

Moreover, as noted above, subparagraph (b)(3) expressly provides that the assertion of colorable defenses in an investigation or judicial or administrative proceeding is an appropriate response to reported evidence of a material violation. Concerns over a chilling effect on advocacy should thus be allayed. At the same time, by including a requirement that this response be undertaken with the consent of the issuer's board of directors, or an appropriate committee thereof, the revised definition is intended to protect against the possibility that a chief legal officer would avoid further reporting "up-the-ladder" by merely retaining a new attorney to investigate so as to assert a colorable, but perhaps weak, defense.

The term "colorable defense" does not encompass all defenses, but rather is intended to incorporate standards governing the positions that an attorney appropriately may take before the tribunal before whom he or she is practicing. For example, in Commission administrative proceedings, existing Rule of Practice 153(b)(1)(ii), 17 CFR 201.153(b)(1)(ii), provides that by signing a filing with the Commission, the attorney certifies that "to the best of his or her knowledge, information, and belief, formed after reasonable inquiry, the filing is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law." An issuer's right to counsel is thus not impaired where the attorney is restricted to presenting colorable defenses, including by requiring the Commission staff to bear the burden of proving its case. Of course, as some commenters noted, an issuer has no right to use an attorney to conceal ongoing violations or plan further violations of the law.

205.2(c) provides:

(c) *Attorney* means any person who is admitted, licensed, or otherwise qualified to practice law in any jurisdiction, domestic or foreign, or who holds himself or herself out as admitted, licensed, or otherwise qualified to practice law.

Commenters suggested that the proposed rule's definition of the term "attorney" was unnecessarily broad. A number of commenters suggested that it was inappropriate to apply the rule to foreign attorneys, arguing that foreign attorneys, and attorneys representing or employed by multijurisdictional firms, are subject to statutes, rules, and ethical standards in those foreign jurisdictions that are different from, and potentially incompatible with, the requirements of

this rule.<sup>39</sup> These points were amplified by foreign attorneys who attended a December 17, 2002 Roundtable discussion hosted by the Commission to address the issues raised by the application of the rule to foreign attorneys.

As noted above, and as set forth more fully below, the rule we adopt today adds a new defined term, "non-appearing foreign attorney," which addresses many of the concerns expressed regarding the application of the rule to foreign attorneys. In addition, other commenters argued that the proposed rule's definition of "attorney" applied to a large number of individuals employed by issuers who are admitted to practice, but who do not serve in a legal capacity. By significantly narrowing the definition of the term "appearing and practicing" as set forth above, we have addressed many of the concerns expressed by commenters concerning the application of the rule to individuals admitted to practice who are employed in non-legal positions and do not provide legal services.

205.2(d) provides:

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

The definition we adopt today has been slightly modified from the definition included in the proposing release. Several commenters suggested that the definition in the proposing release should be amended to include breaches of fiduciary duty arising under federal or state statutes.<sup>40</sup> 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.

205.2(e) provides:

(e) *Evidence of a material violation* means 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.

This revised definition of "evidence of a material violation" clarifies aspects of the objective standard that the Commission sought to achieve in the definition originally proposed.<sup>41</sup> The definition of "evidence of a material violation" originally proposed prompted extensive comment because (read together with the rule's other definitions) it defines the trigger for an attorney's obligation under the rule to report up-the-ladder to an issuer's CLO or qualified legal compliance committee ("QLCC") (in section 205.3(b)). Some commenters, including some practicing attorneys, found the proposed reporting trigger too high.<sup>42</sup> Many legal scholars endorsed the framework of increasingly higher triggers for reporting proposed by the Commission at successive stages in the reporting process but considered the Commission's attempt at articulating an objective standard unworkable and suggested changes to the language in the proposed rule.<sup>43</sup> Nearly all practicing lawyers who commented found the reporting trigger in the rule too low and called instead for a subjective standard, requiring "actual belief" that a material violation has occurred, is ongoing, or is about to occur before the attorney would be obligated to make an initial report within the client issuer.<sup>44</sup> The revised

<sup>41</sup> The proposed rule defines *evidence of a material violation* as "information that would lead an attorney reasonably to believe that a material violation has occurred, is occurring, or is about to occur" and *reasonable belief* as what "an attorney, acting reasonably, would believe."

<sup>42</sup> E.g., Comments of John Bullock, at 1 ("the threshold for mandatory reporting by an attorney should be the level of evidence that a responsible corporate officer should want to know, so that the client can pursue an investigation and take appropriate action. The standard should therefore be 'some credible information that a material violation may have occurred, may be occurring, or may be about to occur.'").

<sup>43</sup> Comments of Richard W. Painter, at 6 (suggesting that "evidence that a violation is 'possible' could trigger the duty to report to the Chief Legal Officer, whereas evidence that a violation is 'likely' could trigger the duty to report to the full board or to the QLCC. Evidence that a violation was 'highly likely' or a 'near certainty' could trigger the requirement of a noisy withdrawal."); Comments of Susan P. Koniak et al., at 9–11, 15–17 (emphasizing the importance of distinguishing between a violation and evidence of one and suggesting the use of the phrase "credible evidence").

<sup>44</sup> Comments of Skadden Arps, Slate, Meagher & Flom, at 10 (proposing to define "*evidence of a material violation*" as "facts and circumstances known to an attorney which have caused the attorney to believe that a material violation has occurred, is occurring or is about to occur"); Comments of Chadbourne & Parke, at 7 (proposing "a subjective standard that an attorney 'knows' that a material violation has occurred, is occurring or is about to occur"); Comments of Sullivan & Cromwell, at 11 ("Evidence of a material violation

<sup>39</sup> See, e.g., Comments of Skadden, Arps, Slate, Meagher and Flom, at 16 (noting that foreign private issuers usually consult with United States counsel on securities matters, and suggesting that limiting the definition of "attorney" to lawyers licensed in United States jurisdictions "will avoid the unfairness of subjecting foreign lawyers to the Proposed Rules without compromising the effectiveness of the rules.").

<sup>40</sup> See Comments of Richard W. Painter, at 10–11 ("Breaches of fiduciary duty to pension funds under federal law such as ERISA, and other similar violations would thus clearly be covered, whereas arguably they are not under the current definition in the Proposed Rules.").