

evidence as provided under paragraph (b)(3) of this section.

The basis for paragraph (b)(4) is implicit in Section 307 of the Act. This bypass provision, however, is not controversial, was not the subject of comment, and is adopted without any substantive change from the corresponding paragraph—(b)(5)—of the proposed rule for the reasons set out in the proposing release.⁸²

205.3(b)(5) provides:

(5) An attorney retained or directed by an issuer to investigate evidence of a material violation reported under paragraph (b)(1), (b)(3), or (b)(4) of this section shall be deemed to be appearing and practicing before the Commission. Directing or retaining an attorney to investigate reported evidence of a material violation does not relieve an officer or director of the issuer to whom such evidence has been reported under paragraph (b)(1), (b)(3), or (b)(4) of this section from a duty to respond to the reporting attorney.

Paragraph (b)(5) addresses circumstances in which those to whom evidence of a material violation is reported direct others, either in-house attorneys or outside attorneys retained for that purpose, to investigate the possible violation. It elicited only a few comments, all of them negative.⁸³ The thrust of these comments was that issuers would be reluctant to retain counsel to investigate reports if those attorneys might trigger up-the-ladder reporting that could result in reporting out to the Commission. The definition of “appropriate response” in section 205.2(b) of the final rule has been modified to address these comments. Further, the modifications to the proposed rule reflected in final rule

§§ 205.3(b)(6) and (b)(7) below, will relieve attorneys retained or directed to investigate or litigate reports of violations from reporting up-the-ladder in a number of instances.

Paragraph (b)(5) is adopted essentially as proposed. This paragraph—numbered (b)(6) in the proposed rule “makes two points: first, that the investigating attorneys are themselves appearing and practicing before the Commission and are accordingly bound by the requirements of the proposed rule; and, second, that the officers or directors who caused them to investigate remain obligated to respond to the attorney who initially reported the evidence of a material violation that other attorneys have been directed to investigate.

205.3(b)(6) and (b)(7) provide:

(6) An attorney shall not have any obligation to report evidence of a material violation under this paragraph (b) if:

(i) The attorney was retained or directed by the issuer's chief legal officer (or the equivalent thereof) to investigate such evidence of a material violation and:

(A) The attorney reports the results of such investigation to the chief legal officer (or the equivalent thereof); and

(B) Except where the attorney and the chief legal officer (or the equivalent thereof) each reasonably believes that no material violation has occurred, is ongoing, or is about to occur, the chief legal officer (or the equivalent thereof) reports the results of the investigation to the issuer's board of directors, a committee thereof to whom a report could be made pursuant to paragraph (b)(3) of this section, or a qualified legal compliance committee; or

(ii) The attorney was retained or directed by the chief legal officer (or the equivalent thereof) to assert, consistent with his or her professional obligations, a colorable defense on behalf of the issuer (or the issuer's officer, director, employee, or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to such evidence of a material violation, and the chief legal officer (or the equivalent thereof) provides reasonable and timely reports on the progress and outcome of such proceeding to the issuer's board of directors, a committee thereof to whom a report could be made pursuant to paragraph (b)(3) of this section, or a qualified legal compliance committee.

(7) An attorney shall not have any obligation to report evidence of a material violation under this paragraph (b) if such attorney was retained or directed by a qualified legal compliance committee:

(i) To investigate such evidence of a material violation; or

(ii) To assert, consistent with his or her professional obligations, a colorable defense on behalf of the issuer (or the issuer's officer, director, employee, or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to such evidence of a material violation.

As noted above in our discussion of paragraph (b)(5) of the final rule, a

number of commenters expressed the view that the final rule should eliminate any requirement that attorneys report up-the-ladder when they are retained or directed to investigate a report of a material violation or to litigate whether a violation has occurred. New paragraphs (b)(6) and (b)(7) respond to these legitimate comments, and narrow considerably the instances when it is likely to be necessary for such an attorney to report up-the-ladder. Paragraph (b)(6) addresses the responsibilities of attorneys retained or directed to investigate or litigate reported violations by the chief legal officer (or the equivalent thereof); paragraph (b)(7) addresses circumstances where attorneys are retained or directed to investigate or litigate reported violations by a qualified legal compliance committee. Where an attorney is retained to investigate by the chief legal officer, the attorney has no obligation to report where the results of the investigation are provided to the chief legal officer and the attorney and the chief legal officer agree no violation has occurred and report the results of the inquiry to the issuer's board of directors or to an independent committee of the board. An attorney retained or directed by the chief legal officer to litigate a reported violation does not have a reporting obligation so long as he or she is able to assert a colorable defense on behalf of the issuer and the chief legal officer provides reports on the progress and outcome of the litigation to the issuer's board of directors. An attorney retained or directed by a qualified legal compliance committee to investigate a reported violation has no reporting obligations. Similarly, an attorney retained or directed by a qualified legal compliance committee to litigate a reported violation has no reporting obligation provided he or she may assert a colorable defense on behalf of the issuer.

205.3(b)(8) and (b)(9) provide:

(8) An attorney who receives what he or she reasonably believes is an appropriate and timely response to a report he or she has made pursuant to paragraph (b)(1), (b)(3), or (b)(4) of this section need do nothing more under this section with respect to his or her report.

(9) An attorney who does not reasonably believe that the issuer has made an appropriate response within a reasonable time to the report or reports made pursuant to paragraph (b)(1), (b)(3), or (b)(4) of this section shall explain his or her reasons therefor to the chief legal officer (or the equivalent thereof), the chief executive officer (or the equivalent thereof), and directors to whom the attorney reported the evidence of a material violation pursuant to

⁸² 67 FR 71686.

⁸³ See Comments of Schiff Hardin & Waite, at 4 (paragraph (b)(5) as proposed goes “too far” in deeming a lawyer engaged by an issuer to conduct an internal investigation of a possible material violation of the securities laws to be appearing and practicing before the Commission and that issuers will be reluctant to retain independent counsel to investigate if the independent counsel have “an obligation to effect a noisy withdrawal if they disagree with the client's response to the finding or recommendation resulting from the investigation”); Comments of the Chicago Bar Association, at 3 (paragraph as proposed is overbroad in requiring an outside lawyer engaged to investigate whether a violation has occurred to withdraw and notify the Commission if it disagrees with the issuer); Comments of the Corporation, Finance and Securities Law Section of the District of Columbia Bar, at 4–5 (“attorneys conducting an internal investigation, and not otherwise interacting with the Commission or even known to the Commission at that point, do not have a sufficient nexus with the Commission's processes” to be covered by the Commission's rules; making them subject to the Commission's rules will “make issuers less willing to retain, and attorneys less willing to conduct, such investigations”; and is unnecessary because section 205.3(b)(2) requires an issuer's CLO “to assess the timeliness and appropriateness of the issuer's response”).