NEW REGULATIONS FOR LAWYERS: THE SEC'S FINAL RULE FOR PROFESSIONAL CONDUCT IN THE WAKE OF SARBANES-OXLEY: CHALLENGES FOR FOREIGN ATTORNEYS

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I. INTRODUCTION

The 1990's was a period of great expansion and innovation in corporate America.[1] The era was characterized by the growth and exploitation of the technological industry.[2] From both a personal and business standpoint, technology throughout the decade became increasingly interwoven into the fibers of everyday life.[3] Unfortunately, the demand for innovation and technology brought with it the evolution of a stock market of new and poorly understood companies.[4] Also, the robust financial times attracted millions of investors who lacked business knowledge, and to business, the decade tempted thousands of high-level professionals who lacked moral scruples.[5] What followed was a number of major corporate and accounting scandals involving some of the most prominent companies in the United States, including such companies as WorldCom, Global Crossing, Tyco, Adelphia, and most notably Enron.[6]

In the wake of these scandals, investor trust in corporate accounting and financial reporting practices in public-issue companies significantly eroded.[7]

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1. Lawrence A. Cunningham, Professor of Law and Business, Boston College, Sarbanes-Oxley and all that: Impact Beyond America's Shores, Speech to the FESE in London (June 12, 2003), *available at* http://www.fese.be/efmc/2003/report/efmc_cunningham.htm: (last visited Feb. 7, 2004) [hereinafter Cunningham Speech].

2. *See id.*

3. *See id.*

4. Lawrence A. Cunningham, Symposium, *Crisis in Confidence: Corporate Governance and Professional Ethics Post-Enron Sponsored by Wiggin & Dana: The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And it Just Might Work)*, 35 CONN. L. REV. 915, 923 (2003).

5. *Id.*

6. *See* William H. Donaldson, Chairman, U.S. Securities and Exchange Commission, Testimony Concerning Implementation of the Sarbanes-Oxley Act, (Sep. 9, 2003), *available at* http://www.sec.gov/news/testimony/090903tswhd.htm (last visited Feb. 7, 2004) [hereinafter Donaldson Testimony].

7. *See id. See also* Press Release, U.S. Securities and Exchange Commission, SEC Charges Fastow, Former Enron CFO, With Fraud (Oct. 2, 2002), *available at* http://www.sec.gov/news/press/2002-143.htm (last visited Feb. 7, 2004) [hereinafter SEC Fastow Release].

In fact, the scandals left a large number of investors perplexed and destitute.[8] Many experts, including Chairman of the U.S. Federal Reserve, Alan Greenspan, believe that this lack of trust was a major contributor to the economic slowdown in U.S. capital market performance in the early twenty-first century.[9]

In response to the worldwide cries to do something, the U.S. Congress enacted arguably the most sweeping and important federal securities legislation since the 1930's,[10] the Sarbanes-Oxley Act of 2002 (Act).[11] Determined to reduce corporate misconduct and protect investors, the Act establishes new standards for corporate accountability and penalties for wrongdoing.[12] Primarily, the standards place increased responsibilities on those involved in the corporate financial reporting process.[13] The broad scope of the Act, which extends to foreign market participants accessing U.S. capital markets, largely ignores the differences in practices and corporate governance regimes between the United States and other countries.[14] Although the Act provides for the Securities and Exchange Commission (SEC) to reduce application of certain provisions to foreign companies, many are surprised by the extent to which U.S. law and regulatory authority has been extended beyond its borders to areas that would normally be governed exclusively by the law of foreign jurisdictions.[15]

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8. *See* Rosanna Ruiz, *Enron Employees file Suit Over Their 401(k) Losses*, HOUS. CHRON., Jan. 28, 2002, *available at* http://www.chron.com/cs/CDA/prinstory.hts/topstory/1228980.htm (last visited Feb. 7, 2004); Marilyn Geewax, *Accounting Reform Faces Key Vote in Senate Panel*, COX NEWS SERV., May 20, 2002, at Financial Pages (noting that the Enron bankruptcy wiped out thousands of jobs and tens of billions in investors' savings).

9. *See* PriceWaterhouseCoopers, Understanding the Independent Auditor's Role in Building Public Trust: A White Paper, at 2, (2003), *available at* http://www.pwcglobal.com/images/gx/eng/about/svcs/grms/pwc_sowp3.pdf (last visited Sept. 2, 2003); *Rebuilding Trust*, LEGAL WEEK GLOBAL, July 24, 2002, *available at* http://www.legalweekglobal.net/ViewItem.asp?id=9949&Keyword=Rebuilding (last visited Feb. 7, 2004).

10. Ethiopis Tafara, Acting Director, Office of International Affairs, U.S. Securities and Exchange Commission, Addressing International Concerns Under the Sarbanes-Oxley Act (June 10, 2003), *available at* http://www.sec.gov/news/speech/spch061003et.htm (last visited Feb. 7, 2004)[hereinafter Tafara Speech].

11. Public Accounting Reform and Investor Protection Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.). The Act is better known by its short title "The Sarbanes-Oxley Act of 2002." The backdrop of this Note is Chapter 98 Public Company Accounting Reform and Corporate Responsibility codified at 15 U.S.C. § 7201 (et. seq.) (2003), which contains the new rules of professional responsibility for attorneys, 15 U.S.C. § 7245 (2003).

12. *See* Tafara speech, *supra* note 10.

13. *See id.*

14. *Id.*

15. *See* Wayne Kirk, Thelen Reid & Priest LLP, *Sarbanes-Oxley Act of 2002: Application to Foreign Private Issuers with Securities Registered Under the 1934 Act* (Aug. 8, 2002), *at* http://www.thelenreid.com/articles/article/art_135_idx.htm (last visited Feb. 7, 2004). *See also* Tafara Speech, *supra* note 10.

Recognizing the role of attorneys as corporate gatekeepers, Section 307 of the Act establishes new standards of professional conduct for attorneys "appearing and practicing" before the SEC in the representation of public-issue corporations.[16] This includes attorneys of foreign private issuers[17] and those that are licensed to practice in foreign jurisdictions.[18] Particularly, the Act and the subsequent final regulations established by the SEC impose responsibilities on corporate attorneys to monitor and report "up the corporate ladder" evidence of material violations of securities laws or fiduciary duties on the part of those involved in financial reporting process.[19] These responsibilities represent new territory in the realm of attorney accountability.[20] The controversial nature of the new SEC regulations has generated significant and extensive debate in the worldwide legal community.[21]

This Note analyzes the responsibilities the SEC's final rule enacting Section 307 imposes on corporate attorneys, specifically with regard to foreign attorneys who do not meet the SEC's definition of "non-appearing."[22] It begins in Part Two with a discussion of the events, including the many corporate scandals that occurred prior to the passage of the Act and the sharp decline in investor confidence that followed. Part Two also reviews the role of attorneys as gatekeepers in the corporate governance process, including an analysis of the attorneys' participation in the Enron scandal. Part Three then turns to congressional response to the corporate scandals, particularly the passage of the Act. This part provides an overview of the Act and discusses its scope and general impact on the foreign corporate community. Next, Part Four examines the details of the SEC's final regulations mandated by Section 307 of the Act. The discussion includes an in-depth analysis of the scope of the regulations, an analysis of each section, and the consequences of non-compliance. Finally, Part Five discusses the international community's reaction to the new regulations, reviews various application issues for foreign attorneys who do not meet the SEC's definition of "non-appearing," and offers practical suggestions for those attorneys to ensure compliance.

16. *See* 15 U.S.C. § 7245. *See also* Tafara Speech, *supra* note 10.

17. *See* 17 C.F.R. § 240.3b-4 (2003).

18. *See* 15 C.F.R. § 205.2(j) (2003).

19. *See* 15 U.S.C. § 7245; 17 C.F.R. § 205.3 (2003).

20. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6,296 (Feb. 6, 2003) (codified at 17 C.F.R. pt. 205). *See also* Tafara Speech, *supra* note 10.

21. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,296. *See also* Tafara Speech, *supra* note 10.

22. 17 C.F.R. § 205.2(a)(1) (2003).

II. WHAT WENT WRONG IN CORPORATE AMERICA: THE BACKDROP OF THE SARBANES-OXLEY ACT

A. Scandal and Corruption in Corporate America

The 1990's was a period of tremendous expansion and innovation in corporate America.[23] The economic growth was fueled largely in part by the exploitation of communications and information technology, which provided companies tremendous resources for conducting more efficient and broader scale operations.[24] In particular, the exploitation enabled widespread use of the internet and proliferation of the nation's extensive telecom infrastructure.[25] This was also true with the general public where technology throughout the decade became increasingly interwoven into the fabric of everyday life.[26] The use of cell phones and email serve as prime examples, where their usage grew from next to nothing in the mid-1990's to becoming the norm by 2000.[27]

Unfortunately, this demand for innovation and technology during that same time period brought with it the evolution of a "telecom/dot.com-infused" stock market of new and poorly understood companies.[28] Also, the robust financial times attracted to investing millions of first-time investors who lacked general business knowledge and to business, the decade attracted thousands of savvy executives who lacked moral scruples.[29] This combination produced and sustained a period of exaggerated achievements and camouflaged setbacks.[30]

The delusions of the 1990's came to an end in March of 2001 when investors began to realize that a "financial bubble" had developed.[31] The insecurity immediately drove stock prices sharply down, leaving them stagnant for months.[32] Eighteen months later, the market index was further jolted by the September 11, 2001 terrorist attacks and resulting threats of

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23. Cunningham Speech, *supra* note 1; Donaldson Testimony, *supra* note 6.

24. *See* Cunningham Speech, *supra* note 1; Donaldson Testimony, *supra* note 6.

25. *See* Cunningham Speech, *supra* note 1.

26. *See id.*

27. *See id.*

28. Cunningham, *supra* note 4, at 923. *See also* Donaldson Testimony, *supra* note 6 (noting that during the stock market boom of the mid 1990s through early 2000, new entrants undertaking IPOs in the market were among the biggest gainers, especially those from the "dot.com" sector of the economy).

29. Cunningham, *supra* note 4, at 923. *See* Donaldson Testimony, *supra* note 6. "Communications, the explosion of information technology and changes in the culture of equity investing, including the shift to more self-directed retirement accounts, brought millions of individuals with their savings into our stock market for the first time." *Id.*

30. Cunningham, *supra* note 4, at 923.

31. *Id.*

32. *Id. See also* Donaldson Testimony, *supra* note 6 (noting that investors fled the financial markets and the IPO market, which had been so strong during the 1990s, had disappeared).

war.[33] Similar to the events of 1929, the strong economic times and subsequent market decline revealed a series of major corporate scandals that significantly shook investor confidence in public-issue companies.[34] In fact, between December 2001 and July 2002, four of the six largest corporate bankruptcy filings in U.S. history occurred.[35] These four corporations, along with many others, concealed their true financial performance from creditors and shareholders until an inability to meet financial commitments forced them to restate earnings and reveal massive losses.[36]

The catalyst for the greed, malfeasance, and other illicit behavior was that during the boom years, corporate America became increasingly focused on short-term financial results, measured by quarter-to-quarter earnings.[37] "Hitting the numbers," rather than creating a strategy for sound, long-term strength and performance, became the primary business goal.[38] Ultimately, as noted by William H. Donaldson, SEC Chairman, "the perception that uninterrupted earnings growth was the standard for sound corporate progress caused too many managers to adjust financial results with the purpose of meeting projected results—in ways that were sometimes large and sometimes small, but especially given the purpose, in all cases unacceptable."[39]

The first of the major scandals and perhaps the most well known was Enron.[40] The corporation's financial troubles were the result of several Enron executives manipulating the corporation's reported financial results through

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33. Cunningham, *supra* note 4, at 923.

34. *See* SEC Fastow Release, *supra* note 7. *See also* Donaldson Testimony, *supra* note 6.

> As happened after the crash of 1929, the falling market that began in 2000 led to other revelations. Starting with the unfolding of the Enron story in October of 2001, it became apparent that the boom years had been accompanied by fraud, other misconduct and a serious erosion in business principles.

Id.

35. *See* Simon Romero & Riva D. Atlas, *WorldCom Declares Bankruptcy; $107 Billion Filing Largest in U.S. History*, HOUS. CHRON., July 22, 2002, at A1 (noting that the six largest bankruptcies in U.S. history by assets, in billions include WorldCom (2002) (107), Enron (2001) (63.3), Texaco (1987) (35.8), Financial Corp. of America (1988) (33.8), Global Crossing (2002) (25.5), and Adelphia Communications (2002) (23.2)).

36. *See* U.S. Securities and Exchange Commission, Litigation Release No. 18335, SEC v. Glisan, Case No. H-03-3628 (S.D. Tx.), SEC Charges Ben F. Glisan, Jr., Enron's Former Treasurer with Securities Fraud (Sept. 10, 2003), *available at* http://www.sec.gov/litigation/litrelease/lr18335.htm (last visited Feb. 7, 2004) [herinafter SEC Glisan Release]. *See also* U.S. Securities and Exchange Commission, Litigation Release No. 18277, SEC v. WorldCom, Inc., Civil Action No. 02-CV-4963 (S.D.N.Y.), J. Gonzalez Approves Settlement of SEC's Claim for Civil Penalty Against WorldCom (Aug. 7, 2003), *available at* http://www.sec.gov/litigation/litrelease/lr18277.htm (last visited Feb. 7, 2004).

37. Donaldson Testimony, *supra* note 6. Even with corporate financial analysts, the emphasis was on the game of "hitting the numbers." *Id.*

38. *Id.*

39. *Id.*

40. Geewax, *supra* note 8.

a series of fraudulent business transactions.[41] These transactions effectively inflated Enron's earnings and cashflows, while at the same time concealing the full extent of the company's debt.[42] They included several sham off-balance sheet partnerships and the manipulation of the company's reported financial results through a series of complex finance transactions, known as "prepays."[43] The off-balance sheet partnerships, which were formed using Enron equity to hedge against potential decline in its market-to-market investments, ultimately allowed Enron to avoid earnings write-downs of over one billion dollars.[44] The prepays, on the other hand, were fraudulently used to bolster financial results by reporting loans from financial institutions as cash from operating activities.[45] As the corporation's bankruptcy proceeded and as the SEC's subsequent investigation began to unfold, the number of Enron executives responsible for the misconduct began to grow.[46] Also, it became clear that a number of prominent financial institutions and professional service firms had aided in the wrongdoing, including Arthur Anderson, LLP; J.P. Morgan Chase & Co.; and Citigroup, Inc.[47] In the wake of the scandal and the massive decline in the company's stock price, Enron employees and outside shareholders were devastated.[48] Early estimates suggest that, in addition to the thousands of jobs that were lost, Enron employees collectively lost more than one billion dollars as a result of the decline in share value.[49]

The next major scandal to hit the mainstream occurred in January of 2002, with Global Crossing's announcement that it was filing bankruptcy.[50] Once again, it was faulty accounting methods and misleading financial reporting that signaled the end of the telecommunications giant.[51] Specifically, when Global Crossing's costly investment strategy failed to

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41. SEC Glisan Release, *supra* note 36.

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.*

46. Cunningham, *supra* note 4, at 924.

47. *Id. See also* In Re Enron Corporation Securities, Derivative & ERISA Litig., 235 F. Supp. 2d 549 (S.D. Tex. 2002); Press Release, U.S. Securities and Exchange Commission, SEC Settles Enforcement Proceedings Against J.P. Morgan Chase and Citigroup (July 28, 2003), *available at* http://www.sec.gov/news/press/2003-87.htm (last visited Feb. 7, 2004) (noting that J.P. Morgan Chase agreed to pay $135 million to settle SEC allegations that it helped Enron commit fraud, while Citigroup agreed to pay $120 million).

48. *See* Ruiz, *supra* note 8. *See also* Geewax, *supra* note 8 (noting that the Enron bankruptcy wiped out thousands of jobs and tens of billions in investors' savings).

49. *See* Enron Employees First Consolidated and Amended Complaint at 1-8 and 247-50, In Re Enron Corporation Securities, Derivative & ERISA Litig., 235 F. Supp. 2d 549, *available at* http://www.enronerisa.com/pdf/enron1stconsolidatedAmendedComplaint.pdf (last visited Feb. 7, 2004).

50. *See* Simon Romero & Seth Schiesel, *The Fiber Optic Fantasy Slips Away,* N.Y. TIMES, Feb. 17, 2002, § 3, at 1.

51. Cunningham, *supra* note 4, at 924.

materialize, the company began to use questionable accounting methods, including engaging in "swapping" fiber capacity with other communications companies and improperly disclosing the transactions in its financial reports.[52] During these swaps, the company would count the outgoing transfer of capacity as revenue while the incoming capacity was transacted as a capital expense, making it appear that the company's cashflow was climbing from such deals.[53] During some of these illicit transactions, Global Crossing and its counterparts issued checks to each other in equal amounts, allowing each to use the proceeds as an increase in revenue.[54] Like Enron, the scandals resulted in SEC allegations, criminal prosecutions, and left investors perplexed and destitute.[55]

In the Spring of 2002, a wave of corporate misbehavior of a different sort began to surface.[56] This time, the motivation was based on greed rather than direct accounting corruption.[57] The widely publicized cases of Adelphia Communications Corp. and Tyco International Ltd. serve as prime examples.[58] Both instances involved massive corporate loans to company executives at extremely favorable terms.[59] Most notably, in March of 2002, Adelphia disclosed that it had failed to report at least $2.3 billion in debt that was attributable to fraudulent loans made by the corporation to the founding family of Adelphia.[60] In July, shortly after the company filed for Chapter 11 bankruptcy, John Rigas, founder, Chairman, and CEO, and two of his sons, along with two other executives, were arrested and charged with nine counts of conspiracy and fraud.[61]

There are many other examples of accounting corruption and executive misbehavior that occurred between 2000 and 2002 that did not get the same notoriety, although they did not go completely unnoticed either.[62] Notable

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52. *See* Romero & Schiesel, *supra* note 50.

53. *Id.* Global Crossing engaged in these swapping transactions with many telecommunication companies around the world. The most notable transactions occurred with Qwest Communications International; however, other companies included Flag Telecom of Britain, China Netcom, and Telecom New Zealand. *Id.*

54. *Id.* In other transactions, no money changed hands. *Id.*

55. *See id.*

56. Cunningham, *supra* note 4, at 924.

57. *Id.*

58. *See id.*

59. *Id.*

60. Andrew Ross Sorkin, *Corporate Conduct* Prosecution, N.Y. TIMES, July 25, 2002, § C, at 1. *See also* Abigail Rayner, *Fallen King Pounced on by* Sleazebusters, THE TIMES (London), July 27, 2002, Business, at 46. In March of 2002 the Rigas family stated that they had borrowed $2.3 billion in company funds without the board's approval. On June 25, 2002 the company filed chapter 11 bankruptcy. *Id.*

61. *Id. See also* Christopher Stern, *Members of Rigas Family Indicted; 3 Ex-Adelphia Officials Accused of Conspiracy,* WASH. POST, Sep. 24, 2002, Financial, at E01 (stating that the Rigas family had been indicted on charges of conspiring to defraud investors out of $250 million and for failing to disclose $2.3 billion in loans to the family).

62. Cunningham, supra note 4, at 925.

corporations, such as AOL Time Warner Inc., Rite Aid Corp., Tyco, and Xerox Corp all faced allegations of corruption and fraud during that time period.[63] The final straw, however, occurred in June of 2002 with "a true and pure accounting deception so large that there was no turning away from Congressional action."[64] That month, WorldCom, the telecommunications goliath and parent company of MCI, announced that corporate financial executives had misled investors by overstating its income from as early as 1999 through the first quarter of 2002.[65] As a result of undisclosed and improper accounting, WorldCom materially overstated the income it reported on its financial statements for that time period by approximately $7.2 billion.[66] The magnitude of the deception was so great that it resulted in civil charges by the SEC against four corporate executives and the payment of a penalty by WorldCom that was seventy-five times greater than any prior penalty imposed on a U.S. corporation.[67] Once again, employees and shareholders were devastated.[68] More than 20,000 employees were laid off between January 2001 and June 2002,[69] and the company's stock price had fallen from its high of $61.99 per share to its post-scandal low of less than one dollar.[70]

B. The Impact of the Scandals on Investor Confidence

The heart of the passage of the Sarbanes-Oxley Act is found in the dramatic erosion in investor confidence and the public outcry that followed the recent corporate scandals.[71] Unquestionably, investor trust in corporate

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63. *Id.*

64. *Id. See also* Geewax, *supra* note 8.

65. U.S. Securities and Exchange Commission, Litigation Release No. 17783, SEC Charges Two Former WorldCom Accountants, Betty Vinson and Troy Normand, with Participating in Multi-Billion Dollar Financial Fraud (Oct. 10, 2002), *available at* http://www.sec.gov/litigation/litrelease/lr17783.htm (last visited Feb. 7, 2004).

66. *Id.*

67. U.S. Securities and Exchange Commission, Litigation Release No. 18219, The Honorable Jed Rakoff Approves Settlement of the SEC's Claim for a Civil Penalty Against WorldCom (July 7, 2003), *available at* http://www.sec.gov/litigation/litrelease/lr18219.htm (last visited Oct. 2, 2003). The court approved a settlement providing that WorldCom was liable for a civil penalty in the amount of $2,250,000,000. *Id.* The judgment, however, was to be deemed satisfied by the Company's payment of $500,000,000 in cash and by its transfer of common stock in the reorganized company having a value of $250,000,000 to a distribution agent appointed by the court. *Id.*

68. *See* Louis Uchitelle, *Turmoil at WorldCom: The Workforce: Job Cuts Take Heavy Toll on Telecom Industry*, N.Y. TIMES, June 29, 2002, § C, at 1. By June of 2002, WorldCom had announced that it would eliminate a total of 23,000 jobs, or roughly 16 percent of its entire workforce. *Id.*

69. *See id.*

70. James P. Miller et al., *SEC Accuses WorldCom of Fraud*, CHI. TRIB., June 27, 2002, News, at 1N.

71. *See Rebuilding Trust*, supra note 9.

accounting and reporting practices was drastically shaken.[72] In a recent press release, the SEC noted that the actions of executives at Enron and other similar companies had significantly "undermined investor confidence in our markets and our system of financial reporting."[73] The magnitude of the public's distrust can be seen in several polls conducted in mid-2002, which demonstrate that:

- Seventy-seven percent of the public believed that CEO greed and corruption had caused the U.S. "financial meltdown."[74]
- Seventy-one percent of investors believed that accounting fraud was rampant.[75]
- Eighty-two percent of investors believed that though new laws of corporate governance were necessary.[76]
- Eighty-one percent of fund managers and analysts believed that executives placed their own interests ahead of that of the shareholders.[77]

As noted by former SEC Chairman Harvey Pitt, the "[r]ecent events have underscored what we already knew—confidence in our capital markets cannot be maintained if the public believes that corporate leaders, their advisors or their cohorts, are 'gaming' the system and focusing principally if not exclusively, on their own personal gain."[78] Even as far as Europe, concerned commentators noted, immediately after the fall of WorldCom, that "[t]he need to rebuild investor confidence is now paramount. It is not just that without it there will be no market recovery. It is also that America's reputation as a place to do business will come under intense threat sending markets ever lower."[79] Ultimately, in the minds of worldwide investors, the recurring issue

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72. *See* Richard S. Dunham, *The Vindication of Arthur Levitt*, BUSINESSWEEK ONLINE, Feb. 19, 2002, *at* http://www.businessweek.com/bwdaily/dnflash/feb2002/nf20020219_2045.htm. (last visited Oct. 18, 2003).

73. SEC Fastow Release, *supra* note 7.

74. PriceWaterhouseCoopers, The Sarbanes-Oxley Act of 2002: Strategies for Meeting New Internal Control Reporting Challenges: A White Paper, at 2 (2003), *available at* http://www.pwcglobal.com/images/gx/eng/fs/acf/4.pdf (last visited Sept. 2, 2003), at 2 (citing CNN/USA Today Poll, July 2002).

75. *Id.* (citing Survey of Main Street Investors, July 2002).

76. *Id.* (citing Harris Poll, July 2002).

77. *Id.* (citing Broadgate Consultants, March 2002).

78. Harvey L. Pitt, Chairman, U.S. Securities and Exchange Commission, Remarks Before the Annual Meeting of the American Bar Association's Business Law Section (August 12, 2002), *available at* http://www.sec.gov/news/speech/spch579.htm (last visited Feb. 7, 2004) [hereinafter Pitt Speech Before the ABA] (Harvey Pitt was Chairman of the SEC during the passage of the Act).

79. Bill Jamieson, *Posse Rides Out to Lasso Investor Confidence*, THE SCOTSMAN, July 2, 2002, at 5. *See also Rebuilding Trust*, *supra* note 9.

was whether the scandals were enabled, promoted, or caused by a lack of corporate reform.[80]

C. *The Attorney's Role in Corporate Governance*

Most experts agree that the wave of recent corporate scandals could not have occurred without the widespread breakdown in the entire corporate oversight system.[81] As noted by former SEC Chairman, Arthur Levitt, this breakdown was the result of a "vast cultural erosion cutting across virtually every gatekeeper that operates in this arena."[82] This group includes corporate executives, corporate directors, accountants, investment bankers, analysts, and most notably, corporate attorneys.[83] These professionals appear to have forgotten (or ignored) that their primary responsibility is to the corporation and its shareholders.[84] Unfortunately, a culture of "what can I get away with" has engulfed the desired culture of "what is good for investors."[85]

This is especially true for corporate lawyers.[86] To restore public confidence, it is important for corporate lawyers to keep their eyes firmly fixed on their public responsibilities and to first make certain that those responsibilities are satisfied.[87] That means putting the interests of the corporation and its shareholders above all others, including their own.[88] The concept of attorneys guarding, defending, and promoting the interests of their

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80. *See* Cunningham, *supra* note 4, at 940.

81. Dunham, *supra* note 72. *See also* Harvey J. Goldschmid, Commissioner, U.S. Securities and Exchange Commission, Post-Enron America: An SEC Perspective, Speech at Third Annual A.A. Sommer, Jr. Corporate Securities & Financial Law Lecture (Dec. 2, 2002), *available at* http://www.sec.gov/news/speech/spch120202hjg.htm (last visited Feb. 7, 2004) (noting that what went wrong during the 1990s and early 2000s was the "systematic failure" of the entire corporate governance checks and balances system) [hereinafter Goldschmid Speech].

82. Dunham, *supra* note 72. *See also Rebuilding Trust*, *supra* note 9.

83. *See* Dunham, *supra* note 72. *See also Rebuilding Trust*, *supra* note 9 (stating that Alan Greenspan, Chairman of the U.S. Federal Reserve, blamed lawyers, among others for failing to check the "infectious greed" of the 1990's that led to the recent collapse of share values). *See also* Goldschmid Speech, *supra* note 81. As Judge Sporkin in *Lincoln Savings* put it, "[d]uring the most dramatic financial scandals that have occurred during my professional life, where were the lawyers?" *Id. (quoting* Lincoln Sav. Ass'n v. Wall, 743 F. Supp. 901 (D.D.C. 1990)).

84. Pitt Speech Before the ABA, *supra* note 78.

85. Dunham, *supra* note 72.

86. *See id.* (noting that in public companies, the most important "gatekeepers" are the accountants and attorneys); *see also* Patti Waldmeir, *Lawyers on Sentry Duty: Corporate Governance: SEC Proposals to turn the US Legal Profession into Guardians of the Market are Causing Controversy*, FINANCIAL TIMES (London), Nov. 6, 2002, Inside Track, at 15 [hereinafter Waldmeir, *Lawyers on Duty*] (discussing comments by Harvey Pitt, former SEC Chairman, that the recent corporate governance scandals have done nothing to improve the lawyers' image of "greed and duplicity").

87. Pitt Speech Before the ABA, *supra* note 78.

88. *Id.*

clients is not new.[89] Indeed, the ABA's Model Rules of Professional Conduct state as much.[90] This model, however, is premised on the idea that clients must feel comfortable in confiding in their attorney.[91] The sticking point is that many feel that governmental controls on how lawyers fulfill their responsibilities can negatively impact the willingness of clients to confide in their lawyers, and thus, curtail the lawyer's ability to maximize the benefits of the lawyer-client relationship.[92] The problem with this notion, however, is that it misses the point. "Lawyers for public companies represent the company as a whole and its shareholder-owners, not the managers who hire and fire them."[93] Too often, corporate attorneys in an effort to please the executives with which they have direct interaction, lose sight of the bigger picture.[94] The net result is that the eager attorney ends up as a necessary partner to corporate misconduct.[95] In fact, to be able to commit most complex corporate fraud, corporations need legal help.[96] It is the attorney's role to make everything look legitimate.[97]

If it is not a blatant violation of the law, the attorney will frequently justify his or her actions, at least in his own mind, by trying to force-fit the conduct into a potential gray area of the law.[98] However, as former SEC Chairman Harvey Pitt recently noted in a speech before the American Bar Association, "[h]elping [the] company to satisfy literal legal prescriptions, even if doing so is contrary to what those legal prescriptions were intended to accomplish, doesn't satisfy a corporate lawyer's duties."[99] Later he adds, "[l]awyers cannot escape their role in giving assistance to corporate wrongdoers by hiding behind their ability to craft a clever phrase to circumvent what they know to be the right answer."[100] He concludes that too often attorneys use their "high mental gifts for guile, and because of their higher endowment their sin is reckoned greater and their place is lower than that of thieves."[101]

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89. *Id.*

90. *See* MODEL RULES OF PROF'L CONDUCT R. 1.3 cmt. (2002). "A lawyer should act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf." *Id.*

91. Pitt Speech Before the ABA, *supra* note 78.

92. *Id.*

93. *Id. See also* Pamela Palmer, *Lawyers in the Spotlight*, LEGAL WEEK GLOBAL, Sept. 18, 2002.

94. *See* Pitt Speech Before the ABA, *supra* note 78.

95. *See* Susan P. Koniak, Symposium, *Regulating the Lawyer: Past Efforts and Future Possibilities: When the Hurlyburly's Done: The BAR's Struggle with the SEC*, 103 COLUM. L. REV. 1236, 1239 (2003).

96. *Id.*

97. *Id.*

98. *See* Pitt Speech Before the ABA, *supra* note 78.

99. *Id.*

100. *Id.*

101. *Id.*

1. The Attorneys' Role in the Enron Scandal

An appropriate example of an attorney's role in corporate misconduct is the allegations raised against the lawyers in the Enron case.[102] Specifically, the involvement of the large and prestigious law firm of Vinson & Elkins (V&E) was a necessary component of Enron's ability to execute its fraudulent behavior.[103] Before going into the details of V&E's participation in the misconduct, it is important to first lay the foundation of the relationship between the two entities. Enron was V&E's largest client, accounting for more than seven percent of the firm's total revenues.[104] Also, over the course of their relationship, more than twenty lawyers left V&E to join Enron's in-house legal department.[105] There is no doubt that there was a deep long-standing relationship between the two entities.[106]

The complaint filed against V&E in 2002 includes a long, elaborate history of improprieties on the part of V&E as Enron's chief outside counsel.[107] However, for purposes of brevity, discussion will focus on a few key behaviors. First, the complaint against V&E asserts that V&E participated in the negotiations and prepared the transaction documents for the illicit partnerships and Special Purpose Entities (SPE) that formed the basis for Enron's fraudulent behavior.[108] This was done with full knowledge that they were "manipulative devices, not independent third parties and not valid SPEs, designed to move debt off of Enron's books, inflate its earnings and falsify Enron's reported financial results and financial condition at crucial times."[109] Moreover, V&E, knowing that the legitimate investor of one of the SPE's had pulled out and that Enron wanted to keep the SPE's liabilities off the books, formed a company totally controlled by Enron to take the investor's place.[110] The Firm then advised Enron to put a non-executive employee in charge of the newly formed entity to avoid SEC and investor disclosure issues.[111]

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102. *See* In re Enron Corp. Sec., Derivative & ERISA Litig., 235 F. Supp. 2d 549 (S.D. Tex. 2002).

103. *Id.* at 627.

104. *Id.* at 656.

105. *Id.*

106. *See generally id.*

107. *Id.* at 657. The case included motions to dismiss by several of the secondary defendants named in the original shareholder complaint. *See In re Enron*, 235 F. Supp. 2d at 686-707. With respect to V&E, the court denied its motion to dismiss the allegations. *See id.* at 704-05.

108. *Id.* at 657-60.

109. *Id.* at 657. *See id.* at 658-65.

110. *Id.* at 656-59.

111. *In re Enron*, 235 F. Supp. 2d at 662.

Next, V&E proceeded to prepare and file Enron's disclosure documents and advised Enron executives that the documents satisfied the Companies legal obligations, when they in fact did not.[112] The complaint alleges that between 1998 and 2002, V&E drafted and approved SEC filings, shareholder reports, and press releases knowing that they were false and misleading.[113] This included concealing material facts in Enron's quarterly reports on form 10-Q, annual reports on form 10-K, and in its annual proxies.[114]

Finally, in 2001, as Enron's use of the SPE's became more aggressive, an Enron Global Financing employee, Sherron Watkins, sent a memorandum to Enron's CEO, Kenneth Lay, complaining that the company was engaging in fraudulent misconduct that would likely lead to its collapse.[115] The letter further warned Kenneth Lay not to use V&E to investigate the issue because V&E had participated in the fraud and had a clear conflict of interest.[116] Despite her warning, Kenneth Lay immediately turned to V&E partners to determine how to cover up the allegations.[117] V&E, disregarding its obvious conflicts of interest, agreed to conduct an investigation and vowed to issue a report dismissing the allegations of fraud.[118] V&E also allegedly agreed to not second-guess the accounting services of Arthur Anderson and to limit its investigation into top Enron Executives.[119] According to the complaint, during the investigation, V&E only interviewed a few top executives that it knew were involved in the fraud but would deny the misconduct.[120] Not surprisingly, on October 15, 2001, V&E issued a letter that dismissed all of Watkins' allegations.[121]

These allegations represent the type of behavior that can and does occur in corporations. The problem is not so much that corporate attorneys engineer massive fraud or that they did so in each of the corporate scandals listed at the outset of this Note, but rather that different lawyer behavior might have prevented or stopped the fraudulent activity on behalf of management.[122]

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112. *Id.* at 659.

113. *Id.* at 657, 660-65.

114. *Id.* at 660-65.

115. *See id.* at 657 n.92. *See also* Email from Sherron Watkins, Global Financing employee, Enron Corp., to Kenneth Lay, Chairman, Enron Corp., (Jan. 20, 2002), *at* http://www.itmweb.com/f012002.htm (last visited Feb. 7, 2004).

116. *In Re Enron*, 235 F. Supp. 2d at 657.

117. *Id.* at 665.

118. *Id.*

119. *Id.*

120. *Id.* at 666.

121. *In Re Enron*, F. Supp. 2d at 666. *See also id.* at 666-68 (includes the letter quoted in part).

122. Jill E. Fisch & Kenneth M. Rosen, Symposium, *Lessons From Enron, How Did Corporate and Securities Law Fail? Is there a Role for Lawyers in Preventing Future Enrons?*, 48 VILL. L. REV. 1097, 1104 (2003).

2. American Bar Association's Attempt to Deal with Attorney Responsibility

It is true that the American Bar Association has attempted to deal with the attorney's obligations as corporate gatekeepers in its Model Rules of Professional Conduct.[123] At the outset, Rule 1.6 provides that:

> [a] lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except . . . a lawyer *may* reveal such information to the extent the lawyer reasonably believes necessary; to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm.[124]

The key to this rule, however, is the use of the word "may." As stated, the lawyer is not required to disclose the information.[125] Also, because the rule only permits the lawyer to reveal information that will prevent a client from committing a criminal act that will likely result in death or bodily harm, the rule essentially precludes a lawyer from revealing a corporations ongoing financial fraud.[126]

Further, pursuant to Rule 1.2, an attorney "shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent."[127] The attorney may, however, discuss the legal consequences of any proposed course of conduct with the client and may assist the client in making a good faith effort to determine the application of the law as it relates to that conduct.[128] The official comment to Rule 1.2 provides that:

> The fact that a client uses advice in a course of action that is criminal or fraudulent does not, of itself, make a lawyer a party to the course of action. However, a lawyer may not knowingly assist a client in criminal or fraudulent conduct. There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity.[129]

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123. *See generally* Patti Waldmeir, *Hidden Dangers of Turning our Lawyers into Watchdogs*, FINANCIAL TIMES (London), May 5, 2003, Features Law and Business, at 10.

124. MODEL RULES OF PROF'L CONDUCT R. 1.6(a) & (b)(1) (2002) (emphasis added).

125. *See id.*

126. *See* Goldschmid Speech, *supra* note 81.

127. MODEL RULES OF PROF'L CONDUCT R. 1.2(d) (2002).

128. *Id.*

129. MODEL RULES OF PROF'L CONDUCT R. 1.2 cmt. (2002).

If a lawyer discovers that his client is engaged in ongoing criminal or fraudulent conduct, ABA Model Rule 1.16 provides the attorney's course of action.[130] Essentially, the rule states that a lawyer must decline or withdraw from representation if the client demands that the lawyer engage in conduct that is illegal or violates the Rules of Professional Conduct.[131] The rule also provides that a lawyer "may" withdraw if the client persists in a course of conduct that the attorney reasonably believes is criminal or fraudulent.[132] The key to Rule 1.16 is that an attorney's obligation to withdraw is only invoked if the client "demands" that the lawyer engage in criminal or unethical conduct.[133] In other words, if the attorney knows the client is engaging in illegal conduct with which he or she is not demanded to participate, the lawyer does not have to withdraw.[134] Also, in such instances where the lawyer does withdraw, he is not required to disclose the information.[135]

Finally, the attorney-client relationship in the context of an organization is described in Rule 1.13.[136] Under Rule 1.13, when the attorney knows that the organization or an employee is engaged in illegal conduct, the attorney is *permitted* to: (1) ask for reconsideration in the matter, (2) advise that a second legal opinion in the matter be sought, or (3) refer the matter to a higher authority within the organization.[137] If the organization refuses to take action to stop the behavior, the lawyer is *permitted* to resign.[138]

In addition to the obvious lack of substance to these rules, they have also been inadequately enforced.[139] Many believe that state bar associations have been lax in their efforts to discipline attorneys for their misconduct, especially when it comes to securities fraud.[140] In fact, the legal profession has largely taken advantage of the fact that it has been left to develop and enforce its own system of self-governance with little or no oversight by the government.[141]

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130. *See* MODEL RULES OF PROF'L CONDUCT R. 1.16 cmt. (2002).

131. *Id.*

132. *See* MODEL RULES OF PROF'L CONDUCT R. 1.16 cmt., 116.

133. *See id.*

134. *See id.*

135. *See* MODEL RULES OF PROF'L CONDUCT R. 1.6 (2002).

136. *See* MODEL RULES OF PROF'L CONDUCT R. 1.13 (2002) (Rule 1.13 is discussed *infra* text accompanying notes 235-39).

137. *See* MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2002) (emphasis added).

138. MODEL RULES OF PROF'L CONDUCT R. 1.13(c) (2002) (emphasis added).

139. *See* Pitt Speech Before the ABA, *supra* note 78.

140. *Id. See* Patti Waldmeir, *SEC Retreats on Sarbanes-Oxley Measures for Company Lawyers*, FINANCIAL TIMES (London), Jan. 24, 2003, Companies & Finance The Americas, at 27 [hereinafter Waldmeir, *SEC Retreats*].

141. *See* Waldmeir, *Lawyers on Duty*, *supra* note 86. "For more than 200 years, the US legal profession has been mostly allowed to police itself. State courts have exercised gentle scrutiny, guided almost entirely by state Bar associations." *Id. See also* Linnea B. McCord & Gia H. Weisdorn, *Blowing the Whistle, Graziadio Business Report*, 6 J. CONTEMP. BUS. PRAC. 3 (2003), *available at* http://www.gbr.pepperdine.edu/033/lawyers.html (last visited Feb. 10, 2004); *see also* Palmer, *supra* note 93.

The frustration of the SEC in this regard is revealed in Harvey Pitt's recent statement that "I'm not impressed, or pleased, by the generally low level of effective responses we receive from state bar committees when we refer possible disciplinary proceedings to them."[142] It is this frustration that helped set the tone for new regulatory standards for corporate lawyers.[143]

II. THE SARBANES-OXLEY ACT

A. *Congressional Response to Corporate Misconduct*

The collapse of WorldCom, Global Crossing, Adelphia and the many others that followed, indicated to the world that Enron was not an anomaly and that drastic corporate reform was needed.[144] These catastrophes led to a fast-developing international consensus on critical areas of corporate reform necessary to restore investor confidence.[145] Responding to the worldwide cries to do something, the U.S. Congress passed the Sarbanes-Oxley Act of 2002 (Act).[146]

The Act was officially signed by President Bush on July 30, 2002, after passing through Congress in relatively quick fashion, bypassing much of the legislative process.[147] The Act is touted as arguably "the most sweeping and

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> In the 1970s and early 1980s, the SEC drew a firestorm of criticism from the US legal profession for seeking sanctions against lawyers based on alleged "unethical or improper professional conduct.". . . The SEC backed down, acknowledging that it had no mandate or expertise to regulate lawyers, aside from enforcing the securities laws and recognizing that there is not uniform US standard of legal ethics and conduct. By 1982, it was the SEC's stated policy to refrain from developing "independent standards of professional conduct" for lawyers.

Palmer, *supra* note 93.

142. Pitt Speech Before the ABA, supra note 78.

143. *See* Waldmeir, *Lawyers on Duty*, *supra* note 86.

144. *See* Tafara speech, *supra* note 10; Jamieson, *supra* note 79. *See also, Corporate Accountability: Hearing Before the House of Rep.*, 148th Cong. E1470, 1472 (2002) (statement of Elliot Spitzer, New York Attorney General) [hereinafter *Corporate Accountability Hearing*]. Before the House of Representatives as it was contemplating the passage of the Act, Mr. Spitzer stated that:

> [i]t is time to restore to boards and institutional shareholders the obligation of serious participation in corporate governance. We need to insist that public companies report results that reflect reality and not cleaver gamesmanship, and that allow investors to understand their true financial position. And we need to strictly punish corporate executives who falsely certify their company's financial statements.

Id.

145. *Id.*

146. Public Accounting Reform and Investor Protection Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

147. President George W. Bush, President Bush signs Corporate Corruption Bill (July 30, 2002), *available at* http://www.whitehouse.gov/news/releases/2002/07/print/20020730.html (last visited Feb. 10, 2004). *See also Corporate Accountability Hearing*, *supra* note 144, at

important U.S. federal securities regulation since the SEC was created in 1934."[148] Determined to reduce corporate malfeasance and restore investor confidence, the Act establishes new standards for corporate accountability and penalties for wrongdoing.[149] Primarily, these standards place increased demands on those involved in the corporate financial reporting process.[150]

The Act contains eleven titles, ranging from additional responsibilities for corporate oversight to enhanced criminal penalties for white-collar crimes, including securities fraud.[151] Within those eleven titles, the Act contains sixty-six sections and provides for more than eleven studies to be conducted by the SEC and Comptroller General on various groups and issues relating to corporate governance.[152] The general categories of reform include public company disclosure, corporate governance, and auditor oversight.[153] The issues and groups addressed by the Act were singled out for their participation in the conduct that led to the Act's passage.[154] Many of the Act's provisions direct the SEC to establish regulating standards for implementation.[155] Without a doubt, the range of the act in terms of whom it affects within the realm of corporate governance and enforceability is broad and powerful.[156]

E1470 (statement of Richard Gephardt, Member, U.S. House of Rep.). The overwhelming consensus of the U.S. Congress in passing the Sarbanes-Oxley Act can be seen in a statement by Representative Richard Gephardt on the floor of the House of Representatives: "[t]his week, . . . the Senate unanimously passed and I'll say it again, unanimously passed, and that's a rare occasion, a crucial bill that would attack the current crisis in confidence." *Corporate Accountability Hearing*, *supra* note 144, at E1470.

148. Tafara Speech, *supra* note 10; Goldschmit Speech, *supra* note 81.

149. *See* Donaldson Testimony, *supra* note 6. *See also* Palmer, *supra* note 93.

150. *See* Palmer, *supra* note 93 (noting that the Act focuses on individual officers, directors, and accounting and legal professionals perceived as responsible for corporate governance and financial reporting); Donaldson Testimony, *supra* note 6.

151. *See* Public Accounting Reform and Investor Protection Act of 2002, *supra* note 11 (Eleven titles include: 1) Public Company Accounting, 2) Auditor Independence, 3) Corporate Responsibility, 4) Enhanced Financial Disclosures, 5) Analyst Conflicts of Interest, 6) Commission Resources and Authority, 7) Studies and Reports, 8) Corporate and Criminal Fraud Accountability, 9) White Collar Crime Penalty, 10) Corporate Tax Returns, and 11) Corporate Fraud and Accountability).

152. *See id.*

153. Tafara Speech, *supra* note 10.

154. *Id.* *See* Donaldson Testimony, *supra* note 6.

> The sweeping reforms of the Act address nearly every aspect and actor in our nation's capital markets. The Act affects every reporting company, both domestic and foreign, as well as their officers and directors. The Act also affects those that play a role in ensuring the integrity of our capital markets, such as accounting firms, research analysts and attorneys.

Id.

155. *See* Tafara Speech, *supra* note 10.

156. *See* Donaldson Testimony, *supra* note 6; Palmer, *supra* note 93.

B. Regulating the World: SEC Regulations on an International Stage

In examining the scope of the Act, it is important to understand the backdrop of foreign growth in U.S. markets. The increasing interdependence of capital markets around the world has virtually made it impossible for the SEC to enact securities regulation without considering its impact on foreign companies.[157] In fact, competition from foreign markets as an alternative source for raising equity capital, the fact that foreign companies often function in an entirely different corporate governance environment, and investor desire for foreign equities as a means for diversifying portfolios, are factors that the SEC has had to seriously consider in drafting and implementing regulations.[158] These considerations have resulted in the SEC's grant of accommodations and exemptions to foreign companies with regard to many of its regulations in the past.[159] The net affect has been a dramatic increase in the number of listings of foreign companies on U.S. public markets.[160] For instance, the number of foreign listings on the New York Stock Exchange (NYSE) increased from 33 listings in 1975 to 2,368 by the end of 2002, encompassing nearly seventeen percent of all listings.[161] In terms of market capitalization, the NYSE reports that in 2002, non-U.S. listed companies had a combined capitalization of $4.3 trillion, nearly one-third of the capitalization of the entire NYSE.[162] It is also important to note that since 1990 the number of foreign listings has more than quadrupled, while since 1998, the number of U.S. company listings has

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157. *See* Tafara Speech, *supra* note 10. "It is clear that, more than ever, capital markets around the world are increasingly interdependent, and changes to national laws can have repercussions outside its borders." *Id.*

158. *Id.*

159. *See* Press Release, U.S. Securities and Exchange Commission, Division of Corporate Finance: International Financial Reporting and Disclosure Issues (May 1, 2001), *available at* http://www.sec.gov/divisions/corpfin/internatl/issues0501.htm#P1052_165500 (last visited Feb. 11, 2004) (noting that the "integrated disclosure system designed for foreign private issuers provides a number of accommodations to practices in other jurisdictions") [hereinafter SEC Press Release, International Disclosure Issues]. *See also* Kirk, *supra* note 15 (recognizing the different treatment between foreign private issuers and domestic issuers in registering securities under 12(b) or 12(g) of the Securities and Exchange Act of 1934).

160. *See* John C. Coffee, Jr., Article, *Racing Towards the Top?: The impact of Cross Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1759-66, 1770-73 & 1824-27 (2002).

161. *Id.* at 1771. *See also* SEC Press Release, International Disclosure Issues, *supra* note 159 (stating that by the end of 1999, there were more than 1,200 foreign registered companies from more than fifty-five different countries registered with the SEC).

162. New York Stock Exchange, Annual Report 2002, at 14 & 43 (2002), *available at* http://www.nyse.com/pdfs/2002ar_NYSE-2002.pdf (last visited Feb. 11, 2004) (noting that the total global market capitalization for NYSE-listed companies for 2002 was 13.4 trillion, including 4.3 trillion for non-U.S. listed companies). The NYSE annual report also noted that it welcomed 152 new companies in 2002, 33 of which were non-U.S. *Id.* at 23. Further, the average daily share volume for non-U.S. companies grew from approximately 10 million in 1987 to approximately 130 million in 2002. *Id.* at 34.

steadily declined.[163] Needless to say, the environment in which the SEC operates has changed considerably.[164]

Given this, the Act poses special concerns for foreign market participants accessing U.S. capital markets.[165] That concern, of course, being that the Act imposes new standards on foreign issuers who are already subject to their home country's corporate governance regulations.[166] In making decisions on the scope of the Act, Congress was clear that the Act was generally to make no distinction between domestic and foreign firms.[167] Congress reasoned that "investors transacting on U.S. markets are entitled to the same protections regardless of whether the issuer is foreign or domestic."[168] The SEC, however, in establishing the final regulations felt it necessary to respect the growth and importance that foreign issuers play in U.S. markets.[169] In fact, the SEC recently noted that the greatest challenge it faced in implementing the Act was fulfilling the congressional mandate, while at the same time respecting foreign law and regulatory schemes.[170] The SEC concluded that the application of the provisions of the Act on foreign companies would need to be done in a reasonable manner.[171] Fittingly, the SEC in drafting its final regulations weighed heavily the concerns and comments of foreign countries expressed through open dialogue with its foreign counterparts, particularly European Union member countries.[172]

C. Scope of the Act and Foreign Private Issuers

The provisions of the Act are primarily directed at "issuers." The Act provides that:

> The term "issuer" means an issuer (as defined in section 3 of the Securities Exchange Act of 1934), the securities of which are registered under section 12 of that Act, or that is required to file reports under section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933, and that it has not withdrawn.[173]

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163. Coffee, *supra* note 160, at 1771.

164. Tafara speech *supra* note 10. "It is clear that, more than ever, capital markets around the world are increasingly interdependent, and changes to national laws can have repercussions outside its borders." *Id.*

165. *Id. See also* Coffee, *supra* note 160, at 1824-27.

166. Tafara speech *supra* note 10. *See also* Coffee, supra note 160, at 1824-27.

167. Tafara speech *supra* note 10.

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.*

173. 15 U.S.C. § 7201(7) (2003) (reference to U.S. Code omitted)

The breadth of this definition includes, "Foreign Private Issuers."[174] The definition of "Foreign Private Issuer" as proffered by the SEC in Rule 3b-4 includes any corporation or other organization established under the laws of any foreign country unless:

1. More than fifty percent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; and
2. Any of the following:
   a. The majority of the executive officers or directors are United States citizens or residents;
   b. More than fifty percent of the assets of the issuer are located in the United States; or
   c. The business of the issuer is administered principally in the United States.[175]

Essentially, any foreign company that seeks to list its securities on the NYSE, American Stock Exchange, or Nasdaq must register its securities with the SEC and thus, comes under the purview of the Act.[176] In the past, the distinction between foreign and domestic issuers has generally been important because most foreign private issuers that register securities under Sections 12(b) or 12(g) of the Securities and Exchange Act of 1934[177] have been treated differently and more favorably than their domestic counterparts.[178] As noted above, the SEC has justified the differing treatment as accommodations to attract foreign corporations and as recognition of the fact that foreign private issuers are subject to conflicting corporate governance regulations from their home country.[179]

Given the environment during which it was passed, the Sarbanes-Oxley Act, however, has generally disregarded this distinction.[180] The Act has, in fact, "largely ignored the differences in practices and corporate governance regimes between the United States and other countries, and has extended the reach of the (sic) United States laws to many aspects of the internal affairs and governance regimes of foreign companies and their auditors."[181] Although the Act provides for the SEC to reduce application of certain provisions to foreign

174. Palmer, *supra* note 93.
175. 17 C.F.R. § 240.3b-4.
176. SEC Press Release, International Disclosure Issues, *supra* note 159. *See* Palmer, *supra* note 93.
177. 15 U.S.C. § 78l (2003).
178. Kirk, *supra* note 15. *See* Tafara Speech, *supra* note 10.
179. Kirk, *supra* note 15. *See* Tafara Speech, *supra* note 10.
180. *See* Kirk, *supra* note 15; Tafara Speech, *supra* note 10.
181. Kirk, *supra* note 15.

companies, many will be surprised "by the extent to which United States law and regulatory authority has *prima facie* been extended beyond the borders of the United States into areas that would generally be considered to be governed exclusively by the law of the home country."[182]

III. SECTION 307 AND SEC REGULATIONS

On January 23, 2003, the Securities and Exchange Commission adopted its final rule as mandated by Section 307 of the Act, imposing new standards of professional conduct for attorneys appearing and practicing the Commission in the representation of public companies.[183] The final regulations were effective on August 5, 2003 and are detailed in Part 205 of Title seventeen of the Code of Federal Regulations.[184] Pursuant to Section 307, the standards were to provide for "up the ladder reporting" of evidence of material violations of securities law or breach of fiduciary duties or similar violations by the issuer to the company's Chief Legal Counsel (CLC) or Chief Executive Officer (CEO); and if they do not respond appropriately to the evidence, the attorney must report the violation to the audit committee of the board of directors, another committee of independent directors, or to the full board of directors.[185]

The final rule is intended to protect investors and increase their confidence in public companies by ensuring that attorneys who work for those companies respond appropriately to material misconduct.[186] Although this

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182. *Id.*

183. Tafara Speech, *supra* note 10. *See also* 15 U.S.C. § 7245 (2003) (official code site to Section 307, Rules of professional responsibility for attorneys).

184. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6,296 (Feb. 6, 2003) (codified at 17 C.F.R. pt. 205) (regulations became effective August 5, 2003). The regulations can also be found at U.S. Securities and Exchange Commission, Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Release No. 33-8185 (Jan. 29, 2003), *available at* http://www.sec.gov/rules/final/33-8185.htm (last visited Feb. 11, 2004).

185. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,296. *See also* 15 U.S.C. § 7245. *See generally* European Commission, *Study of Corporate Governance Codes Relevant to the European Union and its Member States*, at 43 (March 27, 2002), *available at* http://europa.eu.int/comm/internal_market/en/company/company/news/corp-gov-codes-rpt_en.htm (last visited Feb. 11, 2004) [hereinafter European Commission Study]. In the majority of European Union member countries, the independent board of directors is known as the Unitary Board of Directors. *See id.* In countries that utilize a two-tiered board system, the "Supervisory Board" meets this definition. *See id.* Countries that utilize a two-tiered bard system include Germany, Austria, the Netherlands, and Denmark. *Id.*

186. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,297. *See also* 17 C.F.R. § 205.1 (2003). The purpose of Rule 205 is established under Section 205.1, which states:

> This part sets forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in the representation of an issuer. These standards supplement applicable standards of any jurisdiction

intent seems sensible enough, its embodiment within the final regulations generated controversy, especially with regard to foreign attorneys. In fact, as noted by the SEC, the original release of the regulations generated "significant comment and extensive debate" in the worldwide legal community.[187] Specifically, the SEC received 167 comment letters challenging various provisions: 123 came from domestic parties, with forty-four coming from foreign parties.[188] The greatest concern involved a proposed requirement that lawyers make a "noisy withdrawal" in the event that the board of directors ignores the attorney's report.[189] In fact, foreign and domestic reaction was so strong that the SEC decided to shelf but not abandon the noisy withdrawal issue for now.[190] In its final rule, the SEC both modified and clarified its proposed rules.[191]

A. The Scope of the SEC's Final Rule and its International Reach

Section 307 and Rule 205 place attorneys "appearing and practicing" before the SEC "in the representation of an issuer" under the purview of the SEC's rules of professional conduct.[192] Generally, an attorney is considered to be "appearing and practicing" before the SEC when he or she:

> (i) Transacts any business with the SEC, including communications in any form;
> (ii) Represents an issuer in an SEC administrative proceeding or in connection with any SEC investigation, inquiry, information request, or subpoena;
> (iii) Provides advice with respect to U.S. securities laws or the Commission's rules or regulations regarding any document that the attorney has notice will be filed with or submitted to the SEC; or

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> where an attorney is admitted or practices and are not intended to limit the ability of any jurisdiction to impose additional obligations on an attorney not inconsistent with the application of this part. Where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with this part, this part shall govern.

Id.

187. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,296. *See also* Tafara Speech, *supra* note 10.

188. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,296.

189. Koniac, *supra* note 95, at 1270.

190. Tafara Speech, *supra* note 10; Donaldson Testimony, *supra* note 6 (noting that the SEC has not yet made a decision on the implementation of the noisy withdrawal provision or an alternative).

191. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,296.

192. *See* 15 U.S.C. § 7245; 17 C.F.R. § 205.1 (2003).

> (iv) Advises an issuer as to whether information or a statement, opinion or other writing is required to be filed with or submitted to the SEC.[193]

An attorney is not considered to be "appearing and practicing" before the SEC if he or she (i) conducts the items listed above outside the context of providing legal services to an issuer with whom the attorney has an attorney-client relationship; or (ii) is a non-appearing foreign attorney.[194] "In the representation of an issuer" is then defined as "providing legal services as an attorney for an issuer, regardless of whether the attorney is employed or retained by the issuer."[195]

Many commentators and practitioners interpreting these provisions have concluded that the definition is extremely broad and covers both in-house and outside counsel, as well as foreign and domestic attorneys.[196] The SEC notes as an example that an attorney employed by an investment advisor who prepares, or assists in preparing materials for a registered investment company that the attorney has reason to believe will be submitted to or filed with the SEC is appearing and practicing before the SEC.[197]

From this, it is clear that under the SEC's final rule, attorneys need not serve in the legal department of an issuer to be covered, but they must be providing legal services in the context of an attorney-client relationship.[198] In other words, it would not include an attorney employed by a public company working in a non-legal capacity.[199] It is also important to note that an attorney-client relationship can exist even in the absence of a formal retainer or other agreement.[200] As for in-house attorneys, the Rule would encompass an attorney working for a non-public subsidiary of a public company if the attorney is assigned work that he or she has notice will be incorporated into documents submitted to the SEC by the parent company.[201]

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193. 17 C.F.R. § 205.2(a)(1) (2003). *See also* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,297-98.

194. 17 C.F.R. § 205.2(a)(2) (2003). *See also* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,297-98.

195. 17 C.F.R. § 205.2(g) (2003).

196. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,298. *See also* Palmer, *supra* note 93 (recognizing that one of the Act's most far reaching provisions is the standards imposed on lawyers practicing before the SEC, which will affect lawyers worldwide).

197. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,298.

198. *Id.*

199. *Id.*

200. *Id.*

201. Thompson & Knight LLP, Client Alert: Sarbanes-Oxley ACT of 2002 SEC Adopts Rules of Professional Conduct for Attorneys, Feb. 5, 2003, *available at* http://www.tklaw.com/website.nsf/719da00bf30d821086256be400670924/6a7e003d8b5a7e6386256cc9005755c9/$FILE/Sarbanes,%20SEC%20Adopts%20Rules.pdf (last visited Feb. 11, 2004) [hereinafter

With regard to attorneys of Foreign Private Issuers, the final rule excludes foreign attorneys not licensed to practice law in the United States.[202] "Non-appearing" foreign attorneys are described in section 205.2.[203] Under Section 205.2(j), a non-appearing foreign attorney is generally described as an attorney: (1) who is admitted to practice law in a jurisdiction outside the United States; and (2) who does not hold himself or herself out as practicing and does not give legal advice regarding U.S. securities or other laws.[204] Therefore, generally, only foreign attorneys who provide advice regarding U.S. securities law will be subject to the SEC's final rule.[205]

Furthermore, in response to feedback the SEC received regarding the proposed Rule 205.2(j), the SEC modified the regulation to include some situations in which the foreign attorney would be considered to be non-appearing even though the attorney's conduct would not fall under the definition above.[206] Those situations include ones in which the attorney conducts activities that would constitute appearing and practicing before the SEC only (i) incidentally to the practice of law in a foreign jurisdiction, or (ii) in consultation with U.S. counsel.[207] In other words, any foreign attorney that provides legal advice other than incidentally regarding U.S. securities or other law without working in conjunction with U.S. counsel will be accountable to the SEC under the standards of professional conduct.[208] For example, an attorney licensed in Canada who independently advises an issuer regarding the application of SEC regulations regarding periodic filings without consulting U.S. counsel will be subject to the Rule.[209] While this final definition does exclude some foreign attorneys, many others will fall squarely within its scope.[210]

It is important to note that the proposed SEC Rule 205 made no distinction between the obligations of U.S. and foreign attorneys.[211] That release, however, requested comments from attorneys licensed in foreign

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Thompson & Night].

202. Tafara Speech, *supra* note 10; Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,298.

203. *See* 17 C.F.R. § 205.2(j).

204. *Id.*

205. Tafara Speech, *supra* note 10; Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,298.

206. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,303 (noting that the definition of "non-appearing foreign attorney" was expanded due to world-wide reaction to its initial rule proposal).

207. 17 C.F.R. § 205.2(j)(3) (2003).

208. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,303. *See also* Thompson & Night, *supra* note 201, at 2.

209. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,303.

210. *Id.*

211. *Id. See also* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg.71,670 (proposed Dec. 2, 2002) (final Rule is codified at 17 C.F.R. pt. 205).

jurisdictions or otherwise subject to foreign law, rules and ethical standards regarding the scope of the Rule.[212] The SEC made this request realizing that the proposed rule could pose difficult issues for foreign attorneys and international law firms subject to conflicting standards and regulations.[213] The SEC also recognized that many non-U.S. attorneys play a significant role in ensuring the compliance of both foreign and domestic issuers regarding SEC regulations.[214]

In December of 2002, the SEC conducted a roundtable on the international impact of the proposed Rule 205.[215] The roundtable participants included, among others, international regulators, professional associations, and foreign law firms.[216] Not surprisingly, participants objected to many aspects of the proposed Rule.[217] With regard to the definition of "appearing and practicing before the Commission," some expressed concern that a foreign attorney who prepares a contract that is filed as an exhibit to an SEC filing might be covered under the act.[218] Also, some felt troubling that a foreign attorney with little or no training on U.S. securities law may not be competent to recognize whether a "material violation" had in fact occurred, thus triggering his obligation to report the violation "up the corporate ladder."[219]

The SEC also received more than forty comment letters expressing concern regarding the international aspects of the proposed Rule.[220] Many requested that non-U.S. attorneys be exempted from the Rule altogether.[221] They argued that the SEC would be violating principles of international comity by exercising jurisdiction over the legal profession outside the shores of the United States.[222] Others alternatively recommended that the SEC take additional time to consider these conflicts and provide, in the interim, temporary exemption from the Rule.[223]

The SEC took these concerns under advisement in drafting the final definition of "non-appearing foreign attorney" and the scope of "appearing and practicing" before the commission.[224] The SEC ultimately rejected any

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212. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,303-04. *See* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,670.

213. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,304.

214. *Id.*

215. *Id.*

216. *Id.*

217. *See id.*

218. *Id.*

219. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,304.

220. *Id.*

221. *Id.*

222. *Id.*

223. *Id.*

224. *See id.*

notion of exempting foreign attorneys noting that foreign attorneys who are concerned that they may not have the expertise to identify material violations of U.S. law should decline to advise their clients on such issues.[225] The SEC added that they should also seek the assistance of U.S. counsel when undertaking an activity that could potentially fall under the guise of "appearing and practicing before the Commission."[226] Also, the SEC clarified that mere preparation of a document that may be included as an exhibit to a filing with the SEC does not constitute "appearing and practicing" before the commission, "unless the attorney has notice that the document will be filed with or submitted to the [SEC] and he or she provides advice on [U.S.] securities law in preparing the document."[227] Finally, as discussed below, the SEC noted that section 205.6 protects a lawyer practicing outside the United States under circumstances where foreign law prohibits compliance with the SEC's final rule.[228]

B. Issuer as Client

The core of Rule 205 is found in Section 205.3(a), which explicitly states that an attorney representing an issuer, including foreign private issuers, owes his or her professional and ethical duties to the issuer as an organization and not to the individual officers or employees with whom the attorney regularly interacts in the course of that representation.[229]

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225. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,304.

226. *Id.* In response to any notion that foreign attorneys should be exempted from the Rule, the SEC noted that:

> [t]he Commission considers it appropriate . . . to prescribe standards of conduct for an attorney who, although licensed to practice law in a foreign jurisdiction, appears and practices on behalf of his clients before the Commission in a manner that goes beyond the activities permitted to a non-appearing foreign attorney.

Id.

227. *Id.*

228. *Id. See also* discussion *infra* text accompanying notes 329-34.

229. Charles Axelrod, *SEC's Proposed Attorney Responsibility Rules Present new Challenges for In-House and Outside Counsel*, CORPORATE COUNSEL WEEKLY, Jan. 1, 2003. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,305; 17 C.F.R. § 205.3(a) (2003), which provides:

> Representing an issuer. An attorney appearing and practicing before the Commission in the representation of an issuer owes his or her professional and ethical duties to the issuer as an organization. That the attorney may work with and advise the issuer's officers, directors, or employees in the course of representing the issuer does not make such individuals the attorney's clients.

17 C.F.R. § 205.3(a). *See also* Palmer, *supra* note 93. "The Act's message to lawyers is that the issuer is 'the client'—not the CEO or CFO." *Id.*

The proposed rule originally provided that an attorney "shall act in the best interest of the issuer and its shareholders."[230] However, the statement sparked significant controversy with both the foreign and domestic legal communities.[231] The concern was that: (i) the language was inapposite to traditional ethical standards for attorneys in that it required an attorney to act in the "best interest" of the issuer; and (ii) it implied that attorneys have a duty to shareholders, creating the basis for a potential private right of action.[232] After receiving extensive feedback from foreign and domestic sources, the Rule was modified to its current version.[233]

With regard to the first concern, the SEC adopted the language recognizing that it is the issuer/corporation acting through its management who decides on the objectives the lawyer must pursue, so long as they are not illegal.[234] The SEC, however, took issue with the idea being proffered by commenters that an attorney is never charged with acting in the "best interests" of the corporation.[235] The SEC pointed to ABA Model Rule 1.13, which provides that an attorney is obligated to act in the best interest of the corporation in circumstances when the attorney knows the organization is likely to be "substantially injured" by the actions of an individual associated with the organization that is in violation of the law.[236] The Official Comment to rule 1.13 states that in such instances, it is indeed in the best interests of the corporation to report the violation to higher authority within the organization.[237] However, the SEC ultimately determined that because the

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230. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,305; Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,670.

231. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,305. *See generally*, Koniac, *supra* note 95, at 1269-1273 (stating that proposed Rule 205 caught the BAR completely off-guard and that the BAR objected to many of the Rule's provisions).

232. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,305 (citing Comments of Cleary, Gottlieb, Steen & Hamilton, at 3-4; Comments of Corporations Committee, Business Law Section, The State Bar of California, at 7; Comments of the American Corporate Counsel Association, at 11; Comments of Task Force on Corporate Responsibility of the County of New York Lawyers' Association, at 2-3).

233. *Id.*

234. *Id.* at 6,305-06.

235. *Id.* at 6,306.

236. *Id.* (citing MODEL RULES OF PROF'L CONDUCT R. 1.13 (2002)); MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2002). *See* MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. [3] & [7] (2002). Official Comment seven states that:

> There are times when the organization's interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interest the lawyer finds adverse to that of the organization of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation.

MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. [7].

237. MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. [3].

corporate attorney is not obligated to act in the best interest of the issuer with respect to corporate decisions traditionally reserved for management, the statement would be removed.[238]

As to the concern that the proposed language creates a potential basis for a private right of action, the SEC made it clear that Rule 205 does not create a fiduciary duty to the shareholders of the organization.[239] The SEC was cognizant of the fact that courts have generally held that that an attorney does not owe a legal obligation to the constituents of an issuer, including its shareholders.[240] Accordingly, the SEC deleted from the final rule any reference to the attorney acting in the best interest of the shareholder.[241] The final rule makes it clear that the lawyer "owes his or her professional and ethical duties to the issuer as an organization."[242]

C. Material Violation and Up-the-Ladder Reporting

Section 205.3(b) clarifies the attorney's duty to protect the corporation by requiring the attorney to report: (i) "evidence of a material violation" of U.S. federal or state securities law; (ii) a material breach of fiduciary duty arising under U.S. federal or state law; or (iii) a similar material violation of any U.S. federal or state law.[243] Under the Rule, an attorney that becomes aware of evidence of a material violation of any of these categories committed by any officer, director, employee, or agent of the issuer, must report the evidence to the issuer's Chief Legal Officer (CLO) or Chief Executive Officer (CEO) (or the equivalents thereof).[244]

First, it is important to clarify "material violation." The final rule makes it clear that the violation must arise under U.S. federal or state law.[245] The rule does not apply to violations of foreign laws.[246] Also, the rule does not

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238. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,306.

239. *Id.*

240. *Id.* (citations omitted). *See, e.g.*, Carlson v. Fredrickson & Byron P.A., 475 N.W.2d 882 (Minn. Ct. App. 1991) (court held that representation of a business does not amount to representation of the business owner); Cole v. Ruidoso Mun. Sch., 43 F.3d 1373 (10th Cir. 1994); Bobbitt v. Victorian House, Inc. 545 F.Supp. 1124 (N.D. Ill 1982); Field v. Freedman, 527 F.Supp. 935 (Kan. 1981).

241. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,306.

242. 17 C.F.R. § 205.3(a). *See also* Palmer, *supra* note 93.

243. 17 C.F.R. § 205.3(b) (2003); 17 C.F.R. § 205.2(i) (2003). "Material violation means a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law." 17 C.F.R. § 205.2(i).

244. 17 C.F.R. § 205.3(b).

245. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,303. *See also* 17 C.F.R. § 205.2(i).

246. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,303. *See also* 17 C.F.R. § 205.2(i).

define the word "material." The SEC indicates that the omission was intentional, stating that "[t]he final rule does not define the word 'material,' because that term has a well-established meaning under the federal securities laws and the Commission intends for that same meaning to apply here."[247] Case law to which the SEC was referring defined material violation as "conduct or information about which a reasonable investor would want to be informed before making an investment decision."[248]

The SEC did, however, feel that it was important to define "breach of fiduciary duty."[249] Under the final rule, a 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."[250] This definition was only slightly modified from the proposed rules.[251]

The next challenge in enforcement comes with the sufficiency of "evidence." Section 307 and Rule 205 require that the attorney report "evidence" of a material violation.[252] The final rule establishes that evidence includes only, "credible evidence, 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."[253] With this definition, the SEC made it clear that whether evidence of a material violation exists will be measured by an objective standard.[254] Because this essentially triggers the reporting requirement, the proposed definition brought with it extensive debate.[255] Many commenters felt the proposed standard was too high, while

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247. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,303 (citing Basic v. Levinson, 485 U.S. 224, 231-36 (1988); TSC Indus. v. Northway, Inc., 426 U.S. 438 (1976)).

248. *See* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,679.

249. 17 C.F.R. § 205.2(d) (2003).

250. *Id.*

251. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,301.

> Several commenters suggested that the definition in the proposing release should be amended to include breaches of fiduciary duty arising under federal or state statues. The phrase "under an applicable federal or state statute" has been added to clarify that breaches of fiduciary duties imposed by federal and state statutes are covered by the rule.

Id.

252. *See* 15 U.S.C. § 7245(1) (2003); 17 C.F.R. § 205.3(b).

253. 17 C.F.R. 205.2(e).

254. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,301.

255. *See id.*

others thought it was too low.[256] The SEC settled for the objective standard currently imposed.[257]

Evidence of a material violation must first be credible.[258] It is only upon such evidence that an attorney must make the decision to determine whether there has been a material violation of U.S. law.[259] Determining the sufficiency of the evidence in supporting a finding that a material violation has occurred or is about to occur, will be a fact sensitive analysis, including 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 attorneys with whom the attorney can consult.[260] The rule makes it clear that the initial duty to report is not triggered solely when the attorney "knows" that a material violation has occurred or when the evidence is "clear and convincing."[261] To be "reasonably likely," the SEC states that a material violation must be more than a mere possibility, but it need not be more likely than not.[262] Thus, a report up the corporate ladder is required when it is reasonably likely that a violation, has occurred, is ongoing, or when it is reasonably likely that a violation is about to occur.[263]

Once an attorney reports evidence of a material violation to the CLO, the CLO becomes subject to the final rule.[264] The CLO must make a reasonable inquiry into the evidence to determine if a violation has occurred or is about to occur.[265] If the CLO reasonably believes that there is no material violation, he or she must advise the reporting attorney of this conclusion.[266] If the CLO does believe that a material violation has occurred or is about to occur, he or she must take all reasonable steps to cause the issuer to adopt an "appropriate response," including remedial measures or sanctions

256. *See id.*
257. *See id.*
258. *See* 17 C.F.R. § 205.2(e) (2003).
259. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,302.
260. *See id.*
261. *Id.*
262. *Id.*
263. *Id.*
264. *See* 17 C.F.R. § 205.3(b) (2003).
265. *See id.*
266. *See id.*

to stop or prevent the violation.[267] The CLO must then advise the reporting attorney of the issuer's response.[268]

If the CLO does not provide an appropriate response to the reported evidence of a material violation within a reasonable period of time, the reporting attorney is then required to report "up the ladder," to the issuer's audit committee, another committee of independent directors, or to the full board of directors.[269] Similarly, as a bypass provision, if the attorney believes that it would be futile to report evidence of a material violation to the CLO or CEO, the attorney may report the information directly to the audit committee, another committee of independent directors, or the full board of directors.[270] An attorney who has received what he believes to be a reasonable and timely response to the reported evidence has satisfied his reporting requirement under the Rule.[271] If the reporting attorney does not believe that he has received an appropriate response to the report, he must explain his reasons to the CLO, CEO, or to the committee to whom he reported the evidence.[272]

By this point, the attorney has essentially navigated a legal minefield, analyzing issues of "material violation," "breach of fiduciary duty," "evidence of material violation," "appropriate response," "up-the-ladder reporting," and others. Already the tangled web of legal definitions and processes has created a labyrinth that will be challenging for foreign attorneys covered by the Act.[273] The question now becomes, provided the attorney does report the evidence up-

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267. 17 C.F.R. § 205.3(b)(2) (2003); Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,307. Under the Rule an "appropriate response" means:

> a response to an attorney regarding reported evidence of a material violation as a result of which the attorney reasonably believes: (1) That no material violation . . . has occurred, is ongoing, or is about to occur; (2) 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 (3) The issuer, with the consent of the issuer's board of directors . . . has retained or directed an attorney to review the reported evidence of a material violation and either: (i) Has substantially implemented any remedial recommendations made by such attorney after a reasonable investigation and evaluation of the reported evidence; or (ii) Has been advised that such attorney may, consistent with his or her professional obligations, assert a colorable defense on behalf of the issuer . . . in any investigation . . . relating to the reported evidence of a material violation.

17 C.F.R. § 205.2(b).

268. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,307.

269. 17 C.F.R. § 205.3(b)(3) (2003); Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 6,307.

270. 17 C.F.R. § 205.3(b)(4) (2003).

271. 17 C.F.R. § 205.3(b)(8) (2003).

272. 17 C.F.R. § 205.3(b)(9) (2003).

273. Palmer, *supra* note 93.

the-ladder, what happens if, after all of this, the attorney still has not received an appropriate response to the reported evidence?

D. Noisy Withdrawal and Proposed Alternative

Under the 2002 proposed rule, the SEC detailed arguably the most controversial aspect of Rule 205; the requirement of the "noisy withdrawal."[274] The idea was to set a standard for notification of the SEC when appropriate action has not being taken by the corporation.[275] The provision, however, generated so much negative feedback that the SEC decided to delay its implementation while it further examines the issue.[276] Foreign attorneys argued that the "noisy withdrawal" requirement would conflict with laws and principles of confidentiality and attorney-client privilege recognized in many foreign jurisdictions.[277]

Under the proposed rule, an attorney who has not received an "appropriate response" from an issuer would be obligated or, in some cases, permitted to initiate a "noisy withdrawal."[278] The requirement, however, differs depending on whether the attorney is an outside counsel or one employed by the issuer.[279] With respect to outside counsel, the proposed rule imposes an obligation on attorneys who have not received an appropriate response to evidence of a material violation to withdraw from representation of the issuer in all matters.[280] This obligation, however, would only be triggered in situations where the attorney believes that a material violation is ongoing or is about to occur, and the violation is likely to result in substantial injury to the financial interest or property of the issuer or its investors.[281] Then, within one business day of withdrawing, the attorney would be required to notify the SEC, in writing, that the he or she had done so for "professional considerations."[282] The use of the phrase "professional considerations" would protect client confidences, while at the same time serving as a red flag to the

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274. *See* Waldmeir, *SEC Retreats*, *supra* note 140 (noting that with regard to the "noisy withdrawal" provision, "the legal profession unanimously condemned that measure, saying it would have turned lawyers into police and undermined their ability to counsel clients").

275. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,689.

276. *See* Tafara Speech, *supra* note 10; Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,308.

277. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,304. *See also* Waldmeir, *SEC Retreats*, *supra* note 140.

278. *See* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,688-89 (discussion of proposed rule 205.3(d) (2003)).

279. *See id.* at 71,688.

280. *Id.* at 71,689. The additional requirement that the attorney must believe that the violation is likely to result in substantial injury to the financial interest or property of the issuer or its investors makes the threshold for action higher than for reporting "up the ladder." *See id.*

281. *Id.*

282. *Id.*

SEC that a material violation of U.S. securities law was ongoing or was about to occur.[283] Finally, the attorney would be required to disaffirm any document or other information filed with the SEC that was materially false or misleading.[284] In situations where the violation had already occurred and would not be considered ongoing, the proposed requirement would become permissive.[285] In other words, the attorney would be permitted to withdraw, notify the commission, and disaffirm filings but would not be required to.[286]

With regard to in-house attorneys, the proposed rule does not require the attorney to resign.[287] Instead, within one day of concluding that the issuer's response to the reported evidence is inappropriate or unreasonable, the attorney would be required to notify the SEC, in writing, that he or she intends to disaffirm documents filed that he or she believes is false or misleading.[288] The SEC reasoned that requiring an in-house attorney to resign when the attorney receives an inappropriate response to his or her reported evidence would be unreasonably harsh.[289] Similar to outside counsel, in circumstances where the material violation has already occurred and has no on-going effect, the in-house counsel would be permitted to take these steps but would not be required to.[290]

The SEC is also seeking comments from the public regarding an alternative to the "noisy withdrawal" provision.[291] Under this alternative approach, an attorney retained by the issuer would still be required to withdraw but instead of reporting this fact to the SEC, the attorney would be required to notify the issuer, in writing, that his withdrawal was based on professional considerations.[292] If the attorney is employed by the issuer, he or she would be required to cease participating in any matter concerning the violation and would be required to notify the issuer that it has not provided an appropriate response to the attorney's report of evidence of a material

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283. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,689.

284. *Id.*

285. *Id.* at 71,690. The threshold for action includes the same requirement that the attorney believe the past violation is likely to have resulted in substantial financial injury to the issuer. *See id.*

286. *Id.*

287. *See id.* at 71,689.

288. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,689. The SEC notes that if the attorney did not prepare or assist in the preparation of any false or misleading filings, the in-house attorney is not required to notify the SEC. *See id.*

289. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,690.

290. *Id.* at 71,690.

291. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6,324, 6,328 (proposed February 6, 2003); Donaldson Testimony, *supra* note 6.

292. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,328.

violation.[293] Unlike the original "noisy withdrawal" proposal, in either instance, the attorney would not be required to disaffirm any false or misleading documents filed with the SEC.[294] It would then become the issuer's responsibility to publicly disclose the attorney's notice of withdrawal or the in-house attorney's notice that he or she did not receive an appropriate response to a report of evidence of a material violation to the SEC.[295] The issuer would be required to report the information on form 8-K, 20-F, or 40-F within two business days of receiving the notice.[296] If the issuer does not comply with this disclosure requirement, the alternative proposal permits the attorney to notify the SEC of his or her withdrawal.[297] The SEC believes that this alternative approach, by placing the responsibility on the issuer instead of the attorney, addresses many of the concerns regarding conflicts of laws and attorney-client privilege expressed by the foreign and domestic legal communities.[298]

E. Qualified Legal Compliance Committee

As an alternative procedure for reporting evidence of a material violation, an issuer may elect to establish a Qualified Legal Compliance Committee (QLCC).[299] The composition of the QLCC must include at least one member of the issuer's audit committee or, if the issuer does not have an audit committee, one member from an equivalent committee of independent directors and two or more members of the issuer's board of directors.[300] The QLCC must be established by the issuer's board of directors and must adopt written procedures for the confidential receipt, retention, and consideration of any report of evidence of a material violation.[301] To meet SEC requirements, the QLCC must be empowered with the authority to assess and investigate any report of material violation by the issuer, its officers, directors, employees, or agents and have the authority to recommend and oversee an appropriate response to the evidence.[302] The QLCC must also have the power to notify the

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293. *Id.*
294. *Id.*
295. *Id.*
296. *Id.*
297. *Id.*
298. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,329.
299. *Id.* at 6,304. *See* 17 C.F.R. § 205.2(k)(1) (2003).
300. 17 C.F.R. § 205.2(k)(1). The provision provides that the members of the QLCC from the issuer's board of directors must not be employed by the company directly or indirectly, and in the case of a registered investment company, must not be "interested persons" as defined in section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. § 80a-2(a)(19)(2003). *Id.*
301. 17 C.F.R. § 205.2(k)(2) & (3) (2003).
302. 17 C.F.R. § 205.2(k)(3). Section 205.3 provides:
> a chief legal officer (or the equivalent thereof) may refer a report of evidence of a material violation to a qualified legal compliance committee under paragraph

SEC in the event that the issuer fails in any material respect to implement an appropriate remedial measure that has been recommended by the QLCC.[303]

If the issuer elects to utilize a QLCC and provided the Committee is formed prior to the report of evidence of a material violation, an attorney who becomes aware of such evidence may report it directly to the QLCC.[304] In that instance, the attorney's obligations under the final rule would be fulfilled.[305] Additionally, under Section 205.3, a CLO may refer a report of evidence of a material violation to the QLCC instead of conducting his or her own inquiry.[306] Once the CLO has reported the evidence to the QLCC, the QLCC will be responsible for responding to the report, including making a determination as to whether an investigation is necessary, conducting the investigation, and adopting appropriate remedial measures.[307] The CLO's only remaining obligation is to inform the reporting attorney that the issue has been referred to the corporation's QLCC for investigation.[308]

F. Supervisory Attorneys

A provision of the final rules that will be particularly important for attorneys of foreign issuers is that of supervisory responsibility. Under the final rules, a supervising attorney is an attorney who supervises or directs another attorney who is appearing and practicing before the SEC in the representation of an issuer.[309] This includes an issuer's CLO or the equivalent thereof.[310] The provision is based in part on Rule 5.1 of the ABA's Model Rules of Professional Conduct.[311] Essentially, the language adopted by the final rule provides that a supervisory attorney to whom a subordinate attorney reports evidence of a material violation is responsible for complying with the

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(c)(2) of this section if the issuer has duly established a qualified legal compliance committee prior to the report of evidence of a material violation."
17 C.F.R. § 205.3(b)(2).

303. *See* 17 C.F.R. § 205.2(k)(4) (2003).

304. 17 C.F.R. § 205.3(c)(1) (2003).

305. *Id. See also* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,309 (noting that upon reporting to the QLCC of evidence of a material violation, the attorney is freed from any obligation to assess the issuers response to the report).

306. *See* 17 C.F.R. § 205.3(c)(2) (2003).

307. *See id.*

308. *See id.*

309. 17 C.F.R. § 205.4(a) (2003).

310. *Id.*

311. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,313. *See also* MODEL RULES OF PROF'L CONDUCT R. 5.1 (2002) (which provides (1) that a lawyer having direct supervisory authority over another lawyer must make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct; and (2) that a supervisory attorney may be held liable for a subordinate attorney's violation of the rules of professional conduct if he or she knowingly ratifies the behavior or fails to prevent the behavior when he or she is able to do so).

reporting requirements of Section 205.3.[312] This language modified the proposed rule by clarifying that "only a senior attorney who actually directs or supervises the actions of a subordinate attorney appearing and practicing before the Commission is a supervisory attorney under the rule."[313] An attorney who supervises or directs a subordinate attorney on matters unrelated to the subordinate's appearing and practicing before the SEC would not be a supervisory attorney under the final rule.[314] Conversely, if a senior attorney does not normally exercise direct supervisory authority over a subordinate attorney but does provide supervisory direction in matters related to the subordinate's appearing and practicing before the SEC, he or she would be a "supervisory attorney" under the final rule.[315]

This provision has potentially wide implications for supervisory attorneys of foreign issuers. Any senior attorney of a foreign issuer who has direct supervisory responsibility over an attorney who meets the definition of appearing and practicing before the SEC will be subject to the final rule.[316] In other words, even though the supervising attorney may not appear and practice before the SEC, he or she will to an extent be responsible for compliance with the Rule.[317]

G. Whistleblower Protection

It is important to note that the Act provides protection for in-house attorneys who comply with the final rule through Section 806's "whistleblower" provision.[318] Specifically, this "whistleblower" provision provides protection to attorneys, or any other employee, against retaliation because the employee provided information or assistance to a federal law enforcement agency or to a person of supervisory authority regarding alleged violations of U.S. securities law.[319] If an employee experiences retaliation and is able to bring a successful claim, the Act entitles the employee to all relief necessary to make the employee whole.[320] This includes reinstatement with the same

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312. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,313.

313. *Id.* In response to the proposed rule, the ABA argued that defining a supervisory attorney to include attorneys who "have supervisory authority over another attorney" would unnecessarily cover "all partners in a law firm and even senior associates," many of which may not actually exercise direct authority over the attorney in question. *Id.* (quoting Comments of the American Bar Association, at 22-23).

314. *Id.*

315. *Id.*

316. *See generally* 17 C.F.R. § 205.4 (2003); Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,313.

317. *See* generally 17 C.F.R. § 205.4; Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,313.

318. *See* 15 U.S.C. § 1514A (2003); 29 C.F.R. § 1980.100 (et. seq.) (2003).

319. *See* 15 U.S.C. § 1514A(a) (2003); 29 C.F.R. § 1980.102(a) (2003).

320. 15 U.S.C. § 1514A(c) (2003); 29 C.F.R. § 1980.109(b) (2003).

seniority status that the employee would have had but for the discrimination, back pay with interest, and compensation for any special damages sustained, including litigation costs and attorney's fees.[321] As can be seen, an in-house attorney who elects to report evidence of a material violation will be provided protection and also means of restoration under the Act.

H. Discipline and Sanctions

There are four subparts to the Discipline and Sanctions provision of Rule 205, three of which are be applicable to foreign attorneys.[322] The underlying strategy of the SEC was to proceed against individuals violating Rule 205 as it would any other violator of U.S. federal securities law and, when appropriate, initiate proceedings under the Rule seeking appropriate disciplinary sanctions.[323]

The first subpart provides that a violation of Rule 205 will subject such attorney to the civil penalties and remedies for a violation of U.S. federal securities laws in an action brought by the SEC.[324] This provision clarifies that only the SEC may bring an action for violation of Rule 205.[325] The second subpart provides that an attorney appearing and practicing before the SEC who violates any provision of Rule 205 will be 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.[326] This could result in many attorneys who violate the provisions of this rule being subject to discipline by both the SEC and the attorney's home country disciplinary authority.[327] Also, an administrative proceeding initiated by the SEC for a violation of Rule 205 can result in an attorney being censured or being temporarily or permanently denied the privilege of appearing and practicing before the SEC.[328]

Next, subpart (d) speaks directly to the liability of non-U.S. attorneys who do not meet the definition of a non-appearing foreign attorney.[329] As noted above, the adopted definition of non-appearing foreign attorney in subpart 205.2(j) was the response to the large number of comments and

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321. 15 U.S.C. § 1514A(c) (2003); 29 C.F.R. § 1980.109(b) (2003).

322. *See generally* 17 C.F.R. § 205.6 (2003).

323. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,314.

324. 17 C.F.R. § 205.6(a) (2003). *See also* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,314.

325. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,314.

326. 17 C.F.R. § 205.6(b) (2003).

327. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,314.

328. *Id.*

329. *See* 17 C.F.R. § 205.6(d) (2003).

feedback the SEC received from the legal community noting that attorneys practicing in many foreign countries will be subject to other home-jurisdiction regulations that will render compliance with the Rule impossible.[330] This point was also emphasized at the December 2002 Roundtable discussions.[331] As a result, the SEC implemented subpart (d) which provides that "[a]n attorney practicing outside the United States shall not be required to comply with the requirements of this part to the extent that such compliance is prohibited by applicable foreign law."[332] Therefore, the foreign attorney does not have to suffer the dilemma of which regulation to comply with.[333] Instead, the foreign attorney must comply with the final rule to the maximum extent allowed by the laws to which the attorney is subject.[334]

There is also a subpart (c) that provides protection for attorneys who comply with the rule in good faith under inconsistent standards imposed by any state or jurisdiction where the attorney is admitted to practice.[335] In such instances, the attorney will not be subject to discipline.[336] This provision, however, relates solely to attorneys who practice in the United States.[337]

Finally, the final rules provide a "safe harbor" provision with regard to private causes of action.[338] Specifically, Rule 205 does not create a private cause of action against an attorney, foreign or domestic, or issuer, based on their compliance or noncompliance with the Rule.[339] Moreover, the provision affirmatively states that only the SEC can enforce the requirements of Rule 205.[340] The SEC notes that this is intended to "preclude, among other things, private injunctive actions seeking to compel persons to take action under the final rule and seeking private damages against such persons."[341] This protection extends to law firms and issuers.[342]

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330. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,314.

331. *Id.*

332. 17 C.F.R. § 205.6(d).

333. *See id.*

334. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,314-15.

335. 17 C.F.R. § 205.6(c) (2003).

336. *Id.*

337. *See id.*

338. *See* 17 C.F.R. § 205.7(a) (2003).

339. *Id.*

340. 17 C.F.R. § 205.7(b) (2003).

341. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,315.

342. *Id.*

IV. INTERNATIONAL REACTION, APPLICATION ISSUES, AND PRACTICAL SUGGESTIONS

A. International Reaction to the SEC's Final Rule

While U.S corporate counsel are loudly struggling with the requirements and implications of the Sarbanes-Oxley Act, the SEC's final rule has had a slightly different impact on their foreign counterparts.[343] The concerns of the legal international community can be seen in a recent poll of delegates of the International Bar Association (IBA) conducted by Martindale-Hubbell.[344] While the issue of greatest importance in the minds of the members of the IBA was the application of the European Union (EU) Merger Regulations, the potential implications of the Sarbanes-Oxley Act and the SEC's final Regulations was an issue as well.[345] As a preliminary matter, of those surveyed, sixty-three percent revealed that their legal department's work crosses more than one jurisdiction, with a substantial portion (twenty-eight percent) indicating that ninety percent or more of their work is multi-jurisdictional.[346] Also, forty-six percent of the companies represented in the survey reported annual revenues in excess of one billion U.S. dollars.[347] The poll did not state what percentage of the attorneys surveyed provide legal advice regarding U.S. securities law or who might not otherwise meet the Rule's definition of "non-appearing foreign attorney."[348] That is the group that will feel the greatest effects and is likely to express the greatest concerns over the application of the new Rule.[349]

The poll indicates that the majority of the members of the IBA see corporate counsel playing an increasingly substantive role in the day-to-day business operations in the future.[350] This is supported by the fact that sixty percent of those surveyed see the broadening of the legal function as "essential" in business operations.[351] The members of the IBA ranked in order of importance the primary legal/business functions.[352] They included in order: 1) mergers and acquisitions; 2) business-focused legal advice; and 3)

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343. *See International Reaction to Enron and Sarbanes-Oxley: Results of 2003 IBA Poll,* Martindale-Hubbell's Counsel to Counsel, 3 CONNECTIONS 2 (Summer 2003) [hereinafter Martindale-Hubble Poll].

344. *See id.* Martindale-Hubbell polled delegates at the annual International Bar Association Conference held in February of 2003 in Barcelona, Spain. *See id.* at 1.

345. *See id* at 1.

346. *Id.* at 2.

347. *Id.*

348. *See generally* Martindale-Hubble Poll, *supra* note 343.

349. *See* discussion, *supra* text accompanying notes 192-228.

350. *See* Martindale-Hubble Poll, *supra* note 343, at 1.

351. *Id.*

352. *Id.*

corporate governance.[353] Interestingly, general management priorities for legal counsel were more focused on contributing to business strategy and solving business problems than on solving legal problems.[354] The single most important issue facing corporate counsel, however, was risk management.[355]

With regard to the repercussions of the Sarbanes-Oxley Act and the SEC's final regulations, fifty-eight percent indicated that the new regulations would impact their international legal function in some way.[356] The impact on legal counsel includes, more reporting responsibilities, more time spent understanding and applying the new regulations, and more paperwork.[357] Only thirty-two percent of the IBA reported that the regulations would not affect the legal function.[358] The survey further notes that of the companies represented in the survey, fifty-nine percent predicted that their reliance on outside counsel would remain stable, while those who did expect a change thought their reliance on outside counsel would increase.[359]

Finally, the President and CEO of Martindale-Hubbell, John Lawler, in discussing the impact of the new regulations and the corresponding public expectations noted that:

> [c]ommon perceptions—or misconceptions—are arguably the most difficult issues confronting counsel in the post-Enron, post-[Sarbanes-Oxley] environment. Regulations are a cake-walk compared to the shifting expectations of corporate clients, public feelings on pervasive misconduct, and even the self-image of the company itself, which may have unwittingly outgrown the style and structure of its governance program.[360]

He concluded that "[t]he slow process of refashioning corporate culture rests largely in the hands of the legal department."[361]

B. Application Issues For Foreign Attorneys and Foreign Private Issuers

The SEC's final rule for corporate attorneys was meant to change the culture of corporate governance that produced Enron, but some suggest that the real cultural revolution may come not in the way companies are ran but in

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353. *Id.*

354. *Id.*

355. *Id.*

356. Martindale-Hubble Poll, *supra* note 343, at 1.

357. *Id.*

358. *Id.* Ten percent of the IBA indicated that they were not sure how the new U.S. regulations would impact their legal responsibilities. *Id.*

359. *Id.* at 2.

360. John Lawler, A letter from the President, Martindale Hubbell's Counsel to Counsel, 3 CONNECTIONS 2, at 2 (Summer, 2003).

361. *Id.*

the way they relate to their lawyers.[362] They reason that turning corporate lawyers into "watchdogs" will cause corporate executives to avoid them not confide in them.[363] After all, corporate executives often avoid gatekeepers; they are attracted to problem solvers.[364] As a result, corporate executives "may end up breaking more laws out of ignorance than they ever did by design."[365] The unintended consequence may be that corporations will become more secretive, not more transparent.[366]

Furthermore, with regard to the behavioral impact of the SEC's final rule, some foresee potential personal dilemmas, especially with regard to outside counsel. [367] It starts with the notion that outside attorneys generally do not retain clients, rather clients retain attorneys.[368] Also, even though the organization is the client, the attorney is typically hired by and has primary contact with only a few corporate managers.[369] Those same individuals generally define the objectives of the representation and identify the responsibilities for which the attorney has been retained.[370] Ultimately, they make the critical decisions as to the attorney's retention, compensation, and performance evaluation.[371] As a result, even though the attorney's final allegiance runs to the corporation, the attorney's day-to-day responsibilities include reporting to and pleasing these individuals.[372] In an era in which major corporations routinely retain a number of outside law firms, no attorney's position is safe.[373]

The personal dilemma arises when the attorney becomes aware of a material violation of U.S. securities law (assuming the attorney meets the

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362. Waldmeir, *Hidden Dangers*, *supra* note 123.

363. *See id.*

364. *Id.*

365. *Id.* (quoting Burton Staniar, Chief Executive of Knoll, from his speech before a conference of attorneys at Georgetown University Law School). *See also* Waldmeir, *Lawyers on Duty*, *supra* note 86.

> Where lawyers are forced to spy on everything management does, second-guessing business decisions and ratting on managers to the board, company officials may be reluctant to seek legal advice . . . And if they do not know what the law is, there is even more chance they will break it.

Id.

366. Waldmeir, *Hidden Dangers*, *supra* note 123.

367. *See* Fisch & Rosen, *supra* note 122, at 1123. *See also* Palmer, *supra* note 93 (stating that the reporting duties raise "thorny management issues"). For global law firms serving international issuers, the difficulties are compounded. *Id.* Firms must determine how to comply with the new rule while at the same time preserving the confidentiality of communication and trust fundamental to the attorney-client relationship. *Id.*

368. Fisch & Rosen, *supra* note 122, at 1123.

369. *Id.*

370. *Id.*

371. *Id.*

372. *Id.*

373. *Id.*

elements of the final rules subjecting him or her to liability).[374] The attorney is faced with the option of reporting the violation to the corporation's CEO or Board of Directors or keeping it quiet and risking potential sanctions.[375] In many corporations, the attorney's decision to report the violation is likely to have serious consequences with his or her relationship with that client.[376] Particularly, if the Board of Directors has confidence in management, the attorney's report may place the Board in the undesirable position of taking sides between its trusted executives and the outside attorney.[377] The consequence is that if the attorney's report does not result in a finding of tangible evidence of a material violation, his or her future with that client will likely be jeopardized.[378] In addition, the attorney, in such an instance, may compromise his or her professional reputation.[379] Other managers and executives may be unwilling to hire an attorney known in the corporate community as a "whistleblower."[380] Legitimately, they will be concerned with the lack of trust in the attorney and the quality of the representation.[381] Given the abundance of attorneys in the world's legal market, this is a situation attorneys will want to avoid.[382]

On the other end of the spectrum, one can envision an attorney that is eager to avoid liability over-reporting evidence of material violations.[383] This might especially be true for in-house counsel, who will not likely face the replacement issues of outside counsel.[384] Given the somewhat vague standards contained in the final rule for "material violation," "credible evidence," and "appropriate response," an overzealous in-house attorney motivated by avoiding liability is likely to over-report, wasting time and resources.[385] The idea is that "if the scope of the reporting obligations is unclear or ambiguous and the attorney faces meaningful risk of liability, it becomes rational for him or her to report all evidence related to actual, likely or even improbable wrongdoing up the corporate ladder."[386] In fact, some suggest that over-

374. *See* Fisch & Rosen, *supra* note 122, at 1124-25.

375. *See id.*

376. *Id.* at 1125.

377. *Id.* (The situation is similar for in-house attorneys, however, the point is better illustrated with outside counsel).

378. *Id.* at 1126.

379. *Id.*

380. Fisch & Rosen, *supra* note 122, at 1126.

381. *Id. See also At the Top Table*, LEGAL WEEK, Sept. 26, 2002, *available at* LEXIS, News & Business, News, Major World Publications (last visited March. 4, 2004) (noting that "[t]here is . . . a fear that by being branded as potential whistleblowers corporate counsel may lose the trust of their bosses—and with it the ability to influence the decisions their companies make").

382. *See generally* Fisch & Rosen, *supra* note 122, at 1123.

383. *See id.* at 1125.

384. *See id.*

385. *See id.* at 1126.

386. *See id.*

disclosure is consistent with existing operational practices for corporate attorneys.[387]

The fear of potential liability may also reduce the corporate attorney's incentive to become fully informed about the client's business.[388] The final rule does not create a "should have known" standard.[389] As a result, the less the attorney knows, the more likely he or she is to avoid reporting obligations and ultimately liability.[390] Some have suggested that by reducing the lawyer's incentive to get more involved in the operations of the business, the final rule will reduce attorneys' overall performance as counselors.[391]

The SEC's final rule will also impose costs on corporations that fall under the Act.[392] As discussed above, the rule will ultimately cause the corporation's CLO to investigate evidence of material violations, evaluate such evidence, and implement necessary remedial action.[393] The Rule will also cause the CEO, QLCC, and Board of Directors to review evidence of material violations.[394] Each of which will cost in terms of time and financial resources.[395] For instance, a company that elects to form a QLCC might incur costs that include increased compensation and insurance for QLCC members and general administrative costs;[396] not to mention the cost of the corporate legal division's and executive management's time and resources spent learning, circulating, and implementing the new regulations.[397]

Finally, the foreign community has expressed concerns that the requirements of the new rules of professional conduct may have implications where an attorney is subject to conflicting home country ethical requirements.[398] The SEC, however, has made it clear that the provisions of the final rules will prevail.[399]

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387. *See id.*

388. Fisch & Rosen, *supra* note 122, at 1127.

389. *See id.*

390. *See id. See also* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,302.

391. *See* Fisch & Rosen, *supra* note 122, at 1125.

392. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,317.

393. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,307. *See* discussion *supra*, text accompanying notes 243-72. *See also* 17 C.F.R. § 205.3.

394. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,307 & 6,313. *See* discussion *supra* text accompanying notes 243-72 & 298-307. *See also* 17 C.F.R. § 205.3.

395. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,317.

396. *See id.*

397. *See id.*

398. *See* Tafara Speech, *supra* note 10.

399. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,304. The SEC stated that, "[n]on-United States attorneys who believe that the requirements of the rule conflict with law or professional standards of their home jurisdiction may avoid being subject to the rule by consulting with United States counsel whenever they engage in any

C. *Practical Suggestions to Ensure Compliance*

There are a number of things that foreign attorneys and the companies they represent can do to put themselves in the best position to ensure compliance with the new Rule.[400] First, it may be prudent for foreign private issuers to establish a QLCC, which can be the company's audit committee.[401] A properly-functioning QLCC can benefit everyone involved in the corporate governance process.[402] Under the SEC's final rule, if an attorney reports evidence of a possible material violation to the QLCC, his or her reporting obligations have been satisfied.[403] Also, the QLCC can relieve the CLO of the obligation to investigate and respond to reports of potential violations, which would free the CLO up to conduct his or her other legal functions and would likely result in a more consistent and efficient method of dealing with violations.[404] Some suggest that these benefits would outweigh any potential costs in establishing the Committee.[405]

Instituting a QLCC should not be such a leap for much of the world. For instance, Supervisory Body Committees, which function similarly to QLCC's, are common in many European Union member countries.[406] Generally, E.U. member countries rely on such committees to help organize the work of the supervisory board, particularly in areas where the personal interests of management and the interests of the company may come into conflict, such as with financial reporting, auditing, and remuneration.[407] In fact, the trend to use these committees among E.U. countries seems to be growing.[408] The only issue to overcome with regard to the establishment of the QLCC would be in the makeup of the committee itself. Generally, Supervisory Body Committees are composed of a mixture of independent directors and non-executive employees.[409] Under the SEC's final rule, the composition of a QLCC cannot contain a member that is employed directly or indirectly by the issuer.[410] As

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activity that constitutes appearing and practicing before the commission." *Id.*

400. *See* Thompson & Night, *supra* note 201, at 6.

401. *Id.*

402. *Id.*

403. *Id. See* 17 C.F.R. § 205.3(c)(1); discussion *supra* text accompanying notes 299-308.

404. *See* Thompson & Night, *supra* note 201, at 6.

405. *See id.*

406. *See generally* European Commission study, *supra* note 124.

407. *See id.*

408. *See id.* at 78 (nominating committees, audit committees, and remuneration committees are all common occurrences in Belgium, France, the Netherlands, Spain, Sweden, UK and others).

409. *See id.* The reason for having non-executive employees to serve on Supervisory Body Committees is that their presence provides additional assurance to market investors that their interests are defended. *Id.*

410. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,305.

a result, the QLCC would have to function as a subcommittee, excluding the employees of the issuer.

Next, depending on its size and structure, it may be advisable for foreign private issuers to establish a clear hierarchy within the company's legal department.[411] Designating "supervisory attorneys" within the department can minimize the obligations of subordinate attorneys to report evidence of material violations up to the Board of Directors or QLCC.[412] This will not only define roles and responsibilities with regard to the final rule but will also provide a system of checks and balances as to what is being reported and to whom.[413]

Moreover, to combat the inclination on the part of executives to avoid lawyers subject to the final rule, general counsels may want to establish regular meetings with a committee of independent directors and executives, dedicated to the discussion of breaches of law and duty.[414] The idea is that rather than trying to meet only in times of crisis, these gatherings would be routine.[415] As one expert put it, this "may sound like a structural solution to a substantive problem but anyone who has worked in a large organization knows that once the structure exists the substance will follow."[416] If the two sides make it a practice to meet regularly to discuss the law, the company will likely end up obeying it more often.[417]

Also, foreign attorneys should take necessary steps to learn the new regulations.[418] According to the above survey, nearly sixty percent believe that, in some way, the new SEC regulations will affect their performance as corporate counsel.[419] It stands to reason that foreign corporate counsel should take time to learn the new standards. This also applies to those individuals in supervisory roles that do not directly appear and practice before the SEC.[420] As the Rule notes, supervising attorneys have an obligation to ensure that

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411. *See* Briefing Paper, Securities and Litigation Teams, Pillsbury Winthrop LLP, SEC Sets Attorney Professional Conduct Standards under Sarbanes-Oxley Act, at 1 (Feb. 27, 2003), *a t* http://www.pillsburywinthrop.com/files/tbl_s31Publication/PDFUpload208/8727/Client%20Alert%20Securities-Litigation%2002-28-03_1069410.pdf (last visited March 4, 2004) [hereinafter Pillsbury Briefing Paper].

412. *Id. See generally* 17 C.F.R. § 205.4 (discussion *supra* text accompanying notes 309-17); 17 C.F.R. § 205.5 (2003).

413. *See generally* Pillsbury Briefing Paper, *supra* note 411, at 1.

414. Waldmeir, *Hidden Dangers*, *supra* note 123.

415. *Id.*

416. *Id.*

417. *Id.*

418. *See* Palmer, *supra* note 93; Thompson & Night, *supra* note 201, at 6.

419. *See* Martindale-Hubbell Poll, *supra* note 343, at 1.

420. *See generally* 17 C.F.R. § 205.4.

subordinate attorneys abide by the new rules.[421] This holds true for supervising attorneys practicing as in-house or as outside counsel.[422]

The learning process, however, should not stop there. In-house attorneys should also take time to educate and train the foreign issuer's officers and directors so that the company will be adequately equipped to handle evidence of possible material violations.[423] This includes training those individuals on the new governance standards imposed by the Act, generally with regard to securities law, and the attorney's obligations imposed by Section 307.[424] Also, it would be wise for the board of directors to establish and circulate throughout the company, written procedures for handling the receipt, consideration, and investigation of reports of material violations.[425] Only then will the company put itself in the best position to head-off potential securities law violations.[426]

With regard to outside law firms, it would be advisable to ensure that all attorneys within the firm know and understand the SEC's new regulations implementing section 307.[427] This includes every lawyer, not just those working within the corporate/securities practice group.[428] Once again, the goal being that with awareness of the proposed rules, the firm will put itself in the best position to ensure that it meets SEC standards.

Also with regard to the learning process, it is important for attorneys of foreign issuers to become familiar with U.S. securities laws. According to the final rule, the only way for an attorney who would not otherwise meet the definition of a non-appearing foreign attorney to avoid being subject to the rule would be to decline to advise their client on U.S. securities law or to seek the assistance of U.S. counsel when undertaking an issue that could constitute "appearing and practicing before the Commission."[429] As mentioned above, the final rule does not define "material" with regard to "material violation."[430] Instead, the final rule relies on the term's "well-established meaning under federal securities laws."[431] Naturally, an attorney who may be subject to liability under this rule would be well-served to know precisely what that definition is and how it applies to a given set of facts. In short, any attorney that could fall under the definition of "appearing and practicing before the

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421. *See id.*
422. *See id.*
423. *See* Thompson & Night, *supra* note 201, at 6.
424. *See id.*
425. *See id.*
426. *See generally id.*
427. *See id. See also* Palmer, *supra* note 93.
428. *See* Palmer, *supra* note 93.
429. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,304.
430. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,303.
431. *Id.*

Commission" should put forth the time and effort to know and understand U.S. securities law.[432] This will minimize risk to the attorney and to the corporation. Furthermore, because so much of the Rule suggests that a foreign attorney practicing before the SEC can avoid liability by consulting a U.S. attorney, it would be advisable for foreign issuers to retain U.S. law firms to serve as a resource for U.S. securities law issues.[433] Given the potential for liability and the immunity it provides, this might be well worth it.[434]

Finally, as a risk management measure, outside law firms may want to engage in stricter client screening.[435] Some suggest that when a client undergoes a change in control, such as in bankruptcy, merger, or takeover, the risk for SEC involvement and regulatory action will increase.[436] As a result, a law firm will want to screen the potential for such circumstances, and unless the firm specifically practices in those areas, it may want to avoid representation of that client.[437]

V. CONCLUSION

Section 307 of the Sarbanes-Oxley Act and Rule 205 are designed to protect investors and increase their confidence in public companies by ensuring that attorneys who represent issuers report up the corporate ladder evidence of material violations committed by their officers and employees.[438] The idea is that by requiring attorneys to act in this manner, investors will be comforted knowing that the corporation's executives and independent board members will evaluate and deal swiftly with such issues.[439] At the same time, general awareness of the corporate attorney's obligations under the SEC's final rule should deter incidents of corporate misconduct by company employees for fear that wrongdoing will be detected and reported as a matter of course.[440] Ultimately, the SEC's final rule improves the overall governance of corporations, by providing attorneys who appear and practice before the SEC clarity and guidance with regard to their duties and ethical obligations.[441]

Furthermore, the broad scope of the SEC's final rule reaches and will impact foreign attorneys who do not meet the SEC's definition of "non-

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432. *See generally* Palmer, *supra* note 93.

433. *See* 17 C.F.R. § 205.2(j)(3) (2003).

434. *See* 17 C.F.R. § 205.6; Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,314-15.

435. *See* Palmer, *supra* note 93.

436. *Id.*

437. *See generally id.*

438. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,297; 17 C.F.R. § 205.1. *See also* Tafara Speech, *supra* note 10; Palmer, *supra* note 93.

439. *See* Pitt Speech Before the ABA, *supra* note 78.

440. *Id.*

441. *Id.*

appearing and practicing."[442] At very least, the impact will come in the form of heightened reporting responsibilities, more time spent understanding and applying the complexities of the new regulations, and more paperwork.[443] Also, the Rule poses several potentially significant application issues in terms of the way corporations interact with their attorneys and with the personal choices attorneys will have to make in complying with the Rule.[444] However, by implementing a few practical suggestions, attorneys and the corporations that employ them can head off many of these application issues and can put themselves in the best position to ensure compliance with the new Rule.[445] Some have even suggested that as client service professionals, implementing the Rule in the right light may actually improve attorney performance.[446] As one expert put it, "[p]roactive firms will use the new conduct rules to enhance the quality of client service. After all, the new reporting obligations are intended to deter harm to clients from breaches of duty and to improve the quality of their public reporting."[447] Consequently, the net effect should be a reduction in material violations of U.S. securities law and ultimately an increase in investor confidence.

442. Palmer, *supra* note 93. *See also*17 C.F.R. § 205.2(a)(2) (2003); Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6,297-98.

443. *See* Martindale-Hubble Poll, *supra* note 343, at 1.

444. *See supra* text accompanying notes 362-91.

445. *See supra* text accompanying notes 400-437.

446. *See* Palmer, *supra* note 93.

447. *Id.*