities law would be required to prosecute disciplinary violations involving lawyer conduct in connection with complex corporate fraud situations, and such lawyers are lacking in bar counsel offices. The attorneys they would be prosecuting would almost always be from large law firms that have such expertise, not to mention the money and the incentive to fight such charges tooth and nail. Hiring outside counsel to bring disciplinary charges is not a viable option. Contingency fee arrangements are not and should not be available to tempt such lawyers to take those assignments. Ethical and legal prohibitions constrain public prosecutors, even in disciplinary as opposed to criminal proceedings, from working for personal profit.

It is unrealistic to suggest that bar counsels' offices will suddenly be transformed – infused with enough cash and prestige – to do the regulatory job that the ABA and some state judges would have the Commission leave entirely to the states. Nor does § 307 permit that approach: the statutory mandate says that "rules" must be promulgated, "including," not "limited to," the up-the-ladder rule embodied in the legislation itself. The choice is regulation by the Commission or no effective regulation. The Commission's duty under § 307 is to adopt appropriate "rules" to protect investors and in the public interest. The Commission's mandate neither assumes nor allows the Commission to yield to state regulatory regimes that have not and cannot do the job.

C. Waiting for the ABA and the States to Change Their Rules

Does it make sense for the Commission to wait for the ABA to act before doing more than adopting a simple up-the-ladder internal reporting rule, the one rule specified in § 307? As we have said, we do not believe § 307 gives the Commission the option of adopting the report rule and no other "minimum standards of professional conduct." But, assuming for the sake of argument it did, waiting would be a huge mistake.

The ABA and state bar associations do not issue binding rules. Let us assume the ABA, after years of resistance, now does what it should have done years ago: adopt more responsible rules to govern the conduct of corporate/securities lawyers. Those recommended rules would then have to be considered by that state's local bar, then by a committee appointed by the state's high court, and then adopted by action of that court. Past experience indicates that this process takes a lot of time and produces results that are neither consistent nor uniform. The delay would be costly and given the jumble of state rules likely to emerge, not worth the wait. Congress was right to forego that route.

Letting the ABA act first is a bad idea for other reasons. The vast majority of states now have ethics rules that demand more of securities (and other lawyers) than the ABA's current rules (most permit an attorney to disclose confidential information to prevent a client's ongoing or prospective crime or fraud and all require withdrawal in ongoing fraud situations). The problem is that the states have not enforced those current rules against securities lawyers and appear not to be in a position to do much more in the future. Second, some states with weak rules might adopt more stringent ones, but again absent the means of enforcement those rules cannot be expected to have much of an effect. In the meantime, investors are no better protected than they were before Enron's demise. That would defy Congress's intent and would be an irresponsible stance for the Commission to take.

D. State Rules that Require More of Securities Lawyers than the Commission's Rules Should Not Be Preempted

A number of states already have ethics rules that require more of securities lawyers than the Commission's proposed rules. Those rules should not be preempted. Preemption in this situation is not justified under § 307 and is inconsistent with the broader regulatory regime set forth in Sarbanes-Oxley and federal securities legislation. The Commission should take care to eliminate any references or suggestions in the final rules and comments that assert or imply that state ethics rules requiring (or allowing) more disclosure than that prescribed by the Commission's rules are preempted in favor of the Commission's more limited requirements.

Section 307 requires the Commission to adopt "minimum" standards to govern the conduct of securities lawyers, not "maximum" standards. That is why we recommended in Part III, above, that § 205.3(e) be amended to provide that any state ethics rule to the contrary notwithstanding, an attorney may make the disclosures permitted by the section. This language would preempt the ethics rules of the small minority of states (e.g., California and the District of Columbia) that may or do prohibit a lawyer from disclosing confidential information in the situations contemplated by the disclosure provision of § 205.3(e). Attorneys in those states should be permitted by federal law to make such disclosures. The provision should be phrased as a federal rule that preempts state rules that conflict with or interfere with the rule's purpose of protecting companies and investors. Alternatively, the provision could be placed in § 205.3(d).

The Commission is not charged with general responsibility for regulating the practice of law. It is charged with regulating lawyers only as a necessary adjunct to its authority to regulate the securities markets. It is not plausible to maintain that giving lawyers less authority (discretionary or mandatory) to disclose securities fraud or connected violations of law than state regulators allow or require furthers any legitimate federal regulatory goal. Indeed, it would impede the Commission's mission.

V. Foreign Lawyers

We support the Commission's proposal to regulate all lawyers who "practice and appear" before the Commission on an equal basis, whether licensed here or abroad. Exempting foreign lawyers can only have harmful effects for investors and either domestic or foreign lawyers, if not for all three. To exempt foreign lawyers from these rules but allow them to practice and appear before the Commission would undermine § 307 by providing many corporations, and all large ones, with an easy route around the Commission's rules. That in turn would result in violence to the legislative scheme, harm to investors, and harm to the domestic securities bar who would be placed at a competitive disadvantage vis-a-vis their foreign counterparts.

On the other hand, to exempt foreign lawyers and also preclude them from practicing before the Commission, assuming it is legal under other law and treaties for the federal government to do this, would unfairly and unduly restrict multi-national corporations to domestic lawyers for their securities work, which might well drive up corporate legal costs and result in less competent legal representation on securities-related matters that foreign lawyers are more competent to handle.

That leaves, as an alternative to the Commission's proposed approach, granting foreign lawyers or bars the discretion to practice before the Commission by opting in or opting out of rules promulgated under § 307, coupled with a requirement that corporations who choose a non-participating lawyer would have to alert the Commission and investors to that fact and risk greater scrutiny by this agency. But Congress did not choose "transparency" as the solution to the problems it saw with the securities bar. It chose regulation. To have a bifurcated system in which "transparency" is available to corporations as long as they choose foreign lawyers would be to alter the legislative scheme. Further, it too would put domestic lawyers at an unfair disadvantage in competing with their foreign counterparts.

An opt-in system for foreign lawyers preferable to the Commission's proposal in that it could be seen as demonstrating more respect for foreign countries and their own systems for regulating lawyers. But it does not demonstrate more respect than the Commission's proposal.

The path the Commission has recommended gives foreign nations and foreign bars an opportunity to decide to forego securities practice in the United States or, if necessary, to amend their rules for lawyers practicing before the Commission. No foreign country, lawyer or corporation has a "right" to participate in our securities markets on their own terms. They have a choice: to play by our rules or not.

To cede to arguments that foreign rules or laws merit an exemption from securities regulation would be to invite foreign nations, foreign accounting enterprises, foreign investors and foreign investment bankers to lobby for legislation or regulation at home that would merit further exemptions. Perhaps the Commission would not take such arguments seriously, which prompts one to ask what justifies ceding here. The magic of lawyering? The special character of regulating lawyers? If those arguments are insufficient to prevent the Commission from regulating our own bar, we are at a loss to understand why they would be persuasive when it comes to foreign lawyers.

The arguments made by foreign bars are virtually indistinguishable from those made by the ABA to ward off SEC regulation of domestic lawyers. What we know of foreign enforcement efforts against securities lawyers suggests that their arguments are as illusory as those advanced by domestic lawyers in the effort to ward off effective federal regulation. The Commission should maintain its principled, wise and legislatively justified stance to regulate foreign and domestic lawyers equally.

VI. "Appearing and Practicing" Before the Commission

A. Advising as "Practicing"

We support the Commission's inclusion of lawyers who advise and/or draft, but do not sign, documents filed with the Commission, as well as lawyers who advise that documents need not be filed with the Commission. Any other rule would facilitate circumvention of these rules by encouraging corporate managers and corporate counsel to confine lawyer signatures on Commission documents or filings to a bare minimum to ensure no up-the-ladder reporting of wrongdoing. That would risk gutting these rules and § 307. There is evidence, sad to say, that lawyers and corporate managers have already implemented this strategy in an attempt to avoid "primary" liability for violating the securities laws in civil suits, where liability for "mere" aiding and abetting the law is no longer available.

The argument that lawyers should have no responsibility for client illegality, short of signing documents, is an embarrassment. The law rejects this hamstrung vision of lawyer ethics. For example, it is, at a minimum, malpractice for a lawyer, whether negligently, recklessly, or intentionally, to sit by silently or passively when a reasonable lawyer would not, to advise that legally required documents need not be filed, or to counsel that information that should be disclosed need not be. See e.g., *FDIC v. O'Melveny & Myers*, 969 F.2d 744 (9th

Cir.1992) (holding a law firm guilty of malpractice for such conduct). In *SEC v. National Student Marketing*, 457 F. Supp. 682 (D.D.C. 1978), the court said in some circumstances, such conduct is more than malpractice; it amounts to aiding and abetting securities fraud.

And it is useless to argue that civil suits will handle such conduct. First, private parties can no longer bring civil suits for aiding and abetting. More important, investors cannot rely on malpractice actions to deter such behavior. Until and unless a corporation is forced into bankruptcy and a trustee has been appointed, experience has taught us that a malpractice action is very unlikely to be brought. Corporate managers would much prefer to keep the whole matter "private." They have too much to lose. With the law already labeling such conduct malpractice, and sometimes more, and civil actions unlikely to be brought due to either the limits of law or what economists call an "agency" problem, Congress was right to require the Commission to regulate behind-the-scenes assistance, which is precisely what the Commission's rules do.

In introducing and debating § 307, the amendment's sponsors were absolutely clear that the conduct at which § 307 was directed had nothing to do with who signed what and everything to do with lawyers failing to advise and insist that the law's requirements be met, including disclosure of all required information to the Commission and filing all necessary paperwork, whoever signed it. The argument that advising as described in § 205.2(a)(1), (4), and (5) should not be covered by these rules is implausible and unwise.

We understand that the bar sometimes speaks as if every lawyer's job was to behave as lawyers in adversary adjudicatory proceedings are privileged to behave. But that is not so: lawyers who facilitate transactions or advise clients in private on complying with the law perform distinct functions in our democracy and operate in radically different environments from those inhabited by advocates engaged in adversary proceedings. Moreover, the implications of these very real differences to the Commission's proposed regulatory regime do not disappear because the line between advocating and advising is often uncertain. That is true. But it is also true that every legal distinction of any import is subject to the blurry line critique. The line between legal and illegal conduct – which § 307 and these rules employ and with which all lawyers must struggle every day – is also rather blurry. Lawyers understand these realities and are better equipped to deal with them than ordinary Americans, who are held to account for crossing legal lines that also are gray at the edges. And ordinary Americans are neither trained or paid for making these judgments. Securities lawyers are paid good money for negotiating those grays, including the gray between advocacy and advice. The Commission's rules do not demand perfection of lawyers in any area, just reasonable conduct, reasonable judgment and reasonable efforts to find the right side of blurry lines.

In our system, advocates are required to put the other side, particularly if that side is the government, to its proof. They are privileged to put forth all nonfrivolous justifications of their clients' conduct and all nonfrivolous arguments that the law should be read in novel, even unprecedented, ways. But advocates operate in an environment designed to guard against abuses of that broad license to mold facts and laws. First, there is an adversary party equipped (in almost every case) with a lawyer both armed with information sufficient to challenge vigorously every theory, far-fetched or standard, that the opposing lawyer can make. Second, there is a judge who is acting as legal umpire (and sometimes as a neutral fact finder) and frequently a separate fact finder, the jury, in addition to the judge – actors obligated to decide with objectivity and neutrality between the contrasting visions of law and fact presented by the battling lawyers. None of those checks is present when, in the privacy of the office, a legal advisor counsels a client or corporate manager that it can act based on some unprecedented vision of what the law requires or some barely plausible interpretation of facts. In short, advocates have much more license to manipulate law and facts than advisors do.

And that is how it should be. Lawyers as advisors are a private sector solution to intrusive government alternatives to ensure that corporations, other entities and individuals operate within and not without the law. It is simply not true that the advisor's job is to stand by the client's position, no matter how implausible as a matter of fact or law, and not judge the client, as lawyers often assert. Advocates should not judge because there are others charged with that role in the environment in which they operate and they are present to guarantee the clash of positions that our adversary system depends upon. But advisors are relied upon to give advice made on prudent judgments. How else are they to tell anyone what the law requires and what it does not? And that is the role they are retained and paid to perform.

Lawyers always seek to fend off regulation by claiming the government is trying to turn them into whistle-blowers or government agents expected to infiltrate and influence private entities from within. This is nonsense. Again, the Commission's rule requires no action by lawyers other than those actions they are now allowed to take in almost every state. Moreover, the applicable law other than the ethics rules – such as tort law, agency law, and criminal law – already provides that advisors who act as advocates in stretching the law and facts risk running afoul of that law. The Commission's rule does not change the traditional responsibility and role of lawyer-advisors; it just insists that lawyers properly fulfill that role and not act as advocates in situations where such behavior is not permitted or appropriate.

The Commission's rules on this subject, however, should be revised to indicate how they apply to lawyers acting as advocates, and to lawyers advising (or representing as advocates) individuals who, unlike companies, have no CLO, board or board committees. In Parts VI.B. and VI.C, below, we present a framework for how that might be done.

B. Lawyers Advocating Before the Agency

We agree, as provided in § 205.2 (a) (2) and (3), that lawyers acting as advocates should be covered by the regulations issued under § 307, but, as our discussion of the role of advocates above suggests, the Commission needs to tread carefully here to avoid chilling legitimate and vigorous advocacy. Traditionally, the ethics rules and the law of lawyering have protected the advocacy role by distinguishing between the lawyer's obligations with respect to ongoing or future wrongdoing on the one hand and past wrongdoing on the other.

With respect to ongoing or future violations, lawyers acting as advocates have been, and should be, treated no differently than lawyers acting in a transactional capacity. Clients have no right to use advocates to plan future violations of law nor to conceal or further ongoing violations. All jurisdictions require lawyers to withdraw if the client insists that lawyers "aid" them in that manner, and that is so even in criminal cases where the Sixth Amendment guarantees the right to counsel as it does not in SEC proceedings. In *Nix v. Whiteside*, 475 U.S. 157 (1986), the Supreme Court stated that rules requiring criminal defense lawyers to withdraw in those circumstances, even though that withdrawal necessitates notice to the tribunal, do not offend the Sixth Amendment. Individuals involved in SEC proceedings are not entitled to more loyalty than the Supreme Court has said is owed to criminal defendants. In *Whiteside*, the Court stressed that the legal system and our adversary process is strengthened and preserved by rules that prohibit clients from using lawyers, even advocates in criminal proceedings, to further ongoing or future violations of law.

The Comment to this new subsection should emphasize that nothing in these rules prohibits advocates in SEC proceedings, or lawyers "appearing and practicing" before the Commission who are acting as advocates on matters covered by these rules in other fora, who are permitted to do so under the rules of the relevant tribunal, from making a noisy withdrawal or disclosing past illegal conduct of any client, whether corporate or individual, for conduct such as the submission of false evidence in the proceeding. That principle should be stated directly to ensure that clients and lawyers are not misled and so that communication necessary and proper to vigorous representation is not chilled. Notice here that we encourage the SEC to defer to the relevant tribunal's rules in dealing with advocate lawyers because the tribunal must be able to ensure orderly process without disruption from an outside regulatory force. The Commission could deal with the tribunal permission issue by adopting a rule that lawyers are not required to withdraw noisily or otherwise in any situation in which a tribunal's permission is first necessary, the lawyer has requested permission and the tribunal has refused permission.

The argument that to avoid chilling legitimate communication between clients and advocates, advocates should be exempt from the duty to withdraw thus rests on a misunderstanding of the limits on representation. An attorney, even an advocate, cannot be used to further violations of law. When that occurs, the attorney must withdraw, assuming the permission of any tribunal when permission is required before a lawyer withdraws. The attorney-client privilege has not and does not protect client communications intended to further ongoing or future crimes. Given that longstanding legal framework, it is specious to argue that the Commission's proposed rules will somehow disrupt lawyer-client communication or trust as it never has been disrupted before.

The real difficulty occurs not with ongoing or future violations, but with past violations. With respect to past violations, the ethics rules have traditionally protected the lawyer's advocacy role by limiting obligations to rectify the past wrongdoing to situations in which the wrongdoing occurred during the lawyer's representation, and usually to situations in which the lawyer's services were used in furtherance of the wrongdoing. The problem is that neither limitation appears anywhere in the Commission's proposed rule, which uses an "evidence of a material violation" trigger for action without any temporal limitation or connection between the evidence and the lawyer's role. Thus, under a literal reading of the proposed rule, a lawyer hired solely to defend an issuer client in litigation against a charge of past securities fraud would have a duty to withdraw noisily under §205.3(d)(2)(i), and reports by that lawyer required under §205.3(b) would impose improper obligations on the CLO and the QLCC or Board.

We believe the rules should be rewritten to clarify that no duties under the rule are triggered when a lawyer retained to be an advocate acquires evidence of past wrongdoing that occurred before the lawyer's representation and did not involve the lawyer's services. It is true that the Commission almost certainly did not intend the duties under its proposed rule to apply to this kind of advocacy situation, and that it is extremely unlikely that any court would interpret the rule to apply to this situation. It is also true that the danger is mitigated by the fact that the internal reporting obligations would cause no particular hardship in this situation since the CLO and CEO would most likely know the relevant information already, and by the fact that the withdrawal provisions are permissive only, and it is hard to imagine a lawyer in an advocacy role choosing to make a noisy withdrawal. Nevertheless, because we believe that it is important to protect the advocacy role, we think the rules should remove all doubt.

We therefore suggest adding to the end of our proposed revision of §205.2(e), defining (in our new version) "credible evidence" and "credible and substantial evidence," the following:

> When a lawyer is hired to advocate in connection with past conduct in which that lawyer's, or his law firm's, services were not used, credible [or credible and substantial] evidence does not include evidence of past wrongdoing that occurred before the lawyer's representation and did not involve the use of the lawyer's services.

We believe that change is sufficient to preserve the legitimate advocacy role, while at the same time not exempting advocates from legitimate regulation by the Commission.

C. Representation of Individuals Rather than Entities

Section 205.2(a)(2) and (3) include not only lawyers acting in an advocacy role, but lawyers who represent individuals other than issuers. Yet the Commission's proposed rules focus almost exclusively on lawyers who represent issuers, which are typically entity clients. The main substantive rule, §205.3, which contains the duty to report and further obligations, applies only to lawyers who practice before the Commission "in the representation of an issuer." See §205.3(a), (b)(1), (c)(1). That raises the question of what obligations, if any, the Commission intends to impose on lawyers who represent individuals. The Commission may simply have had in mind joint representation situations, in which the lawyer represents the issuer (an entity) and simultaneously represents an employee, officer or board member. The concern might be that lawyers in joint representation situations might believe themselves exempt from the duty to report for information they discover as part of their representation of the individual. If that is the sole purpose of including lawyers who represent individuals, the Commission needs to make that clear.

If, on the other hand, the idea is to include within the rule's ambit lawyers who represent solely individuals, then §205.3 needs to be changed to reflect that fact, for example by replacing "in the representation of an issuer" with something like "in connection with the representation of an issuer." In addition, the reporting requirements would need to be changed to reflect the differences between individuals and entities. That may need to be done in any case, since "issuers," as defined in §205.2(g) (piggybacking on the securities law definition) includes individuals.

Therefore, we propose that the Commission replace §205.2(a)(2) and (3) with a new subsection §205.2(a)(2), which would read as follows:

> Representing any party to, witness in, or subject of any Commission investigation, inquiry, information request, subpoena or administrative proceeding, provided that an attorney representing such an individual exclusively and who does not simultaneously represent the individual's company jointly or exclusively:
>
> (i) Is not required to report information learned from the individual to the company's CLO, any Board Committee or the entire Board, even if the individual client has fiduciary responsibilities to the individual's company.
>
> (ii) Is required to report to the individual client in the same circumstances and applying the same standards as those set out in § 205.3 to govern reporting to a CLO. If the individual does not provide an appropriate response and seeks to use the attorney to conceal ongoing or future violations of law covered by these rules, the attorney must withdraw, assuming permission can be obtained from the requisite tribunal or tribunals, if any, and must inform the Commission of the fact of withdrawal. The attorney must also withdraw any document filed or statement made that furthers or conceals ongoing or future violations of law covered by these rules.

More generally, the Commission needs to clarify how these rules apply to securities lawyers with individual clients.

D. Law Firms as Legal Persons Who "Appear and Participate"

Section 205.2(a) should include a subsection making it plain that law firms, not just individual lawyers, practice before the Commission. When a lawyer within a firm advises a corporation or individual on the securities laws, the law firm, not some individual lawyer, represents the client, and in matters of any size or complexity multiple lawyers in the firm, not just one partner and a few subordinates, are likely to be involved.

Making it clear that law firms, not just individual lawyers, are legal persons (entities) subject to these rules is essential to an effective regulatory regime. The Commission's rules on accountants and other groups acknowledge that fact, and it should be recognized and applied here as well. The duty to regulate lawyers imposed by § 307 implies effective and efficient regulation. To achieve either goal, the rules must include law firms and specify sanctions that will be visited on firms when they are found in violation of the rules. When should law firms be responsible for the acts of individual lawyers? We address that in Part VI of these comments.

E. Resignation and Withdrawal of Attorneys Employed by an Issuer

The Commission should clarify § 205.3(d)(1)(ii), dealing with the obligations of an attorney employed by the issuer "when there is no appropriate response [to the report of a material violation] within a reasonable period of time." The proposed rule, we believe, is sound in relieving inside attorneys from any obligation to resign their jobs, while requiring them to notify the Commission that he or she intends to disaffirm a tainted document or representation that the attorney prepared or assisted in preparing and to submit a writing actually disaffirming the particular items. However, the rule does not deal with the effect of the attorney's actions on continued representation of the company on the tainted matter or matters closely related to it.

The Commission's rule should be amended to make it clear that an inside lawyer *cannot* continue to participate in representing the company in the very matter in which a violation is ongoing or prospective. This should be done for two reasons: First, current state ethics rules and decisional law are correct in requiring total withdrawal from the particular matter (and perhaps from closely related matters as well). No lawyer should be permitted to continue a representation that would assist ongoing fraud (see Model Rule 1.2(d)). Second, any failure to include such a provision is likely to be interpreted as preempting state ethics rules and law that require withdrawal from the particular matter. Preempting a state rule that furthers the Commission's mission is both unsound and unnecessary. State ethics rules appear to take the same approach that the Commission has taken, i.e., requiring the inside lawyer to withdraw from representation in the particular matter, but not requiring them to quit their jobs. See ABA Formal Op. 92-366 (1992).

To ensure that in-house counsel is not subjected to any state ethics rule or interpretation that requires complete withdrawal, inconsistent with the whistle-blower protections of Sarbanes-Oxley, we earlier advised in Part IV.C. that the Commission make plain that the one instance in which an attorney is relieved from state ethics rules requiring a broader duty to withdraw (or to other action designed to provide more protection to investors) concerns in-house counsel. Any state ethics rule or interpretation of a state ethics rule requiring in-house counsel to give up employment by the issuer completely should be preempted.

VII. Law Firms, Imputation, and Subordinates and their Supervisors

A. Law Firm Discipline

The Commission's rules should address the need for discipline of law firms. Specialized corporate and securities practice involves the participation of a team of lawyers who bring differing skills and knowledge. Responsibility for decisions is often divided up or shared in ways that are uncertain or shifting. The diffusion of responsibility and knowledge leads to the argument that no one attorney can be held responsible for what was done. The Commission should add a rule permitting the censure or reprimand of a law firm and the assessment of monetary fines when the firm, which is clearly responsible for the representation, has failed to conform to responsibilities required by the Commission. The rationale for this approach is persuasively argued by Ted Schneyer, Professional Discipline for Law Firms?, 77 Cornell L.Rev. 1 (1991), and has since been adopted in New York and a few other states.

B. Imputation of Knowledge Within a Law Firm

If law firms, in addition to individual attorneys, are subject to the Commission's new rules, questions of imputation of knowledge within the law firm must be faced: when should an entity, in this case a law firm that provides public companies with legal assistance concerning their responsibilities under the federal securities law, be charged with the actions and mental state of the agents within it?

It would be costly and confusing for the Commission to devise novel theories of imputation. Instead, the Commission should adopt imputation principles already found in federal law. Namely, an entity, here a law firm, is responsible for acts of its agents performed within the scope of their employment, and the mental state of an entity is that of the agents within it. On the *mens rea* of entities, federal law holds that the knowledge of individual agents is combined to determine the knowledge, negligence, intent or recklessness of the entity itself.

We understand that Attorneys Liability Assurance Society, a mutual insurance organization of many of the largest law firms in the nation, would have the federal courts adopt a considerably more lenient imputation rule for law firms, one that would modify or reject the normal approach that would impute to a law firm the knowledge of its agents. It is predictable and proper for an insurer to argue for such leniency and understandable that law firms themselves would prefer such a rule. The problem is that no legitimate policy objective supports that approach. On the question of imputation, the rules adopted for other entities by the federal courts (and long applied to law firms as well without any significant dispute) state the appropriate rule. If law firms were not subject to ordinary rules of *respondeat superior*, they would have an incentive to decentralize legal work to minimize the number of lawyers with access to sufficient client information to bring them within the purview of these rules. As a result, the quality of legal work done in securities matters would decline, perhaps in dramatic ways. If the collectivity rule were to be abandoned, law firms would have an even greater incentive to prevent any one lawyer from knowing too much about the client's affairs, again threatening the quality of legal services and the goal of compliance with the securities laws.

On the other hand, *respondeat superior* combined with the collectivity approach to *mens rea* provide law firms with a powerful incentive to provide the highest quality representation. Partners-in-charge or committees within law firms are encouraged to monitor the overall securities work that the firm is providing to individual clients. Compliance with those rules would increase, and the costs of SEC enforcement would decrease. There are two potential objections to this rosy picture: Would law firm fees skyrocket to compensate firms for the added cost of monitoring the overall securities work for each client? And would some companies seek to avoid the reporting requirements of these rules by dispersing legal business among many firms and giving each only discrete and limited assignments?

Excessive cost increases seem unlikely because today's best practices dictate that law firms coordinate and monitor the efforts of multiple lawyers working on an engagement for the same client. First, a failure to coordinate is likely to result in duplication of legal work that itself would unnecessarily escalate fees. Second, failure to coordinate and monitor results in poorer quality representation. The fear that corporations will disperse legal work among firms also encounters the great risk that limited scope of representation and limited knowledge inevitably results in shoddy legal work. Moreover, ethics rules and the hazards of doing inadequate work should lead law firms to decline representation when they are provided with too little information to do the job right or the limitations on the scope of representation are so severe that adequate representation is not possible.

Should firms be rewarded for having compliance programs and procedures reasonably designed to prevent violations of these rules? Yes, but they should not be rendered exempt from the rules based on such programs or procedures for the same reason that such programs and procedures do not exempt other entities, like corporations, from the reach of law. But other entities are entitled to reduced penalties based on the existence of quality compliance programs and procedures to provide an incentive for entities to develop and maintain such programs. We urge the Commission to adopt that approach.

C. Coverage of Firm Lawyers not Practicing or Appearing Before the Commission

The proposed rules are unclear on whether, for example, an antitrust lawyer within a firm in which lawyers are practicing before the Commission, is also subject to this rule. The comments to § 205.2(a) should make it clear such an attorney is not covered if the attorney, as an individual lawyer, does not meet the criteria set forth in that subsection. On the other hand, we believe a firm engaged in securities practice should be subject to sanction under this rule when the firm as an entity has knowledge of a material violation.

D. Subordinates and Supervisors

The Commission's proposed rules on this subject are necessary and well drafted. Section 205.3(d)(4) is an important rule; however, its scope needs to be broadened. There should be a corollary to § 205.3(d)(4) to protect subordinate lawyers, including those practicing in outside firms, from retaliatory action by a law firm for complying with or taking any other action in furtherance of these rules. The whistle-blower provision of Sarbanes-Oxley § 806 coupled with the Commission's duty to establish "minimum standards of professional conduct" for securities lawyers provide ample authority for such a rule. Consistent with our earlier discussion of preemption, the Comments should make clear that nothing in these rules preempts any state ethics rule or interpretation that requires more action to protect victims of client wrongdoing than these rules.

E. Withdrawal of Inside Attorneys

As indicated in Part VI.D., we support the Commission's position in § 205.3(d)(ii) that a reporting inside lawyer does not have to quit his job, i.e., the required notification to the Commission when the company does not make an appropriate response does not extend to loss of employment. However, the rule should be amended to make it clear that an inside lawyer cannot continue to participate in representing the company in the very matter in which a violation is ongoing or prospective. Although the rule will have the effect of preempting state ethics rules that interpret withdrawal as requiring job loss, they should not preempt state ethics rules that limit the requirement of withdrawal in this instance to withdrawal from the particular matter.

VIII. Successor Counsel

Section 205.3(d)(1)(iii) provides that an issuer's chief legal counsel must "inform any attorney retained or employed to replace the [reporting] attorney who has withdrawn that the previous attorney's withdrawal was based on professional considerations." That requirement, however, should be supplemented to require all lawyers accepting a legal assignment from a client that would involve practicing or appearing before the Commission as defined by these rules to inquire into the existence of any reports by attorneys forced to withdraw that have been made by prior counsel, not just those the client deems related to the representation, and to decline the representation if the client refuses the lawyer access to those reports. A lawyer should also be required to make a report to QLCC, if there is one or the board, if the lawyer discovers during the representation that the CLO or any other agent of the client has withheld a report from the lawyer.

Placing the burden on both the issuer *and* on successor counsel is the surest way to guarantee that successor counsel is not innocently drawn into aiding the legal violations that § 307 addresses. Many substantial corporate frauds that have become public involve schemes that are often replicated in new areas and one pattern of serious wrongdoing by a corporation often signals a propensity by one or more managers to engage in other forms of wrongdoing. In short, all prior reports of lawyers forced to withdraw within a given recent period are relevant. The number of required withdrawals is likely to be relatively small even in the aggregate and nonexistent for most public companies. Any indication of earlier wrongdoing, however, provides a warning that a particular company need closer monitoring.

IX. Professional Duty of Confidentiality and Attorney-Client Privilege

The Commission's duty under § 307 to establish "minimum standards of professional conduct" authorizes the Commission to define the scope of and exceptions to the professional duty of confidentiality applicable to lawyers appearing and practicing before the Commission. Section 205.3(e) of the Commission's proposed rules, which permits an attorney under certain circumstances to disclose confidential information to the Commission, establishes an exception to the professional duty of confidentiality. The rule should be described as such in the comments.

We doubt whether the Commission has or should have the authority to dictate the scope of the attorney-client privilege, which is a rule of evidence – a matter of statute in most states and of federal common law in the federal courts. Section 307 extends no such authority to this agency. We assume the Commission is authorized to announce and may want to announce that it shall not deem something a waiver of the privilege in its own proceedings, but going beyond that raises issues of authority and propriety. The Commission has no special expertise that would render it an appropriate body to determine the scope or application of the privilege outside its own walls.

Moreover, the SEC is a party, not the judge, in an enforcement proceeding brought in a federal court. For any one side of an adversary proceeding to claim the right to determine what rules of evidence apply is inappropriate and may offend due process. We understand that the agency is not seeking unfair advantage in attempting to define the privilege in these rules, and we understand that so long as the SEC is purporting to adopt a privilege that is lawyer and corporate friendly, its potential adversaries in court may wish to go along with this stretch of power. But if the SEC is authorized to broaden the scope of the privilege, what principle would stop the Commission from deciding to contract the privilege?

The main point is this: writing rules of evidence to be applied in court proceedings or discovery (whether this agency is a party or not) exceeds the legitimate scope of the SEC's authority. We think it is also unwise for the reasons given above. For further discussion of the privilege, we refer you to Professor Richard Painter's comments.

X. Miscellaneous Matters

A. Definition of "Breach of Fiduciary Duty [§ 205.2(d)].

The Commission's definition of "breach of fiduciary duty" limits the term to breaches of fiduciary duty "recognized at common law." Many fiduciary duties applicable to corporate officers, directors or agents are statutory in character under either state law or, more rarely, under federal law (e.g., fiduciary duties to pension funds created by ERISA). They should be included as well as common law breaches. The definition should be revised to read:

> (d) *Breach of fiduciary duty* refers to any breach of fiduciary duty recognized by state or federal law, including fiduciary duties recognized at common law, including, but not limited to, misfeasance, nonfeasance, abdication of duty, abuse of trust, and approval of unlawful transactions.

B. Access to the Comments to These Rules

We understand that usually the Commission's comments appear only in the original release and not in the CCH or other publications of Commission rules. Given that these rules are for lawyers and that normally the Comments to rules of professional conduct provide important clarifying information, as is true of the Commission's rules, we think it important that the Commission provide easy access to these Comments. Publishers should be encouraged to ensure that their publication of the rule contains the comments or at least indicates that the Comments, which are extensive and important, should be consulted by lawyers seeking to comply with any of the provisions of this rule. In its own publications and on its Internet website, the Commission should publish the Comments with the text of the rule.

C. Suggestion for Further Regulation: Conflicts of Interest Arising Out of Stock-Option Arrangements

The Commission has asked for suggestions on future regulation to consider under § 307. We think an important area of new regulation is the threat to objective and quality legal advice presented by lawyers and law firms holding stock options in corporations whose securities compliance work those outside counsel and firms perform. Other practices that threaten the objectivity and quality of securities' legal services should also be considered, such as outside counsel serving on the boards of their corporate clients; and corporations or their managers providing loans and other benefits to their lawyers (inside and without) that are outside of normal salary packages or fee arrangements. The Commission should also consider whether law firms who are responsible for a company's securities work should be rotated, as audit teams now must be, to avoid in the case of lawyers too much incentive to stay in the good graces of managers by adopting a lenient approach to compliance with the law. We are not now recommending any particular rules on any of these matters and some of these issues may prove to need no regulation. But we believe that they are worth the Commission's study and review.

Concluding Comment

The Commission's staff, Chairman and Commissioners have produced in short order an impressive set of rules on very complicated and sensitive matters. All those involved deserve great praise for their work on this difficult project. We have tried to demonstrate our respect for the agency's work by commenting in detail and as comprehensively as we have found possible in the time available. It is our sincere hope that these comments prove helpful to the Commission in drafting a final version of these rules.

If members of the Commission staff desires more information or to talk with any of us about our comments, we would be pleased to be of assistance.

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LIST OF ACADEMICS WHO SUPPORT THESE COMMENTS

[The co-authors of these comments have circulated a draft of them to a number of academic colleagues, inviting them to endorse these comments or to submit comments of their own to the Commission. Here we list the names and affiliations of those who are in *general agreement with our comments and recommendations*. Because time did not permit consideration of each individual's suggestions, the signers are *not* responsible for the language or details of each comment or recommendation. They have authorized us to attach their names and to say that *they agree generally with the substance and tone of this letter*.]

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[The following was copied from the HTML version of this letter posted 12/29/02 on the SEC's public comments website: http://www.sec.gov/rules/proposed/s74502/spkoniak1.htm]

Due to error, the following person was omitted from the list submitted with the comment letter on December 18, 2002:

W. Bradley Wendel
Washington and Lee University

Shortly after our comment letter was filed, the following persons endorsed the comments on the same terms:

Donald C. Langevoort
Georgetown University

Geoffrey P. Miller
New York University