

For lawyers, the rule could have an effect upon malpractice insurance premiums, which could, in turn, increase the cost of attorney services to issuers. The Commission received three comments suggesting that the rule, and particularly the provisions requiring mandatory withdrawal and reporting to the Commission, would lead to an increase in the number of malpractice suits brought against attorneys.¹³⁹ One of these comments, from an insurance carrier, indicated that the rule could cause malpractice insurance premiums for attorneys to rise by 10% to 50%.¹⁴⁰ The Commission has made a number of changes to the rule in light of these comments. The Commission has clarified and made explicit in Section 205.7 that no private right of action exists based on compliance or non-compliance with the rule. In addition, the Commission has made it clear in Section 205.6(c) that an attorney who complies in good faith with the rule will not be subject to discipline or otherwise liable under an inconsistent state standard. Moreover, the rule, as adopted, will not require attorneys to withdraw or report to the Commission, but will only require reporting to the Commission in the very limited circumstances occurring when a majority of a QLCC determines that an issuer has failed to take remedial action that was directed by the QLCC. Accordingly, the Commission believes that the rule will not have as great an effect on malpractice insurance premiums as suggested by commenters in response to the proposed rule.

Part 205 may also encourage some issuers to handle more legal matters in-house and may cause other issuers to limit the use of in-house counsel and rely more heavily on outside counsel, possibly increasing the cost of legal services. The Commission received one comment indicating that issuers would refer more matters to in-house counsel¹⁴¹ and four comments indicating that the rule would result in more matters referred to outside counsel.¹⁴² None of the commenters attempted to quantify the costs

associated with these shifts. To the extent that the rule, as originally proposed, provided some perceived incentives to transfer functions to or from outside counsel, principally because of the “noisy withdrawal” requirements, we believe that those perceived incentives are not present in the rule as adopted.

There may also be some additional costs of the rule imposed on the market that are exceedingly difficult to predict or quantify. The Commission received comments indicating that the rule, and particularly the proposal regarding “noisy withdrawal,” would cause issuers to be less willing to seek legal advice and would result in issuers being less forthcoming with their counsel.¹⁴³ However, no commenters presented data or attempted to quantify any costs associated with this effect. The Commission also received comments indicating that the rule would not cause any decrease in attorney-client communication.¹⁴⁴ Since the rule, as adopted, will not require mandatory withdrawal or disclosure to the Commission, we believe that Part 205 will not have any adverse impact on attorney-client communications.

V. Effect on Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act (15 U.S.C. 78w(a)(2)) requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, Section 2(b) of the Securities Act (15 U.S.C. 77b(b)), Section 3(f) of the Exchange Act (15 U.S.C. 78c(f)), and Section 2(c) of the Investment Company Act (15 U.S.C. 80a-2(c)), require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

Part 205 is intended to ensure that attorneys representing issuers before the Commission are governed by standards of conduct that increase disclosure of potential impropriety within an issuer so that prompt intervention and remediation can take place. Doing so

should boost investor confidence in the financial markets. We anticipate that this rule will enhance the proper functioning of the capital markets and promote efficiency by reducing the likelihood that illegal behavior would remain undetected and unremedied for long periods of time. Part 205 will apply to all issuers and attorneys appearing before the Commission and is therefore unlikely to affect competition.

The Commission invited comment on this analysis, and received one comment on it.¹⁴⁵ The commenter suggested that the rule could result in a large quantity of information being sent to a CLO or QLCC, which would be expensive and unwieldy to process, and would thus conflict with the goal of promoting efficiency, competition and capital formation. The Commission believes that Part 205 is consistent with the statutory goals and will substantially assist in attaining them by preventing corporate misconduct, restoring investor confidence and lowering the cost of capital.

VI. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis (“FRFA”) has been prepared in accordance with the Regulatory Flexibility Act, 5 U.S.C. 601. An Initial Regulatory Flexibility Analysis (“IRFA”) was prepared in accordance with 5 U.S.C. 603 and was made available to the public.

A. Need for the Rule

Part 205 complies with Section 307 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7245), which requires the Commission to prescribe “minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers. * * *”. The standards must include a rule “requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof” to the CLO or the CEO of the company (or the equivalent thereof); and, if they do not respond appropriately to the evidence, requiring the attorney to report the evidence to the audit committee, another committee of independent directors, or the full board of directors.

B. Significant Issues Raised by Public Comment

The Commission received no comments in response to the IRFA.

¹⁴⁵ Comments of Los Angeles County Bar Association, at 7–8.

Securities Industry 2002,” and represents the SIA value for an Assistant General Counsel in New York City.

¹³⁹ Comments of Chubb Specialty Insurance, at 2–3; Comments of the American Bar Association, at 26–7; Comments of Attorneys’ Liability Assurance Society, Inc., at 8, 11.

¹⁴⁰ Comments of Chubb Specialty Insurance, at 5.

¹⁴¹ Comments of Carter, Ledyard & Milburn, at 2.

¹⁴² Comments of Committee on Investment Management Regulation, Association of the Bar of the City of New York, at 4; Comments of the American Corporate Counsel Association, at 4–5; Comments of Investment Company Institute, at 4; Comments of Debra M. Brown, at 2.

¹⁴³ See, e.g., Comments of the American Bar Association, at 26.

¹⁴⁴ See, e.g., Comments of Susan P. Koniak *et al.*, at 24.