CLIENT
MEMORANDUM

SEC PROPOSES A PROFESSIONAL RESPONSIBILITY RULE FOR LAWYERS

As noted in our memorandum dated July 29, 2002, provisions of the Sarbanes-Oxley Act of 2002 (the "Act") direct the Securities and Exchange Commission (the "SEC") to establish rules of professional responsibility for corporate attorneys. On November 6, 2002, the SEC voted to propose a rule implementing these provisions and issued a press release summarizing certain components of the proposed rule. The November 6 announcement provides that the SEC will release the full text of the proposed rule as soon as possible. The release of the text of the proposed rule will be followed by a 30-day comment period. Adoption of the final version of the rule is expected early next year.

The proposed rule would establish an "up the ladder" reporting regime under which attorneys representing issuers would be obligated to report material violations of law that the attorney reasonably believes have occurred, first to certain officers and, if these officers fail to respond appropriately, to directors. In some circumstances, attorneys would be required to disaffirm SEC submissions where they believe a violation is ongoing or prospective. To further the objectives of the reporting requirements, the proposed rule would allow attorneys to disclose confidential information in certain circumstances and would provide that certain disclosures would not violate the attorney-client privilege.

Attorneys subject to the proposed rule

The SEC recognizes that the reach of the proposed rule is expansive. The proposed rule would govern all attorneys who represent issuers before the SEC, including both in-house lawyers and outside counsel, and both attorneys licensed in the U.S. and those licensed abroad.

Reporting requirements under the proposed rule

In order to comply with the proposed rule, when an attorney "reasonably believes" that a material violation of the securities laws, breach of fiduciary duty, or similar violation has occurred, is occurring, or is about to occur, the attorney must (i) report evidence of the violation either to the issuer's chief legal officer (the "CLO") or to the CLO and the CEO and (ii) document the report and the issuer's response.

Upon receiving a report, the CLO must determine whether an investigation is merited. If the CLO concludes that there has been no violation, the CLO must (i) report this conclusion to the reporting attorney and (ii) preserve documentary evidence of the investigation, if one occurred. If the CLO concludes that a violation has occurred, is occurring, or is about to occur, the CLO must (i) take steps to ensure that the issuer adopts appropriate remedial measures, including disclosure and (ii) report any remedial measures adopted to those "up the ladder" within the issuer and to the reporting attorney.

If the reporting attorney does not receive an "appropriate response" from the CLO or CEO within a "reasonable time," the attorney must report the evidence to the issuer's audit committee, to another committee of independent directors, or to the full board. The proposed rule would allow an attorney to report directly to the audit committee, another independent committee, or the full board if the attorney believes that reporting to the CLO and the CEO would be futile.

In some circumstances, the proposed rule would require a "noisy withdrawal." A noisy withdrawal occurs when an attorney withdraws from a representation and effectively gives notice of such withdrawal to third parties by disclaiming an opinion or document prepared in the course of the representation. The SEC acknowledges that the noisy withdrawal provision of the proposed rule is "not specifically mandated" by the Act. However, under the proposed rule, if an attorney (i) has not received an appropriate response from the issuer, and (ii) believes that a violation is ongoing or prospective, the attorney must disaffirm any submission that the attorney believes is tainted by the violation. The proposed rule would provide that where an attorney files a notification with the SEC as part of a noisy withdrawal, no waiver or violation of the attorney-client privilege occurs. The noisy withdrawal provision of the proposed rule would make a distinction between outside and in-house counsel because the "cost of compliance" to an in-house attorney is greater.

An issuer may avoid the possibility of a noisy withdrawal by establishing a qualified legal compliance committee (a "QLCC") authorized to require the issuer to take remedial action. The proposed rule would require that a QLCC be comprised of at least one member of the audit committee and two or more additional directors, all of whom must be independent. If an issuer fails to take remedial action at the direction of its QLCC, each member of the QLCC will be responsible for notifying the SEC. However, attorneys who report violations to a QLCC will not be subject to the noisy withdrawal requirement.

Confidentiality and privileges

Under the proposed rule, an attorney may disclose confidential information related to the representation (i) to defend against charges of attorney misconduct, (ii) to prevent the commission of an illegal act which the attorney reasonably believes will result in fraud being perpetrated on the SEC or in substantial injury to the financial or property interests of the issuer or a third party, or (iii) to rectify an issuer's illegal actions when the issuer has used the attorney's services to advance those actions.

The proposed rule would also provide that an issuer does not waive any privileges by sharing confidential information regarding a violation with the SEC, provided that the disclosure to the SEC is made pursuant to a confidentiality agreement.

Sanctions

A violation of the proposed rule will constitute a violation of the Exchange Act. Thus, a violator will be subject to the remedies and sanctions available under the Exchange Act, including injunctions, cease and desist orders, and officer and director bars.

Special concerns regarding the proposed rule

As noted above, the SEC acknowledges that the proposed rule goes beyond the requirements of the Act, particularly with respect to the provisions covering confidentiality and privilege. Because these provisions may conflict with established law and rules governing attorney conduct, the ramifications of the proposed rule are difficult to predict. Several specific concerns are noted below.

Attorneys licensed in the U.S are subject to the ethical rules established by the state in which they are licensed. Ethical rules in some states will almost certainly conflict with the mandates of the proposed rule. Most obviously, fulfilling the noisy withdrawal requirement of the proposed rule could constitute a violation of ethical rules governing the preservation of client confidences in some jurisdictions. Similar concerns arise with regard to attorneys licensed in foreign jurisdictions. The SEC recognizes that requiring attorneys licensed abroad to conform to professional conduct rules established by an American regulatory body raises the possibility of "inappropriate interference" with the activities of non-U.S. lawyers. As such, the SEC has invited comment on how to ensure that the requirements of the proposed rule do not inappropriately interfere with these activities.

Further, it is not clear that an SEC rule can displace or overcome the well-developed law of attorney-client privilege. Specifically, it is difficult to predict the force of the proposed rule's assertion that privilege will survive disclosure to third parties where, under current law, such disclosure may be sufficient to waive the attorney-client privilege.

Lastly, because individual states customarily enforce ethical rules, the probable conflict between the proposed rule and state ethics codes may result in conflicts between the enforcement mechanism of the states and the SEC.

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If you wish to obtain additional information regarding the SEC's proposed rule concerning standards of professional conduct for attorneys, please contact Joseph T. Baio (212-728-8203), Benito Romano (212-728-8258), or Elizabeth S. Stong (212-728-8272).

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