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SEC Adopts Standards of Professional Conduct for Attorneys

The SEC has adopted new rules establishing standards of professional conduct for attorneys who appear and practice before the SEC on behalf of issuers. The rules implement Section 307 of the Sarbanes-Oxley Act (the "Act"), which directs the SEC to adopt rules setting forth minimum standards of professional conduct for attorneys.

Although modified from the SEC's original proposal, the new rules will significantly impact the role of attorneys representing issuers. The rules:

- require an attorney to immediately report evidence of a material violation of U.S. federal or state law or a material breach of fiduciary duty or similar duty by an issuer or any agent of the issuer to the issuer's chief legal officer ("CLO") or the CLO and the chief executive officer ("CEO"); and

- unless the attorney reasonably believes the CLO or CEO has responded appropriately within a reasonable time, require the attorney to report the evidence "up the ladder" to the audit committee, another committee of independent directors, or the full board of directors.

The rules also provide an alternative avenue of reporting evidence of a material violation to a Qualified Legal Compliance Committee (a "QLCC") if the issuer has established one.

Due to the complexity of the issue and extensive public comment, the SEC did not adopt the "noisy withdrawal" provisions contained in the originally proposed version of the rules. These provisions would have required, in certain circumstances, attorneys to withdraw from a client representation, notify the SEC of an issuer's material violation and disaffirm any SEC-filed documents that the attorney reasonably believed to be materially false or materially misleading. The SEC has extended the comment period for those provisions for an additional 60 days and has also proposed an alternative issuer reporting-out option, described in Section VI below.

The rules apply to all attorneys, U.S. and foreign, with a broad exclusion for foreign attorneys who are not admitted to practice in the United States and do not advise their clients on U.S. law.

The rules will become effective August 5, 2003.

I. Who is Covered

The new rules apply to any attorney appearing and practicing before the SEC in the representation of an issuer. The rules provide that "issuer" includes any person controlled by an issuer, where an attorney provides legal services to such person on behalf of, or at the behest, or for the benefit of the issuer, regardless of whether the attorney is employed or retained by the issuer. The term "issuer" does not include a foreign government issuer.

Under the rules, an "attorney" is a person who is admitted, licensed, or otherwise qualified to practice law in any jurisdiction, domestic or foreign, or who holds himself or herself out as admitted, licensed, or otherwise qualified to practice law.

"Appearing and practicing" before the SEC is defined to include the following:

- transacting any business with the SEC, including communications in any form;
- representing an issuer in an SEC administrative proceeding or in connection with any SEC investigation, inquiry, information request, or subpoena;
- providing advice with respect to U.S. securities laws or any SEC rule or regulation regarding any document that the attorney has notice will be filed with, submitted to, or incorporated into any document that will be filed with or submitted to, the SEC, including any advice with respect to the preparation, or participation in the preparation, of any document to be filed with the SEC; or
- advising an issuer as to whether information or a statement, opinion, or other writing is required under the U.S. securities laws or the SEC's rules or regulations to be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the SEC.

The rules set forth two exclusions from the definition of "appearing and practicing": (i) "non-appearing foreign attorneys" and (ii) those attorneys who conduct activities set forth in the definition other than in the context of providing legal services to an issuer with whom the attorney has an attorney-client relationship.

A "non-appearing foreign attorney" is an attorney who:

- is admitted to practice law in a jurisdiction outside the United States;
- does not hold himself or herself out as practicing, and does not give legal advice regarding, U.S. federal or state securities or other laws (except for appearing before the SEC in consultation with U.S. counsel as permitted by the rules); and
- either:
    - conducts activities that would constitute appearing and practicing before the SEC only incidentally to, and in the ordinary course of, the practice of law in a jurisdiction outside the United States; or

- is appearing and practicing before the SEC only in consultation with counsel, other than a non-appearing foreign attorney, admitted or licensed to practice in a state or other U.S. jurisdiction.

As a result, the final rules, unlike the proposed rules, will exclude most (but not all) foreign attorneys. Nevertheless, non-United States attorneys who do not hold themselves out as practicing U.S. law, but who engage in activities that would constitute appearing and practicing before the SEC, are subject to the new rules unless they appear and practice only incidentally to their foreign law practice or in consultation with U.S. counsel.

In the adopting release, the SEC stated that an attorney need not serve in the legal department of an issuer to be covered by the rules, but he or she must provide legal services to an issuer within the context of an attorney-client relationship. Whether such a relationship exists, in the SEC's opinion, will be a federal question and, in general, will turn on the expectations and understandings between the attorney and the issuer. An attorney-client relationship may exist even in the absence of a formal retention. Moreover, an attorney-client relationship within the meaning of the new rules may exist even though the attorney-client privilege would not be available with respect to communications between the attorney and the issuer. In addition, the SEC noted that the rules exclude from their coverage attorneys at public broker-dealers and other issuers who are licensed to practice law and who may transact business with the SEC, but who are not in the legal department and do not provide legal services within the context of an attorney-client relationship.

II. What Must Be Reported – Evidence of a Material Violation

Under the rules, an attorney who becomes aware of evidence of a material violation of U.S. federal or state securities laws or a material breach of fiduciary duty or similar duty under U.S. federal, state or common law or a similar material violation of any U.S. federal or state law by the issuer or by any officer, director, employee or agent of the issuer, is required to report such evidence immediately to the issuer's CLO (or the equivalent) or the CLO and its CEO (or the equivalents).

The rules set forth that a "material violation" means a material violation of an applicable U.S. federal or state securities law, a material breach of fiduciary duty arising under U.S. federal or state law, or a similar material violation of any U.S. federal or state law. Material violations covered by the rules must arise under U.S. law and do not include violations of foreign laws. The final rules do not define the word "material," because, in the SEC's view, that term has a well-established meaning under the federal securities laws and the SEC intends for that same meaning to apply in the rules.

"Breach of fiduciary duty" refers to any breach of fiduciary or similar duty to the issuer recognized under an applicable federal or state statute or at common law, including but not limited to, misfeasance, nonfeasance, abdication of duty, abuse of trust, and approval of unlawful transactions.

The reporting obligation, based on the definition of "evidence of a material violation," would be triggered only when there is credible evidence of a material violation, based upon which "it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur." This standard is intended to be objective, while at the same time recognizing that there is a range of conduct in which an attorney may engage without being unreasonable. The "circumstances" in which the attorney decides whether he or she is obligated to make a report, may include, among others, the attorney's professional skills, background and experience, the time constraints under which the attorney is acting, the attorney's previous experience and familiarity with the client, and the availability of other lawyers with whom the lawyer may consult.

The SEC noted that the threshold for initial reporting would be too high if it were triggered only when the attorney knows that a material violation has occurred or when the attorney concludes there has been a violation, and no reasonable fact-finder could conclude otherwise. In order to be "reasonably likely," a material violation must be more than a mere possibility, but it need not be "more likely than not." The use of the term "reasonably likely" is meant to be consistent with the use of the term in connection with the SEC's recent rules governing the disclosure of off-balance sheet arrangements. According to the adopting release, if a material violation is reasonably likely, an attorney must report evidence of this violation.

III. "Up the Ladder" Reporting Procedure

A. Initial Report to CLO or CLO and CEO

Under the rules, an attorney must make an initial report to the issuer's CLO or to both the issuer's CLO and its CEO as soon as the attorney becomes aware of such a violation. The "report" called for by the new rules may be made by telephone, by e-mail, electronically, or in writing.

B. No Contemporaneous Record Requirements

The documentation requirements set forth in the proposed rules and imposed on the reporting attorney and the CLO or CEO who receives the report have been eliminated in the final rules. The SEC stated however, that in the absence of an affirmative rule, prudent counsel would, in all likelihood, consider whether to advise a client in writing that it may be violating the law. In other situations, responsible corporate officials may direct that such matters be documented.

C. Chief Legal Officer's Duty to Investigate

Once a report of evidence of a material violation is received, the CLO (or the equivalent) is required to conduct or cause an inquiry into the evidence of a material violation as he or she reasonably believes is appropriate to determine whether the material violation described in the report has occurred, is ongoing, or is about to occur. If the CLO determines

no material violation has occurred, is ongoing, or is about to occur, he or she is required to notify the reporting attorney and advise the reporting attorney of the basis for this determination.

Alternatively, in lieu of causing an inquiry by the CLO and CEO as described above, a CLO may refer a report of evidence of a material violation to a qualified legal compliance committee (a "QLCC," as described below), if the issuer has duly established a QLCC prior to the report of evidence of a material violation. If the CLO refers the report to a QLCC, the CLO shall inform the reporting attorney of this fact. Thereafter, the QLCC is responsible for responding to the evidence.

D. Appropriate Response to the Report

A reporting attorney who receives what he or she reasonably believes is an appropriate and timely response to a report he or she has made, has satisfied his or her reporting obligations. Unless the CLO reasonably believes that no material violation has occurred, is ongoing, or is about to occur, he or she shall take all reasonable steps to cause the issuer to adopt an appropriate response, and shall so advise the reporting attorney.

Unless the reporting attorney reasonably believes that the issuer has made an appropriate response within a reasonable time, the attorney shall explain to the CLO or the CEO his or her reasons for the conclusion that the response was not appropriate.

As noted above, the initially proposed "noisy withdrawal" provisions have been deferred for further comment. In addition, provisions that require the reporting attorney to notify the SEC that a material violation has occurred (if that is the result of the report) and then disaffirm in writing any SEC-filed documents that the reporting attorney reasonably believes are false or materially misleading, have also been set aside from the final rules for additional comment.

The rules define an "appropriate response" as a response to a reporting attorney, as a result of which the attorney reasonably believes:

- that no material violation has occurred, is ongoing, or is about to occur;
- that the issuer has, as necessary, adopted appropriate remedial measures, including appropriate steps or sanctions to stop any material violations that are ongoing, to prevent any material violation that has yet to occur, and to remedy or otherwise appropriately address any material violation that has already occurred and to minimize the likelihood of its recurrence; or
- that the issuer, with the consent of the issuer's board of directors, a committee thereof to whom a report of a material violation could be made or a QLCC, has retained or directed an attorney to review the reported evidence of a material violation and either:

- has substantially implemented any remedial recommendations made by such attorney after a reasonable investigation and evaluation of the reported evidence; or

- has been advised that such attorney may, consistent with his or her professional obligations, assert a colorable defense on behalf of the issuer (or the issuer's officer, director, employee, or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to the reported evidence of a material violation.

In the adopting release, the SEC emphasized that its intent is to permit attorneys to exercise their judgment so long as it is reasonable. The SEC noted that it will consider attendant circumstances in determining whether an attorney could reasonably believe that an issuer's response is appropriate. In the SEC's view, such circumstances may include the amount and weight of evidence of the material violation, the severity of the violation, the scope of the investigation with respect to the report and that an attorney may rely on reasonable and appropriate factual representations and legal determinations of persons on whom a reasonable attorney would rely. A reporting attorney may not rely on assurances from an issuer's CLO that there was no material violation or that the issuer was undertaking an appropriate response as dispositive.

The SEC also stated that by requiring that the board, an independent committee or a QLCC consent to the retention of counsel to review the reported evidence of a material violation, the rules are intended to protect against the possibility that a CLO would avoid further reporting "up the ladder" by merely retaining a new attorney to investigate so as to assert a colorable, but perhaps weak, defense. The SEC further emphasized that the issuer has no right to use an attorney to conceal ongoing violations or plan further violations of law.

E. Reporting a Material Violation "Up the Ladder"

Unless an attorney who has made an initial report reasonably believes that the CLO or CEO of the issuer has provided an appropriate response within a reasonable time, the attorney shall report the evidence of a material violation "up the ladder" to:

- the audit committee of the issuer's board of directors;

- another committee of independent directors (if the issuer's board of directors has no audit committee); or

- the issuer's full board of directors (if the issuer does not have another committee of independent directors).

Under the rules, if the attorney reasonably believes that it would be futile to report evidence of a material violation to the CLO and CEO, the attorney may report the evidence of a material violation directly to the issuer's audit committee, another committee of independent directors or the full board.

A reporting attorney who has reported a matter all the way "up the ladder" within the issuer and who reasonably believes that the issuer has not responded appropriately must explain his or her reasons for so believing to the CLO, CEO or directors to whom the attorney reported the evidence of a material violation.

IV. Alternative Reporting to a Qualified Legal Compliance Committee

The rules also provide an alternative system for reporting evidence of material violations to a QLCC. If an attorney becomes aware of evidence of a material violation by the issuer or by any officer, director, employee or agent of the issuer, the attorney may, as an alternative to making a report to the CLO or the other channels described above, report such evidence of a material violation to a QLCC, if the issuer has previously formed such a committee.

The rules also provide that, in lieu of conducting his or her own inquiry, a CLO who receives a report of evidence of a material violation may refer the report to a previously established QLCC. The CLO shall inform the reporting attorney that the report has been referred to a QLCC and thereafter, the QLCC shall be responsible for responding to the evidence of a material violation reported to it.

An issuer may, but is not required, to establish a QLCC. The rules state that the QLCC may be the same as the audit committee or another committee of the issuer. The rules provide that if established, a QLCC must:

- consist of at least one member of the issuer's audit committee (or, if the issuer has no audit committee, an equivalent committee of independent directors) and two or more members of the issuer's board of directors who are not employed, directly or indirectly, by the issuer;

- adopt written procedures for the confidential receipt, retention and consideration of any report of evidence of a material violation;

- be duly established by the issuer's board of directors, with the authority and responsibility:

    - to inform the issuer's CLO and CEO (or the equivalents) of any report of evidence of a material violation (except when such a report would be futile, in which case a report is made directly to the audit committee, another committee of independent directors, or to the full board);

    - to determine whether an investigation is necessary regarding any report of evidence of a material violation by the issuer, its officers, directors, employees or agents and, if it determines that an investigation is necessary or appropriate, to:

        - notify the audit committee or the full board of directors;

  - initiate an investigation, which may be conducted either by the CLO or by outside attorneys; and

  - retain such additional expert personnel as the committee deems necessary.

- at the conclusion of any such investigation regarding a material violation, to:

  - recommend, by majority vote, that the issuer implement an appropriate response to evidence of a material violation; and

  - inform the CLO and CEO and the board of directors of the results of any such investigation and the appropriate remedial measures to be adopted; and

- acting by majority vote, to take all other appropriate action, including the authority to notify the SEC in the event that the issuer fails in any material respect to implement an appropriate response that the QLCC has recommended the issuer to take.

The originally proposed rules did not specify whether the QLCC could act if its members did not all agree. The SEC has therefore added majority vote requirements to the various provisions set forth above.

If an attorney reports a material violation to a QLCC, he or she would be deemed to satisfy his obligation to report and would not be required to assess the issuer's response to the reported evidence of a material violation. The SEC has indicated that this type of provision may encourage attorneys to report evidence of a material violation more promptly, because the reporting attorney would not have to worry that he or she might ultimately be obliged to decide whether the issuer's response was "appropriate." Instead, if the issuer fails, in any material respect to take any remedial action that the QLCC has recommended, then the QLCC, as well as the CLO and CEO, all have the authority to take appropriate action, including notifying the SEC if the issuer fails to implement an appropriate response recommended by the QLCC.

The adopting release provided that an issuer is not required to form a QLCC as a new corporate structure, but that it may be formed from the issuer's current audit or other committee, so long as the committee meets the criteria of a QLCC and agrees to function as a QLCC in addition to its other responsibilities. The SEC also noted that it expects a high degree of independence in QLCC members and it therefore anticipates that the QLCC provisions relating to committee member independence will be amended to conform to the final rules defining who is an "independent" director under Section 301 of the Act. The SEC noted that service on a QLCC is not intended to increase the liability of any director under state law and, indeed, the SEC expressly stated that it would be contrary to the public interest for a court to so conclude.

V. Attorneys Retained to Investigate Evidence of Material Violations Have No Obligation To Report

The final rules set forth new provisions not in the originally proposed release, which allow an attorney retained or directed by the issuer or the QLCC, as applicable, in connection with an investigation regarding evidence of a material violation, to be excluded from reporting obligations under the rules.

An attorney shall not have any obligation to report evidence of a material violation under the new rules if:

- the attorney was retained or directed by the issuer's CLO to investigate such evidence of a material violation and:
    - the attorney reports the results of such investigation to the CLO; and
    - except where the attorney and the CLO each reasonably believes that no material violation has occurred, is ongoing, or is about to occur, the CLO reports the results of the investigation to the issuer's board of directors, a committee thereof to whom a report could be made pursuant to the rules, or a QLCC; or
- the attorney was retained or directed by the CLO to assert, consistent with his or her professional obligations, a colorable defense on behalf of the issuer (or the issuer's officer, director, employee, or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to such evidence of a material violation, and the CLO provides reasonable and timely reports on the progress and outcome of such proceeding to the issuer's board of directors, a committee thereof to whom a report could be made pursuant to the rules, or a QLCC.

In addition, the rules provide a similar exclusion from the reporting requirements if an attorney is retained or directed by the issuer's QLCC in connection with an investigation regarding evidence of a material violation. The rules specifically state that an attorney shall not have any obligation to report evidence of a material violation if that attorney was retained or directed by a QLCC:

- to investigate such evidence of a material violation; or
- to assert, consistent with his or her professional obligations, a colorable defense on behalf of the issuer (or the issuer's officer, director, employee, or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to such evidence of a material violation.

The rules provide that an attorney retained or directed by an issuer to investigate evidence of a material violation shall still be deemed to be "appearing and practicing" before the SEC. The rules further make clear that directing or retaining an attorney to investigate

reported evidence of a material violation does not relieve an officer or director to whom such evidence is reported from a duty to respond to the reporting attorney.

VI. "Noisy Withdrawal" Provisions and Alternative Issuer Reporting-Out Proposal

A. "Noisy Withdrawal"

SEC did not adopt, and is instead seeking further public comment on, the "noisy withdrawal" provisions of the originally proposed rules. Under this proposal, attorneys who have made a report all the way "up the ladder" pursuant to the procedures described above and have not received an appropriate response in a reasonable time, and reasonably believe that the reported material violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interest of the issuer or of investors, would be required to:

- withdraw from the representation;
- notify the SEC, within one business day after withdrawing, indicating that the withdrawal was for "professional considerations;" and
- promptly disaffirm to the SEC any submission that the attorney has prepared or assisted in preparing that the attorney reasonably believes is, or may be, materially false or misleading.

The above provisions would apply to both in-house and outside counsel. However, unlike outside counsel, in-house counsel may, but would not be required, to resign.

The proposed rules provide that, if the material violation at issue has already occurred, but is not ongoing and is likely to have resulted in substantial financial injury to the issuer or investors, the reporting attorney may, but would not be required, to withdraw, notify the SEC, and disaffirm false or misleading submissions the attorney has prepared or assisted in preparing. Under the "noisy withdrawal" proposal, an ongoing violation would include an inaccurate disclosure in a submission to the SEC that has not been corrected and may be relied on by investors.

The "noisy withdrawal" proposal would further require the CLO to notify any attorneys retained or employed to replace the attorney who has withdrawn that the previous attorney withdrew based on professional considerations. In the case of withdrawal for professional considerations in connection with evidence of an issuer's past material violation, the same disclosure obligation would be imposed on the CLO.

B. Alternative Issuer Reporting-Out Proposal

As an alternative to the "noisy withdrawal" provisions, the SEC has proposed a separate set of provisions which, if adopted, would impose additional disclosure responsibilities on the issuer instead of the withdrawing attorney, in the event of a withdrawal

by an attorney following a failure to receive an appropriate response to evidence of a material violation.

The SEC's alternative proposal requires an issuer to report to the SEC an attorney's written notice of withdrawal or failure to receive an appropriate response. The SEC has also proposed to amend Forms 8-K, 20-F and 40-F to require issuers to disclose publicly an attorney's written notice of withdrawal within two business days of that notice.

Under the SEC's alternative proposal, if the issuer does not comply with the proposed rules, an attorney may (but is not required) to inform the SEC of his or her withdrawal. The alternative proposal does not contain "noisy withdrawal" or disaffirmation requirements and requires attorney action only where the attorney reasonably concludes that there is substantial evidence that a material violation is ongoing or is about to occur and is likely to cause substantial financial injury to the issuer or investors.

Specifically, the proposed issuer reporting-out rules state that where an attorney who has reported evidence of a material violation to the CLO or CLO and CEO (as opposed to a QLCC):

- does not receive an appropriate response, or has not received a response in a reasonable time;
- has reported the evidence of a material violation "up the ladder" within the issuer's corporate structure as provided by the new rules; and
- reasonably concludes that there is substantial evidence of a material violation that is ongoing or is about to occur and is likely to cause substantial injury to the financial interest or property of the issuer or of investors:
    - an attorney retained by the issuer shall withdraw from representing the issuer, and shall notify the issuer, in writing, that the withdrawal is based on professional considerations; and
    - an attorney employed by the issuer shall immediately cease from participating or assisting in any matter concerning the violation and shall notify the issuer, in writing, that he or she believes that the issuer has not provided an appropriate response in a reasonable time to his or her report of evidence of a material violation.

The proposed rules further provide that:

- An attorney shall not be required to take any action, if the attorney would be prohibited from doing so by order of any court, or similar authority, after having sought leave to withdraw from representation or to cease participation or assistance in a matter.
- An attorney would be required to give notice to the issuer that, but for such prohibition, he or she would have taken such action pursuant to the proposed

rules, and such notice would be deemed the equivalent of such action for purposes of the proposed rules.

- An attorney employed or retained by an issuer who has reported evidence of a material violation and reasonably believes that he or she has been discharged for so doing shall immediately notify the issuer's CLO.

- The issuer's CLO shall notify any attorney retained or employed to replace an attorney who has given notice to an issuer that the previous attorney has withdrawn, ceased to participate or assist or has been discharged, as the case may be.

Once an attorney has provided an issuer with a written notice of withdrawal, intended withdrawal or discharge related to the reporting of evidence of a material violation, the issuer shall, within two business days of receipt of such notice, report such notice and the related circumstances on Form 8-K, 20-F or 40-F, as applicable. The proposed amendments to these forms provide that Forms 20-F and 40-F may consist of only the facing page of the form, the information required under the appropriate item of the form, and a signature page.

The SEC seeks comments in determining whether an issuer should be permitted not to disclose an attorney's written notice in circumstances where a committee of independent directors of the issuer's board may determine, based on the advice of counsel not involved in the matters underlying the reported material violation, that the attorney providing such written notice acted unreasonably in providing such notice, or that the issuer has, subsequent to such written notice, implemented an appropriate response.

If an issuer does not comply with the filing requirements in the proposed rules, an attorney retained or employed by the issuer may inform the SEC that the attorney has provided the issuer with notice, indicating that the withdrawal or attempted withdrawal was based on professional considerations.

The SEC is soliciting comments for an additional 60 days on the "noisy withdrawal" provisions previously proposed, these alternative issuer reporting-out provisions, and on the final rules adopted by the SEC under Section 307 of the Act which may be affected by the remaining proposed provisions, if adopted.

VII. Issuer Confidentiality Issues

The rules provide that a report of a material violation (or contemporaneous record) or any response (or contemporaneous record) may be used by an attorney in connection with any investigation, proceeding or litigation in which the attorney's compliance with the rules are in issue.

The rules also provide that an attorney may reveal to the SEC, without the issuer's consent, confidential information related to the representation of the issuer, to the extent the attorney reasonably believes necessary:

- to prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;

- to prevent the issuer, in a SEC investigation or administrative proceeding from committing perjury, suborning perjury, or committing any act that is likely to perpetrate a fraud upon the SEC; or

- to rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.

VIII. Final Rules Govern in Conflicts with State Law

The final rules provide that the standards set forth in the rules supplement applicable standards of any jurisdiction where an attorney is admitted or practices and are not intended to limit the ability of any jurisdiction to impose additional, higher obligations on an attorney not inconsistent with the application of the rules. Where the standards of a state or other U.S. jurisdiction where an attorney is admitted or practices conflict with the rules, the SEC's rules shall govern.

IX. Discharge

Under the rules, an attorney formerly employed or retained by an issuer who reasonably believes that he or she has been discharged because he or she fulfilled the reporting obligation imposed by the new rules may, but is not required, to notify the issuer's board of directors or any committee of the board, that he or she believes that he or she was discharged for reporting evidence of a material violation. The SEC emphasized that this provision is an important corollary to the up-the-ladder reporting requirement, and is designed to ensure that a CLO (or the equivalent) is not permitted to block a report of a material violation by discharging a reporting attorney.

X. Responsibilities of Supervisory and Subordinate Attorneys

The rules detail the respective responsibilities of supervisory and subordinate attorneys, employed in-house by the issuer and those serving as outside counsel retained by the issuer. The provisions in the rules define "supervisory attorney" to include attorneys who are also "appearing and practicing" before the SEC, as opposed to those just having general supervisory authority. Specifically, the rules provide that:

- an attorney supervising or directing another attorney who is appearing and practicing before the SEC in the representation of an issuer is a supervisory attorney and that an issuer's CLO (or the equivalent) is deemed to be a supervisory attorney;

- a supervisory attorney shall make reasonable efforts to ensure that a subordinate attorney that he or she supervises or directs, complies with the rules;

- to the extent a subordinate attorney appears and practices before the SEC in the representation of an issuer, the supervisory attorneys of such subordinate are also deemed to appear and practice before the SEC;

- a supervisory attorney is responsible for complying with the reporting requirements in the rules when a subordinate attorney has reported evidence of a material violation to the supervisory attorney;

- a supervisory attorney who has received a report of evidence of a material violation from a subordinate attorney under the rules may report such evidence to the issuer's QLCC if the issuer has duly formed such a committee.

The final rules clarify that only an attorney who actually directs or supervises the actions of a subordinate attorney "appearing and practicing" before the SEC is deemed to be a supervisory attorney under the rules and that an attorney who supervises or directs a subordinate on other matters unrelated to the subordinate's "appearing and practicing" before the SEC would not be deemed to be a supervisory attorney. Conversely, an attorney who typically does not exercise authority over a subordinate attorney but who does direct the subordinate attorney in the specific matter involving the subordinate's appearance and practice before the SEC is deemed to be a supervisory attorney under the final rules.

In order to set it aside for further comment, the rules eliminated the "noisy withdrawal" requirement with respect to a subordinate attorney who reasonably believes that a supervisory attorney to whom he or she has reported evidence of a material violation has failed to comply with the reporting requirements of the rules.

The final rules set forth the following responsibilities with respect to subordinate attorneys:

- An attorney who appears and practices before the SEC in the representation of an issuer on a matter under the supervision or direction of another attorney (other than under the direct supervision or direction of the issuer's CLO) is a subordinate attorney.

- A subordinate attorney is required to comply with the rules notwithstanding that the subordinate attorney acted at the direction of or under the supervision of another person.

- A subordinate attorney complies with the rules if the subordinate attorney reports to his or her supervising attorney evidence of a material violation of which the subordinate attorney has become aware in appearing and practicing before the SEC.

- A subordinate attorney may take the steps permitted or required by the rules if the subordinate attorney reasonably believes that a supervisory attorney to whom he or she has reported evidence of a material violation has failed to comply with the rules.

The rules provide that an attorney who appears and practices before the SEC on a matter in the representation of an issuer under the supervision or direction of the issuer's CLO is not a subordinate attorney. Accordingly, that person is required to comply with the reporting requirements of the rules. The SEC gave as an example a Deputy General Counsel (DGC) who reports directly to the issuer's General Counsel (CLO) on a matter before the SEC, and emphasized that in such a case, the DGC is not a subordinate attorney. Thus, the DCG is not relieved of any further reporting obligations by advising the CLO of evidence of a material violation and if the DGC does not receive an appropriate response from the CLO, he or she is obligated to report further up-the-ladder within the issuer.

XI. Sanctions and Discipline

The SEC initially entitled this section "Sanctions" in the originally proposed version of the rules, but has renamed it "Sanctions and Discipline" to emphasize that the SEC intends to proceed against individuals violating the new rules as it would against other violators of the federal securities laws. Violations will be treated as civil violations of the federal securities laws and subject the violator to all the civil penalties and remedies available under the federal securities laws.

The rules include the following sanction and discipline provisions:

- An attorney appearing and practicing before the SEC who violates any provision of the rules is subject to the disciplinary authority of the SEC, regardless of whether the attorney may also be subject to discipline for the same conduct in a jurisdiction where the attorney is admitted or practices.

- An administrative disciplinary proceeding initiated by the SEC for violation of the rules may result in an attorney being censured, or being temporarily or permanently denied the privilege of appearing or practicing before the SEC.

- An attorney who complies in good faith with the provisions of the new rules shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices.

- An attorney practicing outside the United States shall not be required to comply with the requirements of the new rules to the extent that such compliance is prohibited by applicable foreign law.

XII. No Private Right of Action

The rules provide a new safe harbor provision to shield attorneys who comply with the rules from private civil suits. The SEC is of the opinion that, for the safe harbor to be truly effective, it must extend to both compliance and non-compliance under the rules. The rules therefore provide that:

- nothing in the rules is intended to, or does, create a private right of action against any attorney, law firm, or issuer based upon compliance or noncompliance with their provisions; and

- authority to enforce compliance with the new rules is vested exclusively in the SEC.

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The summary of the newly adopted and proposed rules set forth herein is intended to be general in nature. This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. Questions concerning issues addressed in this memorandum should be directed to any member of the Paul Weiss Securities Group, including:

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