

definition incorporates suggested changes into an objective standard that is designed to facilitate the effective operation of the rule and to encourage the reporting of evidence of material violations.

Evidence of a material violation must first be credible evidence.⁴⁵ An attorney is obligated to report when, based upon that credible evidence, "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 formulation, while intended to adopt an objective standard, also recognizes that there is a range of conduct in which an attorney may engage without being unreasonable.⁴⁶ The "circumstances" are the circumstances at the time the attorney decides whether he or she is obligated to report the information. These circumstances may include, among others, 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 lawyers with whom the lawyer may consult. Under the revised definition, an attorney is not required (or expected) to report "gossip, hearsay, [or] innuendo."⁴⁷ Nor is the rule's reporting obligation triggered by "a combination of circumstances from which the attorney, in retrospect, should have drawn an inference," as one commenter feared.

On the other hand, the rule's definition of "evidence of a material violation" makes clear that the initial duty to report up-the-ladder is not triggered only when the attorney "knows" that a material violation has occurred⁴⁸ or when the attorney "conclude[s] there has been a violation, and no reasonable fact finder could conclude otherwise."⁴⁹ That threshold for initial reporting within the issuer is too high. Under the Commission's rule, evidence of a material violation must be

reported in all circumstances in which it would be unreasonable 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. To be "reasonably likely" a material violation must be more than a mere possibility, but it need not be "more likely than not."⁵⁰ If a material violation is reasonably likely, an attorney must report evidence of this violation. The term "reasonably likely" qualifies each of the three instances when a report must be made. Thus, a report is required when it is reasonably likely a violation has occurred, when it is reasonably likely a violation is ongoing or when reasonably likely a violation is about to occur.

205.2(f) provides:

(f) *Foreign government issuer* means a foreign issuer as defined in 17 CFR 230.405 eligible to register securities on Schedule B of the Securities Act of 1933 (15 U.S.C. 77a et seq., Schedule B).

We adopt the definition for this new term prescribed under Rule 405.

205.2(g) provides:

(g) *In the representation of an issuer* means providing legal services as an attorney for an issuer, regardless of whether the attorney is employed or retained by the issuer.

The definition we adopt today has been modified from the definition included in the proposing release. The phrase "providing legal services" has been substituted for the term "acting." Some commenters objected that the term "acting" was both imprecise and overly broad, and that the concept of "representation of an issuer" should "apply only to attorneys who are rendering legal advice to the organizational client. * * * and therefore have the professional obligations of an attorney."⁵¹ The substitution of the term "providing legal services" responds to these concerns. We believe that this change, combined with the narrowing of the definition of the term "appearing and practicing" as

set forth above, addresses the concerns expressed by the ABA and others.⁵²

For the reasons explained in the proposing release,⁵³ an attorney employed by an investment adviser 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 Commission by or on behalf of a registered investment company is appearing and practicing before the Commission under this definition.

Although some commenters objected to this construction of the definition of "in the representation of an issuer,"⁵⁴ those commenters did not contest either the fact that such an attorney, though employed by the investment adviser rather than the investment company, is providing legal services for the investment company or the logical implication of that fact: that the attorney employed by the investment adviser is accordingly representing the investment company before the Commission.⁵⁵ Indeed, the Investment Company Institute ("ICI") opposes the Commission's construction of its rule because, the ICI asserts, the Commission's construction might make investment advisers limit the participation of attorneys employed or retained by the investment adviser in preparing filings for investment companies, thereby forcing the investment companies "to retain their own counsel" to do exactly the same work now performed by attorneys for the investment adviser.⁵⁶

⁵² We also note that the change should address concerns expressed that counsel to underwriters or similar persons might be covered by the rule.

⁵³ 67 FR 71678-79.

⁵⁴ See, e.g., Comments of the Investment Company Institute at 1-5 (asserting that the Commission's construction of its rule may cause investment advisers to "limit or even eliminate the participation of their internal and outside lawyers in the preparation of fund filings and materials, and in providing day-to-day advice to advisory personnel responsible for managing funds, in order to ensure that such lawyers are not 'involved in the representation of an issuer' or 'practicing before the Commission' within the meaning of the proposed rule.>").

⁵⁵ On the correctness of this inference, see, e.g., Comments of Thomas D. Morgan at 3-4 (pointing out that "current law" makes an attorney employed by an investment adviser the "legal representative" of an investment company under these circumstances, although one has to take "a logical step" to reach that conclusion) (citing *Restatement (Third) of the Law Governing Lawyers* section 51(4)(2000)). An attorney-client relationship does not depend on payment for legal services performed. However, the legal services provided by an investment adviser to an investment company are usually performed pursuant to an advisory contract along with other services (such as investment advice) and are covered by the overall investment advisory fee.

⁵⁶ Comments of the Investment Company Institute, at 4. As noted in the proposing release, 67

means information of which the attorney is consciously aware that would, in the attorney's judgment, constitute a material violation that has occurred, is occurring, or is about to occur."); Comments of the American Bar Association, at 17 (recommending use of "the knowledge standard").

⁴⁵ See Comments of Susan P. Koniak et al., at 18.

⁴⁶ Comments of Richard W. Painter, at 5-6.

⁴⁷ Comments of the Association of the Bar of the City of New York, at 10.

⁴⁸ The standard was suggested, e.g., in Comments of the American Bar Association, at 5, 16-17.

⁴⁹ Comments of Cleary, Gottlieb, Steen & Hamilton, at 5-6 (any lower trigger for reporting would be equivocal, would lead to disparate application of the rule, and would "chill" the attorney-client relationship).

⁵⁰ The Commission intends the definition of the term "reasonably likely" to be consistent with the discussion of the term included in the adopting release for the recently adopted final rule governing disclosure of off-balance sheet arrangements, enacted pursuant to § 401(a) of the Sarbanes-Oxley Act.

⁵¹ Comments of the American Bar Association, at 14 ("It is not uncommon for persons who were attorneys and may still retain their license to move into other non-legal capacities in the organization. * * * These persons should be subject to no greater obligations to the organization than someone who is not an attorney."). However, the ABA stated that it believed that the rule "appropriately applied to any attorney for the issuer" who renders legal advice to the issuer. *Id.*