

Attorney Conduct Rules: the SEC has spoken again, and not for the last time



On 23 January 2003, the U.S. Securities and Exchange Commission (the "SEC") adopted the much-anticipated final rules¹ (the "Final Rules") relating to attorney conduct², to set "minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers."

However, most notably, in what has appeared to some as a substantial retreat from the position set forth in the proposed rules³, the SEC announced that it will be extending the comment period – a rare occurrence in itself – on the so-called noisy withdrawal requirement of the proposed rules (which permitted, or, in some cases, required attorneys to "withdraw from representing an issuer and notify the Commission that they have withdrawn for professional reasons"), and will also set forth an "alternative proposal" for comment during this new comment period (the "Further Comment Provisions"). The SEC will be issuing a [separate release](#) soliciting comment on the Further Comment Provisions.

The SEC acknowledges in the Final Rules that the proposed rules "generated significant comment and extensive debate", resulting in 167 comment letters (123 from the U.S. and 44 from non-U.S. parties). By way of explanation, the SEC stated that "given the significance and complexity of the issues involved, including the implications of a reporting out requirement on the relationship between issuers and their counsel", the SEC agreed to "continue to seek comment and give thoughtful consideration to these issues". Other aspects of the proposed rules, relating to up-the-ladder reporting, are not subject to the additional comment period, but are adopted in the Final Rules. The Final Rules acknowledge that in light of the "thoughtful and constructive" comment letters the SEC received, the provisions as adopted have been "significantly modified in light of these comments and suggestions".

Notably for non-U.S. attorneys who had been trying to raise the SEC's awareness of the impact of SEC rulemaking generally outside of the U.S., the SEC held a roundtable

¹ For the text of the Final Rules, see <http://www.sec.gov/rules/final/33-8185.htm>.

² Implementing Section 307 of the Sarbanes-Oxley Act.

³ For the text of the proposed rules, published in November 2002, see <http://www.sec.gov/rules/proposed/33-8150.htm>.

discussion in December 2002 as to the possible impact of the rules on non-U.S. attorneys. Many participants in this process view the recognition of these concerns by the SEC – including in the actual text of the Final Rules – as a significant step towards ongoing future dialogue between the SEC and non-U.S. interest groups as to the impact of what the SEC does outside of the U.S.

However, the SEC maintains in the Final Rules that "[w]e are still considering the 'noisy withdrawal' provisions of our original proposal . . .", and reiterates that it is still the SEC's view that the Final Rules "shall prevail over any conflicting or inconsistent laws of a state or other United States jurisdiction in which an attorney is admitted or practices."⁴

The Final Rules, among other things:

- Require an attorney to report "evidence of a material violation of securities laws or breach of fiduciary duty or similar violation by the issuer or any agent thereof," as determined "according to an objective standard", up the ladder within the client organization to the "chief legal counsel" or the "chief executive officer" of the client, dispense with the documentation requirements proposed in the proposed rules, and provide a "safe harbor" against any inconsistent⁵ state-level standard (i.e., an attorney who complies in good faith with the

Final Rules will not be subject to discipline or otherwise liable under an inconsistent standard of a state or other U.S. jurisdiction where the attorney is admitted or practices), and a safe harbor against any private action (i.e., the Final Rules will not create a private cause of action against an attorney, a law firm or an issuer, based upon their compliance or non-compliance.

- Require an attorney, if the chief legal counsel or the chief executive officer of the client "does not respond appropriately to the evidence", to "report the evidence to the audit committee, another committee of independent directors, or the full board of directors" of the client.

- Provide that the Final Rules apply to attorneys "providing legal services" to a client who have an "attorney-client relationship" with the client, and who "have notice" that "documents they are preparing or assisting in preparing will be filed with or submitted to" the SEC.

- Adopt a definition of "appearing and practicing before the Commission", responding to comments that the proposed rules were too broad, but retain the provision which includes advice that no filing or registration with the SEC is required, as qualifying as "appearing and practicing".⁶

Most importantly for non-U.S. lawyers, however, the Final Rules exempt "non-appearing foreign attorneys" from the definition of "appearing and practicing before the Commission". Thus, excluded from the Final Rules are attorneys who:

- are admitted to practice law in a jurisdiction outside the United States;

- do not hold themselves out as practicing, or giving legal advice regarding, United States law of any kind; and

- conduct activities that would otherwise constitute "appearing and practicing before the Commission" only

- incidentally to, and in the ordinary course of, a non-U.S. law practice, or

- in consultation with United States counsel.⁷

The Final Rules make clear that a non-U.S. attorney must satisfy all three criteria to be excluded from the Final Rules. The Final Rules give the example that an attorney licensed in Canada⁸ who independently advises an issuer regarding the application of SEC regulations to a periodic filing with the SEC will be subject to the rule.

As to in-house counsel for an issuer subject to the Final Rule, if they are non-U.S. qualified, the exemption for "non-appearing foreign

4 This is effectively the SEC's federal pre-emption argument; see n. 5.

5 Attorneys in 41 U.S. states, including New York, are allowed – but not required – by the existing state-level regimes governing attorney conduct to report evidence of an ongoing fraud or crime. The SEC has taken the position – as yet untested in any court – that its new rules would pre-empt U.S. state-level rules in any case where the SEC rules impose more stringent requirements than the state-level rule in question.

6 For example, the so-called "no registration" legal opinions, or even orally advising an issuer client to that effect.

7 Note that this is not limited to U.S. securities counsel. One also assumes that most attorneys not admitted in the U.S. would not provide advice to their clients as to matters of U.S. law without, at a minimum, consulting U.S. counsel.

8 One may insert here any non-U.S. jurisdiction, including England and Wales, by way of example.

attorneys" would equally apply. Thus, if the non-U.S. in-house lawyer fulfills the three criteria, he or she would not be subject to the Final Rules. Non-U.S. in-house lawyers must thus be careful to ensure that if, for example, they assist in the preparation or filing of SEC reports (for example, 8-Ks) for their company, they comply with the Final Rule, in order to be excluded from appearing and practicing before the SEC.

The Final Rules recognize that the proposed rules "took a broad view of who could be found to be appearing and practicing before [the SEC]" and "covered lawyers licensed in [non-U.S.] jurisdictions, whether or not they were also admitted in the United States". The SEC was sympathetic to the concerns raised in comment letters that non-U.S. lawyers "may not have the expertise to identify material violations of United States law". Under the Final Rules, these attorneys "may avoid being subject to the rule by declining to advise their clients on United States law or by seeking the assistance of United States counsel when undertaking any activity that could constitute appearing and practicing before the Commission." The Final Rules also clarify that "[m]ere preparation of a document that may be included as an exhibit to a filing with the Commission" will not constitute "appearing and practicing before the Commission", unless the non-U.S. attorney "has notice that the document will be filed with or submitted to the

Commission and he or she provides advice on United States securities law in preparing the document."

- Allow companies covered by the Final Rules (i.e., U.S.-reporting issuers) to establish a qualified legal compliance committee (QLCC) as an "alternative procedure for reporting evidence of a material violation".⁹ The Final Rules then provide that an attorney could satisfy his or her reporting duty by reporting the evidence of a material violation in question to the client's QLCC.

- Allow an attorney, **without** the consent of the client, to **reveal confidential information** related to the attorney's representation of the client, but only "to the extent the attorney reasonably believes necessary" in order to:

- prevent the client from "committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors";
- prevent the client, "in a Commission investigation or administrative proceeding, from committing perjury, suborning perjury," or committing specified illegal acts that are "likely to perpetrate a fraud upon the Commission"; or
- "rectify the consequences of a material violation or illegal act in which the attorney's services have been used".

In addition, the Final Rules modify the definition of the phrase "evidence of a material violation"

from the proposed rules. The SEC has indicated that the new definition was formulated to provide "an objective, rather than a subjective, triggering standard". The Final Rules define "evidence of a material violation" as "credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney¹⁰ not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur."

This double-negative formulation, though likely to provide some measure of relief to concerned lawyers, has already rattled pro-regulation commentators – usually law professors – who have seized upon it immediately, arguing that the double-negative contained in the standard would allow an attorney not to report, even with actual knowledge, and will make it more difficult for the SEC to establish that a lawyer has failed to comply with a reporting obligation.

Notably, the SEC has announced that it will propose, in a separate proposing release, an alternative to the noisy withdrawal standard of the proposed rules. This new withdrawal proposal ("Withdrawal II") would **still require withdrawal** if the attorney does not "receive an appropriate response to a report of a material violation", but the obligation of **publicly** reporting the attorney's withdrawal to the SEC would fall on the issuer, not the lawyer. The SEC has indicated that it

⁹ The Final Rules provide that the QLCC would have to have at least one member of the company's audit committee or an "equivalent committee of independent directors", and two or more independent members of the company's board of directors, and the QLCC must be charged with the responsibility to recommend that the company "implement an appropriate response to evidence of a material violation".

¹⁰ Note that this is **not** limited to a **securities** attorney.

London

CityPoint

One Ropemaker Street

London EC2Y 9SS

T +44 (0)20 7628 2020

F +44 (0)20 7628 2070

www.simmons-simmons.com

www.elexica.com

will also ask for comment on whether there are any circumstances in which a company should be allowed not to so report an attorney's withdrawal. Withdrawal II would also allow the attorney, if the client has not complied with the requirement to disclose the attorney's withdrawal, to notify the SEC that the attorney has withdrawn or provided the client with notice that they have not received an "appropriate response to a report of a material violation".

Even under the proposed Withdrawal II provisions, difficult questions of attorney-client privilege and confidentiality will likely remain, and be debated, both in the U.S. and in non-U.S. jurisdictions. Withdrawal II will also likely still raise questions for non-U.S. lawyers who may be brought within its ambit as to conflicts with the requirements of their home jurisdictions. For example, under English law, solicitors are under a general duty to keep confidential the affairs of their

clients, and to ensure that the staff of their firm do the same. The Solicitors Practice Rules 1990 set forth the basic principles of professional conduct for a solicitor. A solicitor may, however, be obligated to reveal confidential information that is subject to lawyer/client privilege under certain circumstances. See Charles Mayo and Christopher Lewis, "Regulating Lawyers", *Corporate Financier*, Issue 48. What a solicitor may or may not reveal, however, is clearly not co-extensive with the proposed rules, nor will it likely be with the regime contemplated by Withdrawal II.

Acrimony is already brewing around the latest chapter in this epic struggle. Interest groups are already re-convening to discuss their Withdrawal II lobbying strategy. Further, the SEC has made it abundantly clear that, though it is proposing alternative withdrawal procedures, it has not yet abandoned the original noisy withdrawal proposal. There have

also been indications that suggestions are being made that by extending the comment period and proposing the less-stringent Withdrawal II, the SEC is setting the stage for weaker protections for investors.

Any withdrawal regime, whether the original noisy withdrawal, Withdrawal II or some other standard, will be certain to continue to generate interest and comment, and, if finally adopted in some form, will make its way through, and be tested by, administrative and court challenges, and praise or condemnation by the legal community.

The Final Rules will be effective 180 days after they are published in the U.S. Federal Register.

[January 2003](#)

Further information

If you would like further information, please contact **Christopher Lewis**. Mr Lewis is a U.S. securities partner in the Capital Markets Group of the London Office of Simmons & Simmons

T +44 (0)20 7825 3763

E christopher.lewis@simmons-simmons.com