

all aspects of costs and benefits attributable to proposed Part 205. The Commission requests data to quantify the expected costs and the value of the anticipated benefits.

VII. 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,⁶⁰ Section 3(f) of the Exchange Act,⁶¹ and Section 2(c) of the Investment Company Act⁶² 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.

The proposals should boost investor confidence in the financial markets. We anticipate that these proposals would 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. Proposed section 205.3(d)–(f) would apply to all issuers and attorneys appearing before the Commission and is therefore unlikely to affect competition.

Interested persons are invited to comment upon any aspect of this analysis. We request comment on whether proposed section 205.3(d)–(f), if adopted, would impose a burden on competition. For example, would U.S. lawyers face a competitive disadvantage because attorneys practicing outside the U.S. would not be required to comply with the proposal's withdrawal requirements to the extent that such compliance is prohibited by applicable foreign law? Commenters are requested to provide empirical data and other factual support for their views if possible.

VIII. Initial Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603.

A. Reasons for the Proposed Action

We are proposing section 205.3 to more fully implement Section 307 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7245 *et seq.*) ("the Act") and recently adopted Part 205 of Title 17 of the Code of Federal Regulations.

B. Objectives

Section 307 of the Act 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 laws or breach of fiduciary duty or similar violation by the company or any agent thereof" to the chief legal counsel or the chief executive officer of the company (or the equivalent); 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. This proposal is designed to address those circumstances where the attorney withdraws from representation due to professional considerations. We originally proposed to require the attorney to report such a withdrawal to the Commission; we are still considering that option. However, we are now also proposing an alternative whereby the withdrawing attorney would notify the issuer and the issuer would be required to notify the Commission. An objective is to provide notice of such an event to both the Commission and the public without unduly intruding on the attorney-client relationship.

C. Legal Basis

We are proposing the new rules and amendments under the authority set forth in Sections 7, 10 and 19 of the Securities Act of 1933, Sections 3(b), 4C, 12, 13, 15 and 23(a) of the Securities Exchange Act of 1934, Sections 30, 38 and 39 of the Investment Company Act of 1940, Section 211 of the Investment Advisers Act of 1940, and Sections 3(a), 307 and 404 of the Sarbanes-Oxley Act of 2002.

D. Small Entities Subject to Proposed Part 205

The proposed additions to Part 205 would affect issuers that are small entities. Exchange Act Rule 0–10(a) (17 CFR 240.0–10(a)) defines an issuer, other than an investment company, to be a "small business" or "small organization" if it had total assets of \$5 million or less on the last day of its most

recent fiscal year. As of October 23, 2002, we estimated that there were approximately 2,500 issuers, other than investment companies, that may be considered small entities. For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.⁶³ We estimate that there are 211 small investment companies that would be subject to the proposed rule. The proposed revisions would apply to any small entity that is subject to Exchange Act reporting requirements.

The proposed additions to Part 205 also would affect law firms that are small entities. The Small Business Administration has defined small business for purposes of "offices of lawyers" as those with under \$6 million in annual revenue.⁶⁴ Because we do not directly regulate law firms appearing before the Commission, we do not have data to estimate the number of small law firms that practice before the Commission or, of those, how many have revenue of less than \$6 million. We request data on that issue.

E. Reporting, Recordkeeping, and Other Compliance Requirements

Lawyers who believe that their issuer client is engaged in ongoing illegal conduct would be required to notify their client and withdraw from the representation. Issuers who receive such notices would be required to notify the Commission and the successor lawyer of the withdrawal. The time required for the actual preparation of a report would vary, but should not be extensive.

F. Duplicative, Overlapping, or Conflicting Federal Rules

Proposed § 205.3 would not duplicate, overlap, or conflict with other federal rules. There are no other statutory federal requirements that small entities make similar reports or provide similar information.

G. Agency Action To Minimize Effect on Small Entities

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposed rule, we considered the following alternatives: (a) The establishment of differing compliance or

⁶⁰ 15 U.S.C. 77b(b).

⁶¹ 15 U.S.C. 78c(f).

⁶² 15 U.S.C. 80a–2(c).

⁶³ 17 CFR 270.0–10.

⁶⁴ 13 CFR 121.201.