

paragraph (b)(1), (b)(3), or (b)(4) of this section.

As proposed, paragraphs (b)(8) and (b)(9)—numbered (b)(7) and (b)(8) in the proposed rule—elicited no comment (apart from negative comments on documentation provisions that have been eliminated in the final rule). They are adopted without any other substantive change for reasons explained in the proposing release.⁸⁴

205.3(b)(10) provides:

(10) An attorney formerly employed or retained by an issuer who has reported evidence of a material violation under this part and reasonably believes that he or she has been discharged for so doing may notify the issuer's board of directors or any committee thereof that he or she believes that he or she has been discharged for reporting evidence of a material violation under this section.

Paragraph (b)(10) authorizes an attorney to notify an issuer's board of directors or any committee thereof if the attorney reasonably believes that he or she has been discharged for reporting evidence of a material violation under this section. This provision, an important corollary to the up-the-ladder reporting requirement, is designed to ensure that a chief legal officer (or the equivalent thereof) is not permitted to block a report to the issuer's board or other committee by discharging a reporting attorney.

This provision is similar in concept to paragraph (d)(4) of the proposed rule (as to which, as noted above, the Commission is seeking further comment), although it does not provide for reporting outside the issuer.

205.3(c) provides:

(c) *Alternative reporting procedures for attorneys retained or employed by an issuer that has established a qualified legal compliance committee.* (1) If an attorney, appearing and practicing before the Commission in the representation of an issuer, becomes aware of evidence of a material violation by the issuer or by any officer, director, employee, or agent of the issuer, the attorney may, as an alternative to the reporting requirements of paragraph (b) of this section, report such evidence to a qualified legal compliance committee, if the issuer has previously formed such a committee. An attorney who reports evidence of a material violation to such a qualified legal compliance committee has satisfied his or her obligation to report such evidence and is not required to assess the issuer's response to the reported evidence of a material violation.

(2) A chief legal officer (or the equivalent thereof) may refer a report of evidence of a material violation to a previously established qualified legal compliance committee in lieu of causing an inquiry to be conducted under

paragraph (b)(2) of this section. The chief legal officer (or the equivalent thereof) shall inform the reporting attorney that the report has been referred to a qualified legal compliance committee. Thereafter, pursuant to the requirements under § 205.2(k), the qualified legal compliance committee shall be responsible for responding to the evidence of a material violation reported to it under this paragraph (c).

This alternative to the reporting requirements of § 205.3(b) would allow, though not require, an attorney to report evidence of a material violation directly to a committee of the board of directors that meets the definitional requirements for a QLCC. It would also relieve the reporting attorney of any further obligation once he or she had reported such evidence to an issuer's QLCC.

Under this alternative, the QLCC—itsself a committee of the issuer's board of directors with special authority and special responsibility—would be responsible for carrying out the steps required by Section 307 of the Act: notifying the CLO of the report of evidence of a material violation (except where such notification would have been excused as futile under § 205.3(b)(4)); causing an investigation where appropriate; determining what remedial measures are appropriate where a material violation has occurred, is ongoing, or is about to occur; reporting the results of the investigation to the CLO, the CEO, and the full board of directors; and notifying the Commission if the issuer fails in any material respect to take any of those appropriate remedial measures.

More generally, the QLCC institutionalizes the process of reviewing reported evidence of a possible material violation. That would be a welcome development in itself. It may also produce broader synergistic benefits, such as heightening awareness of the importance of early reporting of possible material violations so that they can be prevented or stopped.

Probably the most important respect in which § 205.3(c) differs from § 205.3(b) is, as noted, that Section 205.3(c) relieves an attorney who has reported evidence of a material violation to a QLCC from any obligation “to assess the issuer's response to the reported evidence of a material violation.” If the issuer fails, in any material respect to take any remedial action that the QLCC has recommended, then the QLCC, as well as the CLO and the CEO, all have the authority to take appropriate action, including notifying the Commission if the issuer fails to implement an appropriate response recommended by the QLCC.

Commenters generally approved of the QLCC in concept, although several proposed changes in how it would work. The American Bar Association agreed with the need for corporate governance mechanisms to ensure legal compliance once a material violation is reported to an issuer's board, but suggested that existing corporate governance reforms should be given time before new reforms are added.⁸⁵ Another commenter suggested that the QLCC should be only one of a number of acceptable governance models, with issuers having freedom to craft techniques suitable to their own circumstances.⁸⁶ The Commission recognizes these concerns, but believes the benefits of the QLCC model, as described above, and the absence of any requirement that an issuer form or utilize a QLCC, justify inclusion of this alternative in the final rule.

One commenter suggested that the Commission's final rules should make clear that, for a matter to be referred to a QLCC, the issuer must have a QLCC in place and is not permitted simply to establish a QLCC to respond to a specific incident.⁸⁷ This comment has been addressed in § 205.3(c), which authorizes referral only to a QLCC that has been previously formed.

Commenters made a number of other suggestions regarding the QLCC provisions in the proposed rule. One commenter proposed that the Commission consider making creation of a QLCC mandatory for each issuer.⁸⁸ The Commission believes that keeping the QLCC as an alternative reporting mechanism is preferable, and that attorneys should be permitted to report up-the-ladder through their chief legal officers. Another commenter suggested that the QLCC proposal be modified to remove the “noisy withdrawal” provision.⁸⁹ The Commission has concluded that, in the extraordinary circumstance in which an appropriate response does not follow a QLCC's recommendation in response to evidence of a material violation, the QLCC should have the authority to take all appropriate action, including notifying the Commission, although it is not required to do so in every case. Another suggestion from a commentator was that the Commission offer a “safe harbor” for a chief legal officer who

⁸⁵ Comments of the American Bar Association, at 27–28.

⁸⁶ Comments of the American Corporate Counsel Association, at 9–10.

⁸⁷ Comments of Richard W. Painter, at 5.

⁸⁸ Comments of Edward C. Brewer III, at 4.

⁸⁹ Comments of the Association of the Bar of the City of New York, at 41–42.