

involved.⁹⁸ Many of the commenters voicing objections to this paragraph suggested that the Commission defer its promulgation until after further developments by state supreme courts⁹⁹ or further discussion.¹⁰⁰ Others, while criticizing the rule, noted that an attorney practicing before the Commission could comply with this permissive disclosure provision, but would have a duty to explain to the client at the outset this limitation on the "normal" duty of confidentiality.¹⁰¹

Commenters supporting the paragraph, however, noted that at least four-fifths of the states now permit or require such disclosures as pertain to ongoing conduct,¹⁰² and that those states that follow the minority rule "narrow[] the lawyer's options for responding to client conduct that could defraud investors and expose the lawyer to liability for legal work that the lawyer has already done."¹⁰³ Several of these comments noted that the Commission could or should have required that lawyers make these disclosures to it when the client insists on continuing fraud or pursuing future illegal conduct,¹⁰⁴ and urged the Commission to make clear that this paragraph does not override state ethics rules that make such disclosures mandatory.¹⁰⁵ Many commenters also stated that it was proper for this paragraph to preempt any state ethics rule that does not permit disclosure.¹⁰⁶ They also noted that the confidentiality interests of a corporate client are not infringed by lawyer disclosure under the circumstances required by the paragraph, as the paragraph addresses a situation where the lawyer reasonably believes that agents of an issuer are engaged in serious illegality that the issuer has failed to remedy; in that situation, an instruction by an officer or even the board of the issuer to remain silent cannot be regarded as

authorized.¹⁰⁷ Others generally supported the provision as injecting vitality into existing ethics rules, and stated that the Commission should not delay action on this provision.¹⁰⁸ One commenter emphasized the need to protect from retaliation attorneys who engage in the reporting mandated by Part 205.¹⁰⁹

The final version of this paragraph contains modifications or clarifications of the paragraph as proposed. In paragraph (2), the description of when an attorney may disclose client confidences is limited "to the extent the attorney reasonably believes necessary" to accomplish one of the objectives in the rule. In subparagraph (i), the term "material violation" has been substituted for "illegal act" to conform to the statutory language in Section 307. In subparagraph (ii), the final version identifies the illegal acts that might perpetrate a fraud upon the Commission in an investigation or administrative proceeding; each of the statutes now referenced in subparagraph (ii) were referenced in the release accompanying the proposed rule.¹¹⁰ The term "perpetrate a fraud" in this paragraph covers conduct involving the knowing misrepresentation of a material fact to, or the concealment of a material fact from, the Commission with the intent to induce the Commission to take, or to refrain from taking, a particular action. Subparagraph (iii) has been modified to cover only material violations by the issuer, and now this material violation must be one that has "caused, or may cause, substantial injury to the financial interest or property of the issuer or investors" before the provision may be invoked.

With regard to the issues raised by the comments on this paragraph, as explained below, the Commission either has addressed the concerns voiced by the commenters, believes that the concerns are adequately addressed by the paragraph, or has found the concerns to be insufficient to warrant further modification. Although commenters raised a concern that permitting attorneys to disclose information to the Commission without a client's consent would undermine the issuers' trust in their attorneys, the vast majority of states already permit (and some even require) disclosure of information in the limited situations

covered by this paragraph,¹¹¹ and the Commission has seen no evidence that those already-existing disclosure obligations have undermined the attorney-client relationship. In addition, the existing state law ethics rules support the proposition that generalized concerns about impacting the attorney-client relationship must yield to the public interest where an issuer seeks to commit a material violation that will materially damage investors, seek to perpetrate a fraud upon the Commission in enforcement proceedings, or has used the attorney's services to commit a material violation.

With regard to the comments that this paragraph would preempt state law ethics rules that do not permit disclosure of information concerning such acts, or the concerns expressed by commenters at the other end of the spectrum that this paragraph could be misread to supplant state ethics rules that require rather than permit disclosure,¹¹² the Commission refers to Section 205.1 and the related discussion above. Section 205.1 makes clear that Part 205 supplements state ethics rules and is not intended to limit the ability of any jurisdiction to impose higher obligations upon an attorney not inconsistent with Part 205. A mandatory disclosure requirement imposed by a state would be an additional requirement consistent with the Commission's permissive disclosure rule. The Commission also notes that, as this paragraph in most situations follows the permissive disclosure rules already in place in most jurisdictions, the conflict raised by these commenters is unlikely to arise in practice.

As for the comments suggesting that attorneys be permitted to disclose only information that would appear to have a material impact on the value of the issuer's securities, the Commission has,

⁹⁸ Comments of the American College of Trial Lawyers, at 6.

⁹⁹ Comments of Conference of Chief Justices, at 4.

¹⁰⁰ Comments of the Federal Bar Council, at 14.

¹⁰¹ Comments of the Law Society of England and Wales, at 12.

¹⁰² Comments of Morrison & Foerster and eight other law firms, Exhibit B (listing jurisdictions whose ethics rules permit or require attorneys to disclose clients' past and/or require attorneys to disclose clients' past and/or ongoing fraud); Comments of Edward C. Brewer, III, at 8 (the proposed rule for permissive disclosure of an issuer's "illegal act" is essentially no different than the existing Model Code provision).

¹⁰³ Comments of Richard W. Painter, at 6.

¹⁰⁴ Comment of Edward C. Brewer, at 8.

¹⁰⁵ Comments of Susan P. Koniak *et al.*, at 26-27;

Comments of Nancy J. Moore, at 2-3.

¹⁰⁶ Comments of Susan P. Koniak *et al.*, 27, 31-32.

¹⁰⁷ Comments of William H. Simon, at 3.

¹⁰⁸ See, e.g., Comments of Manning G. Warren III, at 1; Comments of Douglas A. Schafer, Comment of Elaine J. Mittleman at 2; Comments of Thomas Ross *et al.*, at 6-8.

¹⁰⁹ Comment of Elaine J. Mittleman at 2.

¹¹⁰ See 67 FR at 71693.

¹¹¹ Comment of the American Corporate Counsel Association, at 7 (noting that permissive disclosure standards are "more in line with a majority of state professional rules of conduct").

¹¹² Specifically, New Jersey requires an attorney to reveal confidential "information relating to the representation of a client to the proper authorities * * * to the extent the lawyer reasonably believes necessary to prevent the client: (1) [f]rom committing a criminal, illegal or fraudulent act that the lawyer reasonably believes is likely to result in * * * substantial injury to the financial interest or property of another" or (2) such an act that "the lawyer reasonably believes is likely to perpetrate a fraud upon a tribunal." New Jersey Rule of Professional Conduct 1.6(b). Wisconsin's corresponding rule is virtually identical to New Jersey's, except that it makes no reference to "proper authorities." Wisconsin Supreme Court Rule 20:1.6. Florida requires a lawyer to reveal confidential information "to the extent the lawyer reasonably believes necessary * * * to prevent a client from committing a crime." Florida Rule of Professional Conduct 4-1.6.