

III. Discussion of Proposals

The proposals regarding “noisy withdrawal” contained in the Proposing Release, and the alternative provisions discussed below, are intended to further the purposes of the up-the-ladder requirement and enhance investor confidence in the financial reporting process. The proposed rules are designed to deter instances of attorney and issuer misconduct, and, where misconduct has occurred, reduce its impact on issuers and their shareholders.

At the same time, the Commission does not want the rule to impair zealous advocacy, which is important to the Commission’s processes. The Commission also does not want the rule to discourage issuers from seeking and obtaining appropriate and effective legal advice. In this regard, the Commission today is proposing for comment alternative provisions to the “noisy withdrawal” provisions contained in the Proposing Release.

A. Part 205 as Adopted

In a companion release, we adopted rules under § 307 of the Act that mandate attorneys appearing and practicing before the Commission in the representation of an issuer to report evidence of a material violation up-the-ladder within the issuer.³⁰ The rules require an attorney to report such evidence to the issuer’s chief legal officer, or to its chief legal officer and chief executive officer. The issuer’s chief legal officer is required to inquire into the evidence of the material violation and, unless he or she reasonably believes that no material violation has occurred, is ongoing, or is about to occur, he or she must take reasonable steps to cause the issuer to adopt an appropriate response to the attorney’s report. Unless an attorney, who has made a report of evidence of a material violation, reasonably believes that the chief legal officer or chief executive officer has provided an appropriate response within a reasonable period of time to his or her report, the attorney shall report the evidence to an appropriate committee of the issuer’s board of directors. An attorney who reasonably believes that the issuer has not made an appropriate response shall explain his or her reasons to the issuer’s chief legal officer, chief executive officer, or board of directors. An attorney retained or employed by an issuer that has established a qualified

legal compliance committee (“QLCC”) (a committee established to consider and investigate attorney reports under the rule and to recommend appropriate responses to such reports) may, as an alternative to the reporting requirements described above, report evidence of a material violation to the QLCC.

The final rule provides that members of the QLCC may not be “employed, directly or indirectly, by the issuer.” This language, which is also included in § 205.3(b)(3), is drawn directly from § 307 of the Sarbanes-Oxley Act. The Commission considers it appropriate and consistent with the mandate of the Act, however, to ensure a high degree of independence in QLCC members and members of committees to whom reports are made. Accordingly, we anticipate that these provisions will be amended to conform to final rules defining who is an “independent” director under § 301 of the Act, upon adoption of those rules.³¹ We request comment on who should be considered independent in this context.

The rule as adopted does not require either an attorney or an issuer to report evidence of a material violation, or an issuer’s response to such evidence, outside the issuer. We request additional comment on the rule as adopted. Commenters should consider whether any aspects of the rule, as adopted, should be revised if we adopt any of the proposals discussed in this release. If yes, how should they be revised? If not, why not?

B. Extension of Comment Period/ Solicitation of Comments for “Noisy Withdrawal” Provisions as Previously Proposed

As explained in the Proposing Release, proposed § 205.3(d) addresses what we hope is the rare situation in which an attorney reasonably believes an issuer has either made no response (within a reasonable time) or has not made an appropriate response to reported evidence of a material violation. The proposed section distinguishes between material violations that have already occurred and are not ongoing, and material violations that are either ongoing or are about to occur. The proposed section also distinguishes between outside attorneys retained by an issuer and in-house attorneys employed by an issuer. The section requires an attorney to withdraw from representing an issuer and/or to disaffirm documents filed with the Commission in some

circumstances; it also requires a withdrawing attorney to notify the Commission in writing of his or her withdrawal.

As proposed in the Proposing Release, § 205.3(d)(1) prescribes actions by an attorney who has not received an appropriate response to his or her report of a material violation and who believes that a material violation is ongoing or about to occur.³² It states:

(d) *Notice to the Commission where there is no appropriate response within a reasonable time.* (1) Where an attorney who has reported evidence of a material violation under paragraph 3(b) of this section rather than paragraph 3(c) of this section does not receive an appropriate response, or has not received a response in a reasonable time, to his or her report, and the attorney reasonably believes that a material violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interest or property of the issuer or of investors:

(i) An attorney retained by the issuer shall:

(A) Withdraw forthwith from representing the issuer, indicating that the withdrawal is based on professional considerations;

(B) Within one business day of withdrawing, give written notice to the Commission of the attorney’s withdrawal, indicating that the withdrawal was based on professional considerations; and

(C) Promptly disaffirm to the Commission any opinion, document, affirmation, representation, characterization, or the like in a document filed with or submitted to the Commission, or incorporated into such a document, that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading;

(ii) An attorney employed by the issuer shall:

(A) Within one business day, notify the Commission in writing that he or she intends to disaffirm some opinion, document, affirmation, representation, characterization, or the like in a document filed with or submitted to the Commission, or incorporated into such a document, that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading; and

(B) Promptly disaffirm to the Commission, in writing, any such opinion, document, affirmation, representation, characterization, or the like; and

(iii) The issuer’s chief legal officer (or the equivalent) shall inform any attorney retained or employed to replace the attorney who has withdrawn that the previous attorney’s withdrawal was based on professional considerations.

Proposed § 205.3(d)(2) concerns situations in which the reported

³⁰ See Adopting Release. While we summarize here certain salient aspects of the rules as adopted, for a complete discussion, please review the Adopting Release.

³¹ See Standards Related to Listed Company Audit Committees, Release No. 33–8173 (Jan. 8, 2003).

³² Proposed § 205.3(d) would follow §§ 205.3(b) and (c) as adopted, which set forth the duty of an attorney to report evidence of a material violation up-the-ladder of the issuer’s governance structure, and, if appropriate, to explain to the issuer his or her reasons for believing that the issuer has not made a timely or appropriate response.