

December 2, 2002

**SEC Issues Proposed Rule Concerning
Standards of Professional Conduct for Attorneys**

Section 307 of the Sarbanes-Oxley Act (the “Act”) directs the SEC to establish a rule setting forth minimum standards of professional conduct for attorneys appearing and practicing before the SEC. On November 21, 2002, the SEC issued a proposed rule to implement Section 307 of the Act.

The comment period on the proposed rule ends December 18, 2002.

The full text of the rule proposal is available on the SEC’s website at <http://www.sec.gov/rules/proposed/33-8150.htm>.

Reporting Obligations

The SEC’s proposed rule would require an attorney who appears and practices before the SEC in the representation of an issuer to report evidence of a material violation of the securities laws, a material breach of fiduciary duty, or a similar material violation to the issuer’s chief legal officer or to the issuer’s chief legal officer and CEO. An attorney’s reporting obligation is triggered when the attorney becomes aware of information that would lead a reasonable attorney to believe a material violation has occurred, is occurring or is about to occur.

The attorney must also take reasonable steps to document his or her reports, as well as any response received from the chief legal officer or CEO, and retain the documentation for a reasonable time. In its rule proposal, the SEC stated that keeping such documentation will protect the attorney in the event his or her compliance with the proposed rule is questioned at some future date.

Upon receiving a report of a possible material violation, the chief legal officer would be obligated to conduct a reasonable inquiry to determine whether the reported material violation has occurred, is occurring or is about to occur. If the chief legal officer reasonably concludes that there has been no material violation, he must notify the reporting attorney of this conclusion. If the chief legal officer concludes that a material violation has occurred, is occurring or is about to occur, he must take reasonable steps to ensure that the issuer adopts appropriate remedial measures

and/or sanctions, including appropriate disclosures. Additionally, the chief legal officer must report “up the ladder” within the company what remedial measures have been adopted or sanctions imposed and advise the reporting attorney of his conclusions.

If the reporting attorney receives an appropriate response within a reasonable time and has taken the necessary steps to document both the report and the response to it, the reporting attorney would have satisfied his obligations under the proposed rule. If, however, the reporting attorney does not receive an appropriate response within a reasonable time, he would be required to report the evidence of a material violation to the company’s audit committee, or, if the company does not have an audit committee, to another committee of independent directors, or to the full board if the company does not have another committee of independent directors. If an attorney who has reported a matter all the way “up the ladder” reasonably believes that the company has not responded appropriately, the rule would require the attorney to take reasonable steps to document the response or absence thereof.

The proposed rule also provides an alternative system for an attorney to report evidence of a material violation . A company may establish a qualified legal compliance committee (“QLCC”) composed of at least one member of the company’s audit committee and two or more independent board members for the purpose of investigating an attorney’s report of a material violation. The rule would provide that the QLCC must have the authority and responsibility to conduct any necessary inquiry into the reported evidence, to require the company to adopt appropriate remedial measures to prevent an ongoing violation or alleviate a past, material violation and to notify the SEC of the material violation and disaffirm any tainted document submitted to the SEC. The QLCC would also be required to notify the board, the CEO and the chief legal officer of the results of any inquiry and the remedial measures the QLCC decided were appropriate. If the company fails to take the remedial measures directed by the QLCC, each member of the QLCC, the CEO and the chief legal officer would each be individually responsible for notifying the SEC of the material violation and for disaffirming any tainted submission to the SEC. A chief legal officer may also refer a report to the QLCC in lieu of conducting his own inquiry.

Further Obligations If The Attorney Does Not Receive an Appropriate Response

An attorney who does not receive an appropriate response from the company would have further obligations under the proposed rule. In this regard, the proposed rule distinguishes between inside and outside counsel.

Outside attorneys who have made a report and have not received an appropriate response and who 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 interests of the company or its investors would be required to:

1. Withdraw from representing the company, indicating that the withdrawal is based on professional considerations;
2. Within one business day of withdrawing, notify the SEC in writing of their withdrawal, indicating that the withdrawal was based on professional considerations; and
3. Disaffirm any submission to the SEC that they have participated in preparing and that they believe is tainted by the violation.

In-house attorneys who reasonably believe that the reported violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interests of the company or its investors would be required to disaffirm to the SEC any tainted submission they have participated in preparing, but would not be required to resign.

In the event an attorney reasonably believes that a material violation has already occurred and has no ongoing effect, the attorney would be permitted, but not required, to take the steps described above, provided, however, he or she also reasonably believes that the reported material violation is likely to have caused substantial injury to the financial interests of the issuer or its investors.

What is Evidence of a Material Violation

Under the proposed rule, a material violation is defined as a material violation of the securities laws, a material breach of fiduciary duty, or a similar material violation. The proposed rule defines “evidence of a material violation” as information that would lead an attorney reasonably to believe that a material violation has occurred, is occurring or is about to occur. In its rule proposal, the SEC stated that this objective standard is intended to preclude reports based on mere suspicion of a material violation while providing reasonable flexibility to

attorneys when evaluating their reporting obligations. An attorney would not be excused from reporting evidence of a material violation on the grounds that he does not personally believe a material violation has occurred, is occurring or is about to occur.

Under the proposed rule, an ongoing violation includes an inaccurate disclosure in a filing with or submission to the SEC that has not been corrected and may be relied on by investors.

What is an Appropriate Response

The proposed rule would impose on attorneys additional reporting obligations if they do not receive an appropriate response to a report of evidence of a material violation. The proposed rule provides that a response would be deemed appropriate if it provides a basis for the reporting attorney reasonably to believe that: (1) no material violation is occurring, has occurred or is about to occur; or (2) the company has, as necessary, adopted remedial measures, including appropriate disclosures, and/or imposed sanctions that can be expected to stop any material violation that is occurring, prevent any material violation that has yet to occur and/or rectify any material violation that has already occurred.

Definition of Appearing and Practicing Before the Commission

The proposed rule would apply to attorneys appearing and practicing before the SEC in the representation of a public company. The proposed rule would broadly define the term “appearing and practicing before” the Commission. The term would include representation of a company during the course of an investigation or inquiry conducted by the SEC. The proposed rule specifically provides that an attorney appears and practices before the Commission if he (1) advises a company that a statement, opinion or other writing does not need to be filed with or incorporated into any type of submission to the SEC; or (2) that the company is not required to submit or file any registration statement, notification, application, report, communication or other document with the SEC. Moreover, under the proposed rule, the term’s definition makes clear that it covers all communications (oral or written) with the SEC on behalf of a company, as well as the preparation of any statement, opinion or other writing submitted to the SEC.

Under the proposed rule, an attorney would not be deemed appearing and practicing before the SEC if his representation of a company involved no business or communication with the SEC, no participation in an SEC process and no assistance in the preparation of materials submitted to the SEC.

Disclosure of Confidential Information

The proposed rule would allow an attorney to disclose, under certain circumstances, confidential information related to his or her appearance and practice before the SEC in the representation of an issuer. Under the proposed rule, an attorney would be allowed to use documentation he prepared under the rule to defend against charges of attorney misconduct. The rule would also allow an attorney to reveal confidential information to the extent necessary to prevent the commission of an illegal act that the attorney reasonably believes would result either in the perpetration of a fraud on the SEC or in substantial injury to the financial or property interests of the company or its investors. Similarly, an attorney would be allowed to disclose confidential information to rectify a company's illegal actions when such actions have been advanced by the company's use of the attorney's services.

Responsibilities of Supervisory and Subordinate Attorneys

Under the proposed rule, an individual serving as the chief legal officer of a company (or who serves in an equivalent role) is a supervisory attorney. The rule proposal would place responsibility for compliance with the rule's reporting requirements and documentation obligations on the supervisory attorney after he has been informed by a subordinate of evidence of a material violation.

Subordinate attorneys would not be exempt from the rule. They will be deemed to have complied with the rule where they report evidence of material violations they learn about to their supervisory attorney. In addition, a subordinate attorney who reports evidence of a material violation to a supervisory attorney and who believes that the supervisory attorney has failed to comply with the reporting requirements of the rule, would be permitted, but not obligated, to report the evidence "up the ladder" within the company.

Where a company has no general counsel or chief legal officer, the proposed rule provides that the "equivalent" would be the CEO.

Implications for the Attorney-Client Privilege

The proposed rule states that an attorney's notification to the SEC of his intent to withdraw from representing a company and to disaffirm any submissions to the SEC does not breach the attorney-client privilege. The SEC reasoned that a "noisy withdrawal" signals that something is wrong without revealing any privileged communication between attorney and client.

The proposed rule also provides that where a company, through its attorney, shares with the SEC, pursuant to a confidentiality agreement, information related to a material violation, such sharing of information will not constitute a waiver of any otherwise applicable privilege or protection as to third parties.

Sanctions

Violations of the proposed rule would subject an attorney to all of the remedies and sanctions available under the Securities Exchange Act, including injunctions and cease and desist orders. In addition, an attorney violating the proposed rule will have engaged in improper professional conduct and might also be subject to administrative disciplinary proceedings that could result in a censure or a suspension or bar from practicing before the SEC.

Under the proposed rule, an attorney would be subject to discipline for (1) intentional, including reckless, violations of the rule, and (2) negligent conduct in the form of a single instance of highly unreasonable conduct or repeated instances of unreasonable conduct that results in a violation of the proposed rule. The proposed rule provides that the SEC may discipline and sanction an attorney who violates the rule even when the attorney is subject to discipline in the state where he practices or is admitted.

The SEC has noted that it does not intend for the proposed rule to create a private right of action against an attorney based on his compliance or non-compliance with the rule.

This document is intended as an informational reminder and does not constitute legal advice. If you have any questions or would like to discuss a particular situation, you should contact your usual W&D attorney or one of us.

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