United States Securities and Exchange Commission

File No. 33-8150.wp

Proposed Rule:
Implementation of Standards of Professional Conduct for Attorneys

Comments of Professor Thomas D. Morgan
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Identification and Experience

I write to comment on the Proposed Rule in my capacity as an academic lawyer who has worked in the field of attorney professional responsibility for over 25 years. I teach at The George Washington University Law School, having previously taught law at the University of Illinois, Emory University and Brigham Young. I am co-author of *Problems and Materials on Professional Responsibility* (7th Ed. 2000), long one of the most widely-used professional responsibility casebooks in the country. I am the only person to have served as an Associate Reporters for both the American Law Institute's Restatement Third, The Law Governing Lawyers (1986-2000) and the American Bar Association's Ethics 2000 Commission (1998-1999). I consult on loss prevention matters to the Attorneys' Liability Assurance Society (ALAS). I also testify as an expert witness in cases challenging attorney conduct, and in recent years, my testimony in a majority of cases has been critical of the challenged conduct.

General Principles and Overview

The Commission has proposed carefully crafted standards that, in largest part, are both faithful to the statutory mandate of Section 307 of the Sarbanes-Oxley Act and consistent with traditional standards of attorney professional conduct. In particular, the proposed standards correctly focus on attorneys' treating corporations, not corporate management, as their clients. They impose requirements on attorneys based on the attorneys' personal, not imputed knowledge. And they put primary responsibility for investigating possible wrongdoing where it belongs, within the issuer itself and not upon the attorney or private law firm that first suspected the wrongdoing.

Three important assumptions will run through my comments. First, the primary object of the Commission's standards should not be to find people to blame when something has gone wrong; the primary object should be to prevent the wrong from occurring. Sarbanes-Oxley § 307 and these regulations seek to direct attorneys to interdict client plans that would otherwise violate fiduciary standards and the securities laws. The first test of the proposed rules, then, should be how effective they are likely to be at stopping that corporate misconduct.

Second, I assume and believe that most attorneys and most regulated issuers want to obey

the law. There will be exceptions, of course, but it is costly both in reputation and defense cost to face a charge of wrongdoing. Further, it does not take the Sarbanes-Oxley legislation to go after genuine criminals. Indeed, attorneys and clients who are truly dishonest will try to evade any regulations the Commission establishes. Thus, the second test of the Proposed Rule should be its realism about the context in which honest attorneys work, the kinds of questions with which they deal every day, and the demands the regulations put on such attorneys.

Third, I believe the proposed standards should maximize their consistency with current state rules that regulate attorney conduct. The Commission clearly has some authority to create rules that regulate attorneys; standards governing conduct in Commission hearings are an obvious example of such regulation. I also recognize that one can argue that the Commission's authority may extend to creation of additional standards that supercede some attorney regulation by the states. I respectfully suggest, however, that the last thing the Commission and the investing public need is a period of litigation over the validity of the Commission's rules. Indeed, even if Commission authority to issue additional rules were ultimately upheld, confusion about whether the Commission's standards apply in particular settings and to particular kinds of conduct would only complicate an attorney's work and ultimately not serve the public interest.

I will group the specific comments that follow under four major headings:

1. An attorney's duties run to clients. The duties established by the Commission should relate only to persons and entities with which an attorney has an attorney-client relationship.

2. The terms "reasonable" and "appropriate" inherently describe a range of possible action, not a single kind of response to particular situations. To be realistic and effective, the Commission's standards should acknowledge attorneys' discretion to act within a zone of reasonable and appropriate conduct.

3. The conditions that trigger required attorney conduct are critical to achieving compliance with the standards. Those conditions should be described more fully.

4. While noisy withdrawal represents a possible course for attorneys in a narrow range of cases, it is the ultimate weapon in the attorney's arsenal. Noisy withdrawal should not be required by the Commission, and even its permissive use should be appropriately limited.

My comments will be of two kinds. In part, I will suggest material in the discussion accompanying the proposed standards that should be made a part of the standards themselves. That will give attorneys and reviewing courts a more complete picture of the Commission's requirements. Second, I will suggest ways to make the proposed standards more consistent with the law that now governs attorneys in most states. In some cases, that will bring the proposed standards more into line with the ABA Model Rules of Professional Conduct (hereafter Model Rules). On other important issues, it will bring standards more in line with the law described in the Restatement Third, The Law Governing Lawyers (hereafter Restatement) which on some issues – notably issues of confidentiality – more accurately reflects the law applicable in a

majority of states.

Under each of my general headings, I will try to comply with the Commission's request that comments be focused and specific. Without trying to suggest that my drafting is the only possible way to make each point, I will offer specific amendments to the Commission's proposed standards.

1. An attorney's duties run to clients. The duties established by the Commission should relate only to persons and entities with whom an attorney has an attorney-client relationship.

Proposed Amendment to the Proposed Rule

The definition in proposed § 205.2(f) of "in the representation of an issuer" should be revised to read "In the representation of an issuer means retained or employed by, or otherwise acting as the legal representative of an issuer."

Discussion

In § 205.3(a), the proposed standards correctly say that "[a]n attorney appearing and practicing before the Commission in the representation of an issuer represents the issuer as an organization and shall act in the best interest of the issuer and its shareholders." That concept is consistent with – indeed, may be a better statement of – the principle embodied in Model Rule 1.13(a). It is the concept taught to all law students and one that all attorneys should know.

In my view, the Commission's approach in § 205.3(a) represents the ideal way to proceed in that it reinforces principles attorneys already know. The Commission's imprimatur will make clear to attorneys that there is another sheriff in town with an even bigger gun, but the conduct required will be familiar and clearly acknowledged as consistent with an attorney's duties.

The problem with the definition in the Commission's proposed § 205.2(f) is that it departs from that perception and, unless changed, it will present serious problems at it relates to attorneys who represent individuals or even different corporate clients whose officials' work will be "incorporated into" something filed with the Commission.

Suppose, for example, that the CLO of an issuer asks her counterpart at another company for a letter confirming to an auditor that a dispute between the companies, pending during a previous year's audit, has been resolved. In some sense, that letter will be "incorporated into" the current audit. Assume the other attorney's response will be honest and correct.

Given the way the proposed standards work, the other company's attorney now would be deemed to be "appearing and practicing before the Commission in the representation of [the] issuer." If the other attorney were to hear from whatever source – say an executive of the other attorney's client – that the issuer may have unreported problems, the proposed standards would,

as written, require the other attorney to report the concerns to the issuer's CLO. That would seem to be true even if the other attorney learned the information in a privileged conversation with an official of the other attorney's client. The issuer's CLO, in turn, would be required to report highly sensitive – probably privileged – proposed corrections back to the attorney for the other company.

That surely cannot be what the Commission intends. One might think my illustration improbable, but my point is more general. The underlying premise supporting the proposed standards is that the attorney's duty to report possible misconduct grows out of his or her duty to serve his or her corporate client well. That is why current attorney ethical standards such as Model Rule 1.13(b) also create such a duty to speak up. But only attorneys who have a fiduciary duty to the corporate client can be reached by the Commission under such a theory.

The Commission's own discussion accompanying the proposed standards suggests no such incongruous results were intended.

The first example offered in the discussion of this point is of an attorney for a non-public subsidiary operating under an arrangement in which the attorney represents both the parent and all of its subsidiaries. That attorney should indeed be reached and can be without the broad proposed definition. My definition would reach that attorney equally well because the example expressly says that the attorney represents the parent among several joint clients.

The second example the discussion offers is an attorney retained by the issuer to report evidence of misconduct by an underwriter or other agent of the issuer. Again, my definition would reach that attorney because the attorney represents the issuer in that investigation.

The third example is of an attorney for an investment adviser to a registered investment company. The rationale for the standards including such an attorney is that the investment adviser is at common law an agent of the investment company and owes the company fiduciary duties. I acknowledge that one has to take a logical step to reach that attorney under my definition, but current law takes that step and creates duties on attorneys for trustees to the beneficiaries of the trust. See Restatement § 51(4).

I am not arguing that labels should control reality and artificially define whom attorneys represent. What I am saying is that the words "on behalf, at the behest, or for the benefit of an issuer, whether or not employed or retained by the issuer" – taken with a rule that reaches anything "incorporated into" a filing with the Commission – sweep much too far and would produce results bordering on the absurd. The redrafted definition I have proposed satisfies each of the examples offered without such collateral effects.

In discussions with other academic colleagues, it has been suggested that the Commission might be trying to impose reporting duties on attorneys for individual executives, for example, or attorneys for individual board members. To that I would simply say that such individuals are entitled to attorneys of their own; their decisions whether to report corporate

misconduct should be matters between the individuals and their attorneys. One does not lose the right to counsel or the attorney-client privilege simply by becoming a corporate officer. Indeed, to say otherwise could, in some cases, create serious constitutional issues under the Sixth Amendment.

Attorneys retained to represent corporate subsidiaries, or perhaps the audit committee of the board, do present questions of interpretation even under my definition. A wholly-owned subsidiary might appropriately be considered to be part of the parent company, for example, although a subsidiary in an unrelated business with a separate CLO, might not be so considered. When one is dealing with a subsidiary with outside investors, on the other hand, the attorney for the subsidiary ordinarily has no responsibility – or authority – to reveal confidential information to individual shareholders, even if one of the shareholders is an issuer of securities.

The same should be true for the attorney for the audit committee. Suppose the committee thinks the company CLO is part of the problem, i.e., she is too close to top management and may be involved in misconduct herself. Situations play out very differently, and the last person to whom the audit committee's attorney should be *required* to report in such a situation would be the company CLO. If audit committees have separate counsel, they presumably have that counsel for a good reason and the independence of that counsel should be respected.

My point in these examples, then, is to say that the only principle that will consistently work well in the real-life situations that will arise under the Commission regulations is one that says that attorneys represent identified clients and have duties to those clients. Attorneys for other clients should not be given duties under the proposed rules that may conflict with duties to their own clients. My proposed amendment to the proposed rule would correct this problem.

2. The terms "reasonable" and "appropriate" inherently describe a range of possible action, not a single kind of response to particular situations. To be realistic and effective, the Commission's standards should acknowledge attorneys' discretion to act within a zone of reasonable and appropriate conduct.

Proposed Amendments to the Proposed Rule

a. The definition of "reasonable or reasonably" in § 205.2(k) should be revised to read: "Reasonable or reasonably denotes the range of conduct in which a prudent and competent attorney with the attorney's training, experience, position and seniority might engage."

b. A second sentence should be added to the § 205.2(b) definition of "appropriate response" saying: "In determining that a response is 'appropriate,' the attorney may rely on factual representations and legal determinations of persons on whom a reasonable attorney would rely that respond to the attorney's legal and factual concerns and are otherwise reasonable."

Discussion

a. The words “reasonable and reasonably” create the objective test that is one of the hallmarks of the proposed standards. I agree that such an objective standard is appropriate. Otherwise, an attorney could try to say that he or she alone was subjectively “unaware” or had a particular subjective belief, and no one could reliably prove the contrary.

What is missing in the Commission’s proposed rule, however, is a sense that reasonable attorneys, acting reasonably, may act quite differently in given situations. Questions whether conduct would violate securities laws or violate fiduciary duties often do not appear in easy, non-controversial forms. Not all questions are in a gray area, of course, and the zone of reasonable conduct is not always large, but enough answers in life are uncertain that any single attorney’s answer may not be the only good one.

No one condones illegal conduct, but the implication of the proposed rule is that what “reasonably” constitutes “evidence of a material violation,” for example, will be self-evident to a reasonable person. Even a moment’s reflection, however, illustrates that such an expectation fails to acknowledge the complexity of many situations in which attorneys give assistance.

Perhaps the point can be helped by an illustration. Many might be used, but imagine that a company is considering relocating its operations so as to take advantage of a provision of the Internal Revenue Code. If the IRS does not challenge the proposed plan, the company believes it will realize substantial savings that will increase its reported earnings per share. A respected, experienced tax attorney says that the plan is lawful, indeed common.

A different attorney, however, questions the plan and says that the trend of cases in the lower courts cast doubt on its legitimacy. The second attorney says that company’s reported earnings may have to be materially restated if the company incurs a large tax liability and that reporting the higher earnings that the tax savings were supposed to produce may violate the securities laws. A third tax attorney consulted by the CLO says that the second attorney is wrong and that the “trend” to which that attorney referred is a product of that attorney’s imagination.

In my example, which attorneys can be said to “know” or have “ become aware” of what within the mean of the Commission’s regulations? Would a “reasonable” attorney consider the dispute at least “‘evidence’ of a material violation”? Does that mean that all of the attorneys – including the attorneys who believe the second attorney is wrong – must formally report the dispute to the CLO (who in the example, and undoubtedly in real life, already knows about it)?

Then, what is the CLO to do in this kind of situation? If he gets an opinion from yet a fourth attorney, may everyone take that as authoritative? Must they do so? If the second attorney continues to believe that the company will lose the tax case, must that attorney resign from all representation of the company and notify the Commission of that action?

I do not claim that any single hypothetical proves a major point, but I think this one does illustrate a reality that anyone who has given legal advice has to recognize. Reasonable

attorneys can have reasonable opinions that reasonably differ about whether a client is really about to violate the law. What attorneys do today is make their points forcefully and candidly and let company officers – or sometimes the company's board – decide what the company should do in the face of uncertainty.

I respectfully submit that that is exactly how the system should work. However, it can only do work that way if the terms "reasonable and reasonably" that in turn drive the definition of "evidence of a material violation" and other critical concepts in the proposed rule are given a definition that acknowledges that they represent a range of appropriate behavior, not a single standard of conduct.

b. Similarly, whether or not an attorney receives an "appropriate response" to a report of evidence of misconduct determines what the attorney must do thereafter. If the response is deemed "appropriate," then under § 205.3(b)(7) the attorney enters a safe harbor in which his or her responsibilities are at an end. If the response is not appropriate, then under § 205.3(b)(4) the attorney must report to higher authority within the corporation, and ultimately may have to make the noisy withdrawal required under § 205.3(d). Thus, defining what conduct is "appropriate" is also critically important.

Just as was true about the term "reasonable," an attorney's conclusion that a response is "appropriate" should be evaluated in terms of whether if falls within a range of appropriate responses. The language I have proposed tries to describes how a determination of appropriate – or inappropriate – can reliably be made. The proposed language is not my own. It is a paraphrase of the second paragraph following the definition of "appropriate response" in the discussion section of the Commission's proposed rule. One could – and perhaps should – go on as the discussion section does and also address what would constitutes adequate corrective action, but I believe the proposed language would be sufficient to give an attorney a reliable basis to decide whether further steps are required.

3. The conditions that trigger required attorney conduct are critical to achieving compliance with the standards. Those conditions should be described more fully.

Proposed Amendments to the Proposed Rule

a. In the first sentence of § 205.3(b)(1), the phrase "becomes aware" should be replaced by "knows." The term "knows," presently, should then be defined in § 205.2 to mean "actual knowledge of the fact in question, not information that merely could be imputed to the attorney. Actual knowledge can be inferred from circumstances; an attorney cannot evade knowledge by closing the attorney's eyes to the obvious."

b. In § 205.2(e), the following should be added to the end of the definition of "evidence of a material violation": "Evidence of a material violation within the meaning of this definition does not include: (1) acts undertaken where the law is unsettled, even if a court might in the future hold the acts violate the securities laws, (2) acts not declared illegal in states where the

issuer does business, and (3) acts that a corporate officer or employee might decide not to undertake."

c. The term "similar violation," presently undefined, should be defined to mean "any other violation of a legal obligation by the issuer or violation of law which reasonably might be imputed to the issuer."

Discussion

The critical issue for an attorney seeking to comply with the proposed standards is whether what are traditionally called the "triggering" conditions are present that require action. In the ABA Model Rules, those conditions are described in Rule 1.13(b). In the Commission's proposed rule, they are described in § 205.3(b)(1) and the definitions that underlie its terms. I have proposed three changes in the definitions to help clarify the attorney's responsibilities.

a. The extent to which information is sufficiently apprehended by an attorney to trigger a required response has been among the most difficult issues for rule drafters to express. The term that has been most consistently used, however, has been the most obvious. An attorney must act based on what the attorney "knows."

The text accompanying notes 42 - 44 in the discussion of the proposed standards suggests that "knowledge" may be too high a standard. The problem is said to be the chronic one that no one truly knows what they know. Thus, it might seem, an attorney could always justify inaction by saying that he or she could not be completely sure whether apprehended facts were really true, or if true, what they meant for appropriate action.

My suggested definition, however, is an amalgam taken from several places in the Model Rules and makes clear that such reasoning would not justify inaction. An attorney's knowledge can be inferred from circumstances; an attorney knows what a reasonable attorney in the situation would know. An attorney may not be "consciously ignorant," i.e., the attorney may not close his or her eyes to the obvious.

The problem with the Commission's "becomes aware" phrase is that it has all of the ambiguity of "knows" with none of the history helpful in defining the term. "Becomes aware" implies that apprehension of facts is an evolving process. Sometimes that may be true, but it does not advance understanding of when the attorney is required to act. Surely action is not required when the attorney is only "dimly aware," for example. In short, it does not take much reflection to see that the "awareness" contemplated by the proposed standard is "knowledge" under another name, a name with much less history and less basis for reasonable construction.

In addition, I have added a phrase to the proposed definition that makes clear the knowledge an attorney is deemed to have is personal, not imputed. I understand that some of my academic colleagues may challenge that view in their own comments to the Commission, so I will explain my position briefly.

Clearly, no attorney will in fact be able to act on anything other than personal knowledge; imputation is a fiction that at most creates a duty for attorneys to share information. Suppose, for example, that a litigator in a law firm's St. Louis office knows one fact about a client that seems innocent in itself, while a transactional attorney in the firm's Boston office knows a different, equally innocent fact. If the two attorneys had happened to share the two facts, however, they might have learned something about possible client wrongdoing.

The law implicitly says for purposes of conflicts of interest that all attorneys in a firm are assumed to know whom that firm represents. They do not know that, of course, but the rule works because firms maintain client lists and can do conflicts checks at the outset of a representation. In the case of the random information that I have described, however, imputing information from one attorney to another would be an utter fiction.

The proposed standards should not countenance willful blindness, but neither should they subject an attorney to a professional duty to act upon information the attorney would have no reason to know in the course of his or her ordinary work for a client. If, given the nature of their work for the client, attorneys share files or and regularly read each other's memoranda, for example, under the Commission standards as already proposed one could say that each should be deemed to have actual knowledge of what is in the files. The Commission should not, however, attribute knowledge among people who ordinarily would have no reason to exchange it.

b. The fundamental issue for an attorney under the proposed standards will be what constitutes "evidence of a material violation" and thus what must be documented and reported "up the ladder" pursuant to § 205.3(b). The standard will also be relevant to the issuer, because reports received will require undertaking extensive investigation and potential action by the board or a committee of independent directors. In short, it is important that the definition of "evidence of a material violation" have some outer boundary; otherwise, there may be too many investigations instituted – not too few – as attorneys try to protect themselves against the outside chance that they will be said to have reported too little.

The discussion accompanying the definition in the second paragraph following the text accompanying note 46 in the Commission's proposed standards provides helpful perspective on the scope of intended reporting. The language I have proposed to add is taken directly from that paragraph. Once published in the Code of Federal Regulations, this discussion material is likely to be less accessible to attorneys seeking to comply with § 205.3(b) as the Commission intends. Thus, the addition of the proposed sentence to the rule should focus attorneys on reporting evidence of misconduct that directly puts the issuer at risk of violating the law, but not reporting random information that does not entail a significant risk.

c. Inclusion of the term "similar violation" in Sarbanes-Oxley § 307 was unfortunate because it is understandably hard to know what content, if any, to give to it. Left undefined, however, it is likely to be a source of endless confusion and potential risk for attorneys.

My proposed definition is derived directly from Model Rule 1.13(b) and § 96(2) of the

Restatement. Thus, it reflects matters attorneys should understand they are already required to report within a corporate client. Furthermore, the definition is limiting in the sense that it references a violation of law – something on which the attorney is presumably expert – not simply a business judgment that might turn out later to be unwise but not illegal.

4. While noisy withdrawal represents a possible course for attorneys in a narrow range of cases, it is the ultimate weapon in the attorney's arsenal. Noisy withdrawal should not be required by the Commission, and even its permissive use should be appropriately limited.

Proposed Amendments to the Proposed Rule

a. The alternatives provided in § 205.3(b) & (c) should each be said to satisfy an attorney's reporting obligation completely. Then, § 205.3(d)(1) and references to it should be deleted.

b. In § 205.3(d)(2), at the end of the introductory clause, after the words "property of the issuer or of investors," the word "but" should become "that" and after the words "is not ongoing" the words "but in which the attorney's services were employed and the injury from which can be prevented, rectified or mitigated" should be added.

a. In the discussion section of the proposed standards, at the discussion of § 205.3(c), the Commission acknowledges that "Congress itself did not explicitly direct the Commission to address by rule what an attorney who had reported evidence of a material violation should do in the event that an issuer's directors did not respond appropriately."

The same discussion also says that guaranteeing that a report completely satisfies the attorney's obligation under the regulation "may well encourage attorneys to report evidence of a material violation more promptly" because the attorney will not thereby assume an obligation to evaluate the response to that report and possibly make a noisy withdrawal.

Either of those reasons, taken alone, should convince the Commission of the wisdom of eliminating any requirement for a noisy withdrawal from the proposed rule. Taken together, the need to eliminate the requirement of mandatory action is inescapable.

I have described noisy withdrawal as the attorney's "ultimate weapon." That may be a bit of hyperbole but it makes an important point. Interaction of the proposed standards with state attorney-client privilege and attorney confidentiality requirements is clearly the most sensitive issue for attorneys that the proposed standards present. Indeed, I expect it will be the subject of the most frequent comments the Commission receives.

The proposed standards purport to decree that no disclosure under the standards will result in loss of the attorney-client privilege. Courts tend to be jealous of their right to recognize and construe that privilege, however. Ultimate recognition of the Commission's efforts to

protect the privilege in later state or federal proceedings in which the issuer is involved simply cannot be guaranteed by Commission order.

In general, the proposed standards do a reasonably good job of avoiding conflict with principles of confidentiality except as those are defined in a few states (most prominently California). But I respectfully suggest that the discussion accompanying the standards oversimplifies the state of current law and creates more conflict with that law than is necessary.

The discussion of the proposed standards is clearly correct in saying that disclosure to the CLO and others in the client corporation does not threaten the corporate attorney-client privilege. On the other hand, noisy withdrawal will call attention of many more people, including many outside the corporation, to the fact something may be wrong and thus may result in immediate injury to the corporate client and its shareholders.

At the very least, such a noisy withdrawal could be alleged to be a breach of the attorney's duty of loyalty to the client, particularly where the board itself or a committee of its independent directors has decided that action is not required. Even where the withdrawing attorney turns out to be right about the client's potential violation of law, the need to encourage candor between corporate officials and corporate counsel requires that a noisy withdrawal not be made without clear justification. If the attorney turns out to be wrong about his or her concerns – as certainly may happen in many close cases like my earlier illustration – the need to avoid unwarranted injury to a company and its investors dictates that the noisy withdrawal only be undertaken as a last resort. Use of any weapon of last resort – almost by definition – should not be mandatory.

Furthermore, the authority for such a noisy withdrawal today is derived from the requirement in Model Rule 1.2(d) that an attorney not "counsel a client to engage, or assist a client, in conduct that the attorney knows is criminal or fraudulent." Comment [14] to Model Rule 1.6 goes on:

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

Taken together, these provisions make clear that "noisy withdrawal" is a measure by which an attorney avoids counseling or assisting a client's criminal or fraudulent conduct. It is not a general purpose device by which an attorney calls attention to conduct about which the attorney knows. See also ABA Formal Opinion 92-366 (1992) (attorney who has given opinion based on what attorney now knows to be false information must withdraw from the representation and disavow prior opinion lest it continue to mislead).

I understand that some of my academic colleagues may be telling the Commission that mandatory noisy withdrawal is not so bad because a corporation can always create a QLCC and avoid that possibility. My own reaction to that observation is precisely the opposite. If no mandatory reporting regime is required under a QLCC regime, there should be none under the otherwise largely parallel system in which the report is made initially to the CLO.

Indeed, the effect of deleting § 205.3(d)(1) as I have proposed would be to make the approach for reports to a QLCC in § 205.3(c) also the model for § 205.3(b) reports to a CLO. Presumably, many companies will adopt the QLCC as an effective way to guarantee a thorough, independent analysis of attorney reports. Smaller companies or those with simpler operations might continue to have reports go to the CLO, but either way, the ultimate decision whether a reported problem requires action should rest with the company's directors.

Under § 205.3(b)(3) as currently drafted, the CLO must make a report of remedial action adopted and/or sanctions imposed to the audit committee or the full board. Under § 205.3(b)(4), the original reporting attorney must also report to the audit committee or another committee or the full board if he or she believes the CLO's report is inadequate or untimely.

Thus, what a board or independent board committee will have before it under § 205.3(b) will be the "evidence of a material violation" from the reporting attorney, a response from the CLO saying either that there was no material violation or that it was corrected (which response may itself be based on reports of outside counsel), and a response from the reporting attorney that the CLO's response is inadequate. In short, the board will have before it an honest dispute between reputable attorneys about what the law does or does not require in a particular context.

As argued above, such a dispute among reasonable attorneys presents a classic situation requiring the board members' judgment, not unilateral action by either or both attorneys. Board members might decide to get yet another legal opinion; they might read the opinions they have and conclude they show a business risk but not likely illegality; they might decide that action is indeed illegal or at least too risky. In any event, however, board members and the top officers of the issuer will focus on and be held responsible for their decisions. They will have every incentive to make that decision correctly.

Just as § 205.3(c) would leave the final decision with the directors, § 205.3(b) should as well. Otherwise, the proposed standards will create a situation in which the reporting attorney might consider him- or herself required to take a matter to the Commission, with all the collateral consequences that entails, when the board or its independent directors had decided the proposed conduct was not illegal. Surely, such a result would be totally inconsistent with any reasonable theory of corporate governance.

b. The effect of deleting mandatory withdrawal under § 205.3(d)(1) would be to retain permissive withdrawal under § 205.3(d)(2), (d)(4), § 205.3(e), and § 205.5(d). That is still a lot of the "ultimate" arsenal to retain. However, the amendment I have proposed to (d)(2) is important to bring it into line with current law and the requirements of the other cited sections.

The situation described in proposed § 205.3(d)(2) is one in which the attorney knows a fraud was committed in the past that caused substantial injury to the issuer, its investors or both. Without the amendment that I have proposed, however, the proposed standards assume that the attorney played no part in the misconduct and that nothing can now prevent, mitigate or rectify the consequences of that misconduct. I suggest that the proposed rule should require both attorney involvement and the possibility of doing some good before even permitting a noisy withdrawal.

As discussed above, the theory under which an attorney may engage in noisy withdrawal at all is that it allows the attorney to avoid counseling or assisting a client's crime or fraud. That is the source of the requirement that the attorney have played a part (unknowing to be sure) in the misconduct. Another way of putting this point is that the ultimate weapon is appropriate because the client has duped the attorney into rendering an opinion or otherwise assisting the misconduct.

This state of the law is confirmed by Restatement § 67, which goes farther than any other authority on the subject to permit disclosure of client fraud. That section was drafted carefully and after considerable research and discussion. The Restatement expressly says that disclosure is only permitted where "the client has employed or is employing the attorney's services in the matter in which the crime or fraud is committed." See Restatement § 67(1)(d) and Comments *e & f*.[1]

Further, allowing conduct that clearly can do harm to a client but by definition can do no good for others is more than common sense would permit. The purpose of my amendment is not to perpetuate a cover-up. Indeed, the issuer may conclude that it is better for the issuer to reveal wrongdoing now than to have it discovered later by the Commission or someone else. The amendment simply acknowledges that confidentiality of attorney-client communications is an important value for all issuers of securities and should not be impaired without a reasonable belief that noisy withdrawal will at least mitigate or rectify the consequences of misconduct.

Indeed, proposed standard 205.3(e)(2), corresponding to Model Rule 1.6(b)(2) & (3) as proposed by the ABA Ethics 2000 Commission, imposes exactly the kinds of conditions I am proposing in the above amendment. As I read § 205.3(d)(4), the conditions are implicit there as well. I respectfully suggest that the Commission would get only a minimal number of extra voluntary disclosures or noisy withdrawals by stating a broader right of disclosure than is permitted by current law (and hopefully one day by the Model Rules). The benefits associated with making the Commission's proposed standards consistent with current law – and avoiding unnecessary confusion and conflict with that law – seem likely to be much greater.

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[1]The statement in the discussion paragraph after the text accompanying note 50 that "The ABA's Model Rule 1.16 requires even an advocate in a criminal case to withdraw, unless ordered not to by a court, where continuing the representation 'will result in violation of the rules of professional conduct,' as asserting frivolous defenses would, under Model Rule 3.4" is wrong for many reasons. Suffice it to say that it constitutes no legitimate basis for the position taken in the proposed standards.

Summary and Conclusion

The changes in the proposed standards recommended here are modest and are designed to help make the standards better achieve what Congress and the Commission intended. The changes would focus responsibility for reporting on attorneys who have a current fiduciary duty to a corporate client. They would retain an objective standard by which to judge the attorney's acts, but they would acknowledge the range of conduct in which an attorney might reasonably engage. The changes would better suggest when initial reporting is required, and they would place the decision about how to proceed in the face of legal uncertainty where it belongs, in the board of directors. Noisy withdrawal would not be mandatory, and would be permitted where – but only where – current law developed over many years would permit such action.

In addition, I believe the Commission should create – or ask Congress to create – a safe harbor protection from private suits of at least the same scope and nature granted to auditors by 15 U.S.C. § 78j-1(3)(c). The requirements of § 205.3, even if amended as suggested in these comments, will necessarily involve attorneys struggling in good faith with whether or not a report is required. Especially so long as the report is made only to the corporate client, the Commission presumably will want attorneys, in close cases, to err on the side of reporting.

Nevertheless, it will be inevitable that even internal reports may have a negative effect on the careers of particular officers or employees who may claim defamation. If the report leads ultimately to noisy withdrawal, the damage to the client may be substantial and a claim for breach of fiduciary duty could follow. Even if the attorney were to prevail in such litigation, the cost of defense would likely be significant and anticipation of that cost can be expected to deter reporting early when it might do the most good. Efforts to grant protection against such suits thus seem essential to help achieve the Commission's goal of getting to the level of reporting required in the interest of investors.

Whatever the Commission does will be criticized by some, but with the changes proposed here, I respectfully suggest that the Commission's proposed standards will make an important contribution to corporate governance and corporate responsibility.