

stated that it “places counsel to the issuer in the untenable position of having to protect himself or herself while trying to advise his or her client.”⁷³ Similarly, another commenter pointed out that documentation would “occur at exactly the time when there was disagreement between an attorney and the client. At the very least, requiring the attorney to produce such product by virtue of his or her separate obligation to the Commission is bound to present potential for conflict of interest.”⁷⁴ Indeed, it was pointed out, there may be occasions where the preparation of documentation is not in the best interests of the client.⁷⁵

Additionally, commenters opined that the documentation requirement might increase the issuer’s vulnerability in litigation. They noted that a report will be a “treasure trove of selectively damning evidence”⁷⁶ and, while the Commission may be of the view that such documentation should be protected by the attorney-client privilege, the applicability of the privilege will be decided by the courts. Thus, there is considerable uncertainty as to whether it will be protected. At a minimum, it was contended, assertions of privilege will be met with significant and prolonged legal challenges.⁷⁷

At least at the present time, the potential harms from mandating documentation may not justify the potential benefits. In all likelihood, in the absence of an affirmative documentation requirement, prudent counsel will consider whether to advise a client in writing that it may be violating the law.⁷⁸ In other situations, responsible corporate officials may direct that such matters be documented. In those situations, the Commission’s goal will be met, but not in an atmosphere where the issuer and the attorney may perceive that their interests are in conflict.

205.3(b)(2) provides:

(2) The chief legal officer (or the equivalent thereof) shall cause such inquiry into the evidence of a material violation as he or she reasonably believes is appropriate to determine whether the material violation described in the report has occurred, is ongoing, or is about to occur. If the chief legal

officer (or the equivalent thereof) determines no material violation has occurred, is ongoing, or is about to occur, he or she shall notify the reporting attorney and advise the reporting attorney of the basis for such determination. Unless the chief legal officer (or the equivalent thereof) reasonably believes that no material violation has occurred, is ongoing, or is about to occur, he or she shall take all reasonable steps to cause the issuer to adopt an appropriate response, and shall advise the reporting attorney thereof. In lieu of causing an inquiry under this paragraph (b), a chief legal officer (or the equivalent thereof) may refer a report of evidence of a material violation to a qualified legal compliance committee under paragraph (c)(2) of this section if the issuer has duly established a qualified legal compliance committee prior to the report of evidence of a material violation.

Paragraph (b)(2) (corresponding to paragraph (b)(3) of the proposed rule, as revised) describes the responsibilities of the issuer’s CLO (or the equivalent thereof) in handling reported evidence of a material violation. The final rule adds a provision expressly allowing the CLO to make use of an issuer’s QLCC. The revision eliminates the CLO’s documentation requirement and, for the time being, the CLO’s obligation, as part of the QLCC process, to notify the Commission in the unlikely event that the issuer fails to take appropriate remedial actions recommended by the QLCC after a determination by the QLCC that there has been or is about to be a material violation. It also changes language that would have required a CLO who reasonably believed that a material violation had occurred, was ongoing, or was about to occur to “take any necessary steps to ensure that the issuer adopts an appropriate response” to language that would, under the same circumstances, require the CLO to “take all reasonable steps to cause the issuer to adopt an appropriate response.” These are the points on which the corresponding paragraph in the proposed rule was criticized.⁷⁹ Reporting up-the-ladder was otherwise consistently supported. The CLO is

responsible for investigating the reported evidence of a material violation for the reasons set out in the proposing release.⁸⁰ The second sentence of this paragraph has been modified to clarify the circumstances under which the CLO must advise a reporting attorney that no violation has been found. Thus, the term “determines” has been substituted for “reasonably believes” in the second sentence. This change makes the second sentence consistent with the first sentence which requires the CLO to cause an inquiry to be conducted “to determine” whether a violation has occurred, is ongoing, or is about to occur. Other minor textual changes have been made to the paragraph that do not alter its substantive requirements.

205.3(b)(3) provides:

(3) Unless an attorney who has made a report under paragraph (b)(1) of this section reasonably believes that the chief legal officer or the chief executive officer of the issuer (or the equivalent thereof) has provided an appropriate response within a reasonable time, the attorney shall report the evidence of a material violation to:

(i) The audit committee of the issuer’s board of directors;

(ii) Another committee of the issuer’s board of directors consisting solely of directors who are not employed, directly or indirectly, by the issuer and are not, in the case of a registered investment company, “interested persons” as defined in section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(19)) (if the issuer’s board of directors has no audit committee); or

(iii) The issuer’s board of directors (if the issuer’s board of directors has no committee consisting solely of directors who are not employed, directly or indirectly, by the issuer and are not, in the case of a registered investment company, “interested persons” as defined in section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(19))).

This paragraph describes the circumstances under which an attorney who has reported evidence of a material violation to the issuer’s CLO and/or CEO is obliged to report that evidence further up-the-ladder within the client issuer. The paragraph tracks the statutory language in Section 307 of the Act, is not controversial, and is adopted without change from the corresponding paragraph in the proposed rule—(b)(4)—for the reasons set out in the proposing release.⁸¹

205.3(b)(4) provides:

(4) If an attorney reasonably believes that it would be futile to report evidence of a material violation to the issuer’s chief legal officer and chief executive officer (or the equivalents thereof) under paragraph (b)(1) of this section, the attorney may report such

⁷³ Comments of Skadden, Arps, Slater, Meagher & Flom, at 23.

⁷⁴ Comments of Corporations Committee, Business Law Section, the State Bar of California, at 10.

⁷⁵ *Id.*

⁷⁶ Comments of the American Corporate Counsel Association, at 5.

⁷⁷ See Comments of Corporations Committee, Business Law Section, the State Bar of California, at 10.

⁷⁸ See Comments of Cleary, Gottlieb, Steen & Hamilton, at 6.

⁷⁹ *E.g.*, Comments of the SIA/TBMA, at 16 (CLO should be able to make use of the QLCC); Comments of J.P. Morgan Chase & Co., at 3 (CLO should not be required to notify the Commission that a material violation has occurred and disaffirm documents that the issuer has submitted to or filed with the Commission that the CLO believes are false or materially misleading); Comments of Compass Bancshares, at 2–3 (requiring CLO “to issue a response in writing to the attorney creates an undue burden on the CLO [in] responding to an issue which the CLO may not feel is warranted”); Comments of Charles Schwab & Co., at 1–2 (CLO “typically does not have authority to sanction employees outside of his or her chain of command, to require the business units to adopt new procedures, or even to make disclosure on behalf of the company without the concurrence of other executives”).

⁸⁰ 67 FR 71685–86.

⁸¹ 67 FR 71686.