

consistent with the Commission's mandate under Section 307 and is necessary to effectuate the up-the-ladder reporting rule, because it addresses the situation where an issuer inappropriately refuses to implement remedial measures.¹⁷ One commenter not only thought the Commission's proposed rule was sound, but opined that "considerably more demanding reporting obligations would be consistent with the most plausible interpretation of corporate interests in confidentiality."¹⁸ Other commenters supported the proposal but recommended certain modifications.¹⁹

On the other hand, a greater number of commenters opposed the "noisy withdrawal" provisions. Some commenters objected to the proposal because they are of the view that the Commission does not have the statutory authority to require "noisy withdrawal." They pointed to legislators' comments that, in their view, supported the position that Section 307 does not require the Commission to promulgate a rule mandating "noisy withdrawal."²⁰ Other objectors were concerned that the provision would conflict with longstanding requirements under state ethics laws and therefore would infringe on the jurisdiction of state ethics-setting bodies.²¹ One commenter argued that such a provision would subject attorneys to conflicting liability claims, whether or not they complied with the rule. Several commenters from outside the United States stated that compliance with the "noisy withdrawal" requirement would cause them to violate the laws of their home jurisdiction.²² Finally, several commenters believed that the rule would not further the Commission's goals because it would cause clients to exclude attorneys from meetings where information was exchanged that could lead an attorney to believe a material violation had been committed.²³

The vast majority of commenters suggested that the Commission defer action on a rule mandating "noisy withdrawal" and provide interested parties an additional opportunity to

comment. Their principal concerns were that: The rule raises novel issues with respect to establishing ethical rules for attorneys that require reporting to a third party; the rules are complex and the period of time provided under Section 307 did not allow adequate time for the preparation of comments or for the Commission to consider those comments; and because Section 307 requires the Commission only to issue the up-the-ladder reporting requirements within 180 days, the Commission need not issue a "noisy withdrawal" provision at the time it adopts the up-the-ladder reporting system and can postpone its consideration of the issue.

In light of these comments, the Commission has determined to extend the comment period on proposed § 205.3(d) of the proposed rule.²⁴ The Commission is soliciting comments on proposed alternative provisions, which prescribe attorney withdrawal in a narrower set of circumstances, and which require the issuer, rather than the attorney, to report to the Commission the attorney's withdrawal or written notice of failure to receive an appropriate response to a report of a material violation. The Commission also requests comment on whether any rules we are currently adopting under Section 307 should be revised if we adopt either of these proposals. The Commission is interested especially in receiving comments from interested parties outside the legal profession, such as issuers and investors, who might be affected by, or benefit from, the final rule or the proposals.²⁵

II. The Role of Attorneys Who Appear Before the Commission

As discussed in more detail in the Proposing Release and the Adopting Release, attorneys play a varied and crucial role in the Commission's processes. Attorneys prepare, or assist in preparing, materials that are filed with or submitted to the Commission by or on behalf of issuers. Public investors rely on these materials in making their investment decisions. Thus, the Commission, and the investing public, must be able to rely upon the integrity of in-house and retained lawyers who represent issuers before the

Commission. Attorneys also play an important and expanding role in the internal processes and governance of issuers, ensuring compliance with applicable reporting and disclosure requirements, including requirements mandated by the federal securities laws.

The actions of some attorneys have drawn increasing scrutiny and criticism in light of recent events demonstrating that at least "some lawyers have forgotten their responsibility."²⁶ Moreover, existing state ethical rules have not proven an effective deterrent to attorney misconduct.²⁷ The July 16, 2002 *Preliminary Report of the American Bar Association Task Force on Corporate Responsibility* (the "Cheek Report") noted that "a disturbing series of recent lapses in corporations involving false or misleading financial statements and alleged misconduct by executive officers" has compromised investors' confidence in both the "quality and the integrity" of public company governance.²⁸ Indeed, the Cheek Report concluded that "the system of corporate governance at many public companies has failed dramatically." Moreover, the Cheek Report acknowledges that attorneys representing and advising corporate clients bear some share of the blame for this failure.²⁹

²⁶ See remarks by Senator John Edwards, 148 Cong. Rec. at S6551 (July 10, 2002). See also Speech by SEC Chairman Harvey L. Pitt: Remarks Before the Annual Meeting of the American Bar Association's Business Law Section (Aug. 12, 2002) ("recent events have refocused our attention on the need for the profession to assist us in ensuring that fundamental tenets of professionalism, ethics and integrity work to ensure investor confidence in public companies"), available at <http://www.sec.gov/news/speech/spch579.htm>.

²⁷ See remarks by Senator Michael Enzi, 148 Cong. Rec. at S6555 ("I am usually in the camp that believes that [s]tates should regulate professionals within their jurisdiction. However, in this case, the [s]tate bars as a whole have failed. They have provided no specific ethical rule of conduct to remedy this kind of situation. Even if they do have a general rule that applies, it often goes unenforced").

²⁸ See Cheek Report at 3-4.

²⁹ See Cheek Report at 7 ("It is a clear failure of corporate responsibility if executive officers aware of potential accounting irregularities sell millions of dollars of stock to public investors who are unaware of [earnings misstatements and self-dealing by corporate officers]. It is a clear failure of corporate responsibility for insiders to borrow enormous amounts from their companies without adequate security beyond inflated stock of the company itself. And it is a clear failure of corporate responsibility when outside directors, auditors and lawyers, who have important roles in our system of independent checks on the corporation's management, fail to avert or even discover—and sometimes actually condone or contribute toward the creation of—the grossest of financial manipulations and fraud").

¹⁷ See, e.g., Comments of Susan P. Koniak, *et al.*, at 23.

¹⁸ See Comments of William Simon, at 2.

¹⁹ See, e.g., Comments of Richard Painter, at 2-3.

²⁰ See Comments of Attorneys' Liability Assurance Society, Inc., at 8; Comments of Frederick Lipman, at 1-3.

²¹ See Comments of the Conference of Chief Justices, at 3; Comments of Attorneys' Liability Assurance Society, Inc., at 8.

²² See, e.g., Comments of Shearman & Sterling, at 3-7.

²³ See Comments of Attorneys' Liability Assurance Society, Inc., at 8.

²⁴ Proposed Part 205.3(d) should not be confused with Part 205.3(d) as adopted ("Issuer Confidences"). In the event that proposed Part 205.3(d), or an alternative thereto, is adopted, current Part 205.3(d) will be re-numbered.

²⁵ Persons who previously commented on proposed Part 205 need not re-submit the same comment letters. We will consider all relevant comment letters previously submitted, as well as any new comment letters we receive, in our deliberations on the rule.