

Subsection 205.2(k)(1) of the final rule, which addresses the composition of the QLCC, provides that if an issuer has no audit committee, the requirement to appoint at least one member of the audit committee to the QLCC may be met by appointing instead a member from an equivalent committee of independent directors. The Commission does not intend to limit use of the QLCC mechanism only to those issuers that have an audit committee. However, the Commission believes that the requirement that the QLCC be comprised of members who are not employed directly or indirectly by the issuer is warranted and appropriate, and thus disagrees with a commenter's suggestion to permit non-independent board members to be on the QLCC.<sup>61</sup>

Subsection 205.2(k)(3)(iii)(A) has been modified to clarify that the QLCC shall have the authority and responsibility to recommend that an issuer implement an appropriate response to evidence of a material violation, but not to require the committee to direct the issuer to take action. This modification responds to comments that the proposed rule would be in conflict with established corporate governance models insofar as the QLCC would have the explicit authority to compel a board of directors to take certain remedial actions.<sup>62</sup>

The proposed rule did not specify whether the QLCC could act if its members did not all agree. In response to comments expressing concern over this point,<sup>63</sup> language has been included in subsections 205.2(k)(3) and (4) of the final rule to clarify that decisions and actions of the QLCC must be made and taken based upon majority vote. Unanimity is not required for a QLCC to operate; nor should an individual member of a QLCC act contrary to the collective decision of the QLCC. Accordingly, the final rule specifies that a QLCC may make its recommendations and take other actions by majority vote.

Commenters suggested both that issuers would have great difficulty finding qualified persons to serve on a QLCC because of the burdens and risks of such service,<sup>64</sup> and that many companies will utilize a QLCC because reporting evidence of a material

violation to a QLCC relieves an attorney of responsibility to assess the issuer's response.<sup>65</sup> The Commission does not know how widespread adoption of the QLCC alternative will be, but encourages issuers to do so as a means of effective corporate governance. In any event, the Commission does not intend service on a QLCC to increase the liability of any member of a board of directors under state law and, indeed, expressly finds that it would be inconsistent with the public interest for a court to so conclude.

As in the proposed rule, the final rule provides that members of the QLCC may not be "employed, directly or indirectly, by the issuer." This language, which is also included in Section 205.3(b)(3), is drawn directly from Section 307 of the Sarbanes-Oxley Act. The Commission considers it appropriate and consistent with the mandate of the Act to ensure a high degree of independence in QLCC members and members of committees to whom reports are made under Section 205.3(b)(3). Accordingly, the Commission anticipates that these provisions will be amended to conform to final rules defining who is an "independent" director under Section 301 of the Act, upon adoption of those rules.

205.2(l) provides:

(l) *Reasonable* or *reasonably* denotes, with respect to the actions of an attorney, conduct that would not be unreasonable for a prudent and competent attorney.

The definition of "reasonable" or "reasonably" is based on Rule 1.0(h) of the ABA's Model Rules of Professional Conduct, modified to emphasize that a range of conduct may be reasonable.

205.2(m) provides:

(m) *Reasonably believes* means that an attorney believes the matter in question and that the circumstances are such that the belief is not unreasonable.

This definition is based on the definition of "reasonable belief" or "reasonably believes" in Rule 1.0(i) of the ABA's Model Rules of Professional Conduct, modified to emphasize that the range of possible reasonable beliefs regarding a matter may be broad—limited for the purposes of this rule by beliefs that are unreasonable. Because the definition no longer is used in connection with the definition of "evidence of a material violation," the proposed rule's attempt to exclude the subjective element in "reasonable belief" has been abandoned.

205.2(n) provides:

<sup>65</sup> Comments of Susan P. Koniak *et al.*, at 11; Comments of Richard W. Painter, at 5; Comments of Thomas D. Morgan, at 12.

(n) *Report* means to make known to directly, either in person, by telephone, by e-mail, electronically, or in writing.

The definition for this term has not been changed from the one included in the proposed rule.

#### Section 205.3—Issuer as Client

205.3(a) provides:

(a) *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.

This section makes explicit that the client of an attorney representing an issuer before the Commission is the issuer as an entity and not the issuer's individual officers or employees that the attorney regularly interacts with and advises on the issuer's behalf. Most commenters supported the second sentence of the subsection as it is consistent with a lawyer's recognized obligations under accepted notions of professional responsibility.<sup>66</sup> Thus, this sentence remains unchanged in the final rule.

The proposed rule provided that an attorney "shall act in the best interest of the issuer and its shareholders." Commenters raised three principal concerns regarding that provision: It misstates an attorney's duty under traditional ethical standards in charging an attorney with acting in the "best interest" of the issuer; it suggests attorneys have a duty to shareholders creating a risk that the failure to observe that duty could form the basis for a private action against the attorney by any of these shareholders;<sup>67</sup> and it appears to contradict the view expressed by the Commission in the proposing release that "nothing in Section 307 creates a private right of action against an attorney."<sup>68</sup> As the Commission agrees, in part, with these comments, it has modified language in the final rule.

As to the first concern, the Commission recognizes that it is the client issuer, acting through its management, who chooses the

<sup>66</sup> See ABA Model Rule 1.13, "Organization as Client," at 1:139.

<sup>67</sup> See, e.g., 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.

<sup>68</sup> See Comments of the Association of the Bar of the City of New York, at 47–50.

State Bar of California, at 12; Comments of Skadden, Arps, Slate, Meagher & Flom, at 12, 20, 25.

<sup>61</sup> See Comments of America's Community Bankers, at 5–6.

<sup>62</sup> Comments of Business Law Section, New York State Bar Association, at 14–15; Comments of the Business Roundtable, at 2–3.

<sup>63</sup> Comments of the American Bar Association, at 27; Comments of Business Law Section, New York State Bar Association, at 15.

<sup>64</sup> Comments of Clifford Chance, at 4–5; Comments of Emerson Electric Co., at 5.