

that an issuer's disagreement in good faith with the Commission over a matter in litigation should not raise a reporting obligation under the rules.³² Others suggested that the definition of "appropriate response" include the assertion of "a colorable defense or the obligation of the Commission staff to bear the burden of proving its case."³³ Some commenters stressed that an attorney representing an issuer should be able to take any position for which there is an evidentiary foundation and a nonfrivolous legal basis.³⁴ The commenters did not want the final rules to impair an advocate's ability to present non-frivolous arguments. Some commenters noted that an issuer has no right to use an attorney to conceal ongoing violations or plan further violations of the law.³⁵

The standard set forth in the final version of Section 205.2(b) requires the attorney to "reasonably believe" either that there is no material violation or that the issuer has taken proper remedial steps. The term "reasonably believes" is defined in Section 205.2(m). In providing that the attorney's belief that a response was appropriate be reasonable, the Commission is allowing the attorney to take into account, and the Commission to weigh, all attendant circumstances. The circumstances a reporting attorney might weigh in assessing whether he or she could reasonably believe that an issuer's response was appropriate would include the amount and weight of the evidence of a material violation, the severity of the apparent material

violation and the scope of the investigation into the report. While some commenters suggested that a reporting attorney should be able to rely completely on the assurance of an issuer's CLO that there was no material violation or that the issuer was undertaking an appropriate response, the Commission believes that this information, while certainly relevant to the determination whether an attorney could reasonably believe that a response was appropriate, cannot be dispositive of the issue. Otherwise, an issuer could simply have its CLO reply to the reporting attorney that "there is no material violation," without taking any steps to investigate and/or remedy material violations. Such a result would clearly be contrary to Congress' intent in enacting Section 307. On the other hand, it is anticipated that an attorney, in determining whether a response is appropriate, may rely on reasonable and appropriate factual representations and legal determinations of persons on whom a reasonable attorney would rely.

Some commenters expressed confusion over the "and/or" connectors in the proposed subparagraph (b)(2), and they have been eliminated in the final rule. The Commission believes that the revisions to this subparagraph make clear that the issuer must adopt appropriate remedial measures or sanctions to prevent future violations, redress past violations, and stop ongoing violations and consider the feasibility of restitution. The concern that under subparagraph (b)(2) any issuer's response to a reporting attorney that remedial measures are ongoing but not completed must be deemed to be inappropriate, thereby requiring reporting up-the-ladder, appears to be overstated. Many remedial measures, such as disclosures and the cessation of ongoing material violations, will occur in short order once the decision has been made to pursue them. Beyond this, the reasonable time period after which a reporting attorney is obligated to report further up-the-ladder would include a reasonable period of time for the issuer to complete its ongoing remediation.

By broadening the definition of "appropriate response," subparagraph (b)(3) responds to a variety of concerns raised by commenters. Subparagraph (b)(3) permits an issuer to assert as an appropriate response that it has directed its attorney, whether employed or retained by it, to undertake an internal review of reported evidence of a material violation and has substantially implemented the recommendations made by an attorney after reasonable investigation and evaluation of the

reported evidence. However, the attorney retained or directed to conduct the evaluation must have been retained or directed with the consent of the issuer's board of directors, a committee thereof to whom a report could be made pursuant to 205.3(b)(3), or a qualified legal compliance committee.

Subparagraph (b)(3) also explicitly incorporates into the final rule our view, expressed in the proposing release, that "[i]t would not be an inappropriate response to reported evidence of a material violation for an issuer's CLO to direct defense counsel to assert either a colorable defense or a colorable basis for contending that the staff should not prevail."³⁶ Subparagraph (b)(3) incorporates this standard into the definition of "appropriate response" by permitting an issuer to respond to a report that it has been advised by its attorney that he or she may assert a colorable defense on behalf of the issuer in response to the reported evidence "in any investigation or judicial or administrative proceeding," including by asserting a colorable basis that the Commission or other charging party should not prevail.³⁷ The provision would apply only where the defense could be asserted consistent with an attorney's professional obligation. Once again, the attorney opining that he or she may assert a colorable defense must have been retained or directed to evaluate the matter with the consent of the issuer's board of directors, a committee thereunder to whom a report could be made pursuant to Section 205(b)(3), or a qualified legal compliance committee.

We noted in our proposing release our intention that the rule not "impair zealous advocacy, which is essential to the Commission's processes."³⁸ The attorney conducting an internal investigation that is contemplated under subparagraph (b)(3) may engage in full and frank exchanges of information with the issuer he or she represents.

³⁶ The text of the final rule does not specifically include a reference to a "colorable basis for contending that the staff [or other litigant] should not prevail," nor does it specifically refer to requiring the Commission staff or other litigant to bear the burden of its case. The Commission, however, considers these and related actions permitted to an attorney, consistent with his or her professional obligations, to be included within the reference to asserting a "colorable defense."

³⁷ Subparagraph (b)(3) thereby also addresses the concern of some commenters that an attorney representing an issuer in connection with a Commission investigation or administrative proceeding not be required to report the information. Under subparagraph (b)(3), asserting a colorable defense on an issuer's behalf in an investigation or administrative proceeding may constitute an appropriate response, and no further reporting would be required.

³⁸ 67 FR 17673.

Hamilton, at 9 ("There would be an unavoidable chilling effect on the advocacy of lawyers who represent clients before the Commission in investigations and administrative proceedings if Rule 205 applies to them."); Comments of the Association of the Bar of the City of New York, at 19-20 (stating that it would be "unfair[] to include attorneys who are adverse parties in enforcement or administrative proceedings within the reporting and withdrawal requirements of the proposed rules"); Comments of Susan P. Koniak *et al.*, at 36 (final rules should "avoid chilling legitimate and vigorous advocacy").

³² Comments of Richard Hall, Cravath, Swaine & Moore, at 3.

³³ Comments of Morrison & Foerster and eight other law firms, at 14.

³⁴ Comments of Securities Regulation Committee, Business Law Section, New York State Bar Association, at 6 (stating that "a lawyer need not subjectively believe that he or she has the 'better side of the argument' or that it is a position likely to prevail. The attorney is permitted to undertake the representation if he or she, after a reasonable investigation, believes that there is (or will be) evidentiary support for the position and that the assertions of law are nonfrivolous. See, e.g., Rule 11, Fed. R. Civ. P."). See also Comments of Cleary, Gottlieb, Steen & Hamilton, at 9 ("Lawyers representing clients before the Commission must be free to make all non-frivolous arguments to the staff.").

³⁵ Comments of Susan P. Koniak, *et al.*, at 37.