Section 307 of the Sarbanes-Oxley Act: Eroding the Legal Profession's System of Self-Governance

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I. INTRODUCTION

After years of maintaining that it is not in the business of regulating attorney ethics,¹ the Securities and Exchange Commission (SEC), pursuant to section 307 of the Sarbanes-Oxley Act of 2002 (the Act),² has established rules governing attorney action when confronted with a corporate client’s wrongdoing (the Final Rules).³ Section 307 specifically required a rule

(1) 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 chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and

(2) if the counsel or officer does not appropriately respond to the evidence . . . requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer, or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.⁴

¹. See, e.g., Letter from David M. Becker, General Counsel, Securities and Exchange Commission, to Richard W. Painter, Professor of Law, University of Illinois (March 28, 2002) (on file with North Carolina Banking Institute) (“[S]ince the Carter and Johnson Rule 102(e) proceeding, 47 SEC 471 (1981), the Commission has not brought Rule 102(e) proceedings against lawyers based on allegations of improper professional conduct, or otherwise used the Rule to establish professional responsibilities of lawyers.


The ideas behind section 307 are not new, nor are the concerns regarding balancing the attorney-client relationship against other interests such as investor protection and economic security. The SEC's rules of attorney conduct are based on the SEC's philosophy that the corporate attorney is vital to the successful functioning of the SEC and to the investing public.

The Final Rules detail the process by which an attorney must climb the corporate ladder to report client misconduct. While section 307 does not specifically authorize SEC rules requiring that corporate attorneys report client misconduct outside of the client organization, the original proposal by the SEC (the Proposed Rules) included limited outside reporting requirements. These “noisy withdrawal” provisions have been postponed, but not forgotten.


7. See Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296 (to be codified at 17 C.F.R. § 205). The Final Rules are specific in detailing to which individual or committee the attorney must report, see Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6321-22 (to be codified at 17 C.F.R. §§ 205.3(b)(1), (b)(3)), to avoid “a situation in which one attorney might report some evidence of a material violation to one committee of directors while another attorney might report other evidence of a material violation to a second committee, obscuring the full, cumulative significance of reported evidence.” Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,686.

8. See Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,673. “Under certain circumstances, these provisions permit or require attorneys to effect a so-called ‘noisy withdrawal’ and to notify the Commission that they have done so and permit attorneys to report evidence of material violations to the Commission.” Id.

Many believe that section 307 and the ensuing rules put the attorney into conflict between fulfilling section 307's disclosure requirements and protecting the attorney-client relationship. There are fears that individuals within the corporate client will hesitate to consult with the corporate attorneys on crucial matters for fear of being reported to management. In addition, section 307 has raised concerns because it is one of the few federal legislative attempts to regulate attorney professional responsibility, which, until now, has been controlled by the states and local bar organizations. There is an uneasy feeling that the legal profession's tradition of self-governance is in danger. Others, however, believe it is past time for such changes.

The Final Rules address many questions left unanswered by section 307 of the Act, including: What does it mean to practice "before the Commission in any way in the representation of issuers" – which attorneys are affected by section 307? What conduct is "material" so as to require reporting to the chief executive officer, audit committee, or directors? What evidence

10. See Guy Harrison, Protecting Our Profession, 65 Tex. B.J. 678, 678 (2002). "[T]here is certainly some risk that corporate lawyers will end up owing conflicting duties to their clients and to the public." It is important to remember that in the context of corporate representation, "the lawyer represents the corporation and its shareholders." Chairman Harvey L. Pitt, Speech by Securities and Exchange Commission Chairman: Remarks Before the Annual Meeting of the American Bar Association's Business Law Section, at http://www.sec.gov/news/speech/spch579.htm (Aug. 12, 2002).


12. See, e.g., id. ("the Sarbanes-Oxley Act is an intrusion into the regulation of the practice of law"); Reich & Wirtner, supra note 5, at 43 (noting that, with few exceptions, "the regulation of lawyers has traditionally been the exclusive province of state supreme courts" and commenting on the profession's "self-governing" status); Becker, supra note 1 (noting "[t]here has been a strong view among the bar that these matters are more appropriately addressed by state bar rules, which historically have been the source of professional responsibility requirements for lawyers, and have been overseen by state courts").

13. See Reich & Wirtner, supra note 5, at 39. The article goes on to note that "[i]f the profession fails to adequately police itself, our government will enact legislation that not only polices lawyers, but extends liability for corporate governance fiascos." Id. at 43.

14. See 148 Cong. Rec. S6551 (July 10, 2002) (statement of Sen. Edwards) (stating that part of the cause of recent corporate scandals "is that some lawyers have forgotten their responsibility").


16. Id. at 71,678-79.
triggers the reporting requirement – must the attorney undertake an investigation? The scope of the Final Rules is both broad and troublesome.

This Note examines section 307's effect on the existing regime of attorney ethics regulation. Part II of this Note provides a synopsis of the history of section 307 of the Act. Part III places section 307 in the context of the existing corporate landscape and of similar existing rules such as the American Bar Association's (ABA) Model Rule of Professional Conduct 1.13 and 17 C.F.R. § 201.102. Part IV questions the scope of authority left open to the SEC by section 307's broad language, including: attorneys affected by section 307 and the Final Rules as defined by "practice before the Commission," the meaning of "material" conduct, and what "evidence" will trigger an attorney's responsibility to report up the corporate ladder. Part V examines what, if any, whistleblower protections are available for attorneys who report corporate wrongdoing as mandated by section 307 of the Act and the Final Rules.

II. BACKGROUND OF SECTION 307 OF THE SARBANES-OXLEY ACT: FROM 1981 TO THE PRESENT

Since 1981, the SEC has not taken an aggressive position regarding attorney reporting responsibilities. In 1981, the SEC considered implementing rules of attorney conduct to end client non-compliance with SEC disclosure rules, but the ABA argued

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17. Id. at 71,681-84.
18. See infra notes 22 through 31 and accompanying text.
19. See infra notes 32 through 53 and accompanying text.
20. See infra notes 54 through 105 and accompanying text.
21. See infra notes 106 through 116 and accompanying text.
22. See, e.g., Becker, supra note 1 ("[S]ince the Carter and Johnson Rule 102(e) proceeding, 47 SEC 471 (1981), the Commission has not brought Rule 102(e) proceedings against lawyers based on allegations of improper professional conduct, or otherwise used the Rule to establish professional responsibilities of lawyers."). But cf. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,673 (noting that while the SEC has not adopted formal rules of professional conduct for attorneys, the SEC has held "on a case-by-case basis that lawyers appearing and practicing before the Commission have an obligation to report corporate misconduct to appropriate officers and directors").
against adoption and ultimately defeated the proposition. Since that time, the Commission has steadfastly refused to undertake regulation of attorney ethics.

2001 and 2002 saw many scandals shake the foundations of the corporate world. In the wake of Enron and other corporate scandals, over forty professors of law from across the United States wrote a letter asking the SEC to implement a rule requiring lawyers to report a client’s wrongful acts to the highest authority of the client organization. Noting one of the professor’s articles on the subject and the Bar’s insistence that regulation of professional ethics be left to state bar rules and state courts, the SEC intimated that any change in attorney ethics regulation should be initiated by congressional legislation, not by SEC initiative.

While attorney responsibility for corporate client wrongdoing was debated among members of the legal profession, the subject was also contested in the House and Senate. North Carolina Senator John Edwards, taking note of the attitudes of the

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24. Supra note 22 and accompanying text.
25. See Am. Bar Ass’n Task Force on Corp. Responsibility, Preliminary Report of the Am. Bar Ass’n Task Force on Corp. Responsibility July 16, 2002, 58 BUS. LAW. 189, 190-91 n.3 (2002). WorldCom’s revelation that it had overstated its earnings in excess of $3.8 billion resulted in a twenty percent workforce reduction and a loss in market capitalization of almost $115 billion. Id. Adelphia Communications sought bankruptcy protection after disclosing that it had guaranteed billions of dollars in loans to its controlling shareholders. Id. Tyco International lost approximately $100 billion in market capitalization following allegations of looting of corporate funds by its chief executive officer and general counsel. Id. Over a three-year period (1999-2001), the former head of Global Crossing Ltd. sold stock in the company in excess of $700 million. Id. Global Crossing Ltd. has now declared bankruptcy amid claims of inflated revenues based on nothing more substantive than accounting maneuvers. Id.
27. Painter & Duggan, supra note 5.
28. See Becker, supra note 1.
ABA and the SEC, roundly criticized the corporate lawyers, the Bar, and the SEC, stating that if the SEC would not respond to the concerns stated in the professors' letter, then Congress would act.29 On July 24, 2002, Congress approved the Act, including section 307,30 and President George W. Bush signed the new legislation on July 30, 2002.31

III. SARBANES-OXLEY SECTION 307 IN THE CONTEXT OF EXISTING RULES

Section 307 does not exist in a vacuum. Administrative agencies, the ABA’s Model Rules, and state bar rules all have provisions regarding when an attorney must take remedial action based on a client's wrongful conduct.32 Section 307 of the Act mandates SEC regulations requiring corporate counsel to report up the corporate ladder when the attorney has “evidence” that the company is acting in some way that is either illegal or a breach of duty.33 Some lawmakers would push government regulation of the legal profession beyond the current scope of section 307 and beyond the current scope of existing rules.34 Certain members of the legal profession also believe that attorneys should be required to do more than report internally.35 The Proposed Rules went beyond the Act’s express mandate and created limited instances where external reporting would be required.36 Section 307 of the Act does not create a private cause of action and the Final Rules confirm that only the SEC has enforcement rights.37

30. Reich & Wirtner, supra note 5, at 39.
31. Id.
32. E.g., id. at 39, 41-42.
34. Reich & Wirtner, supra note 5, at 40. During the Act’s passage through the Senate, “Sen. Richard Shelby of Alabama attempted (albeit unsuccessfully) to attach an amendment to S. 2673 that would have restored a private cause of action for aiding and abetting in securities cases.” Id.
35. Painter et al., supra note 26 (remarking that “some of [the signers of the letter] believe that in certain circumstances a lawyer also should be required to do more than report to a client’s board of directors”).
37. See Implementation of Standards of Professional Conduct for Attorneys, 68
A. Section 307 of the Sarbanes-Oxley Act

Section 307 of the Act enables and requires the SEC to establish rules of ethics for those attorneys practicing before it. The only rule specifically set forth in section 307 requires attorneys covered by the act 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," first to the chief legal counsel or chief executive officer and then, if appropriate remedial action is not taken, to the audit committee, a committee of independent directors, or to the full board of directors.  

B. American Bar Association's Model Rule of Professional Conduct 1.13: Organizations as Client

In contrast to section 307, the rule promulgated by the ABA contains no such mandatory provision for "climbing the corporate ladder." Instead, ABA Model Rule 1.13 provides that, if a company's lawyer knows that someone within the client organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer shall proceed as is reasonably necessary in the best interest of the organization.

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Fed. Reg. 6296, 6323 (Feb. 6, 2003) (to be codified at 17 C.F.R. § 205.7); Reich & Wirtner, supra note 5, at 40.

38. See 15 U.S.C.A. § 7245 (mandating that the SEC "issue rules ... setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers . . . .").

39. See id.


The circumstances that give rise to attorney action under ABA Model Rule 1.13 are narrower than in section 307 of the Act. While section 307 requires an attorney to climb the corporate ladder to report evidence of a material violation of law or fiduciary duty regardless of relation to the attorney's representation, ABA Model Rule 1.13 requires attorney action only if: 1) the lawyer knows of an actual or potential violation; 2) the violation is in regard to a matter related to the attorney's representation; and 3) the violation will likely result in substantial harm to the corporation.

In comparison, under section 307 of Act, actual knowledge of a violation is not required; mere "evidence" of a violation will suffice. Further, the violation need not be related to the attorney's area of representation under section 307: any "material violation of securities law or breach of fiduciary duty or similar violation" must be reported. Finally, section 307 does not condition its internal reporting requirement on any finding that the violation would result in harm to the corporation. Thus, the focus of Sarbanes-Oxley includes protection of the investors, not solely protection of the corporate entity.

C. Rule 102(e): Appearance and Practice before the Commission

The SEC already has disciplinary power over the attorneys who practice before it. This disciplinary power is embodied in Rule 102(e). Although this provision has been applied rigorously

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43. See MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2002).
45. Id.
46. See id.
49. See id.
50. Id. The SEC may discipline anyone, including an attorney, who is found:
   (i) Not to possess the requisite qualifications to represent others;
   or
   (ii) To be lacking in character or integrity or to have engaged in
to accountants, prior attempts to apply the provision to attorneys, without express statutory authority, have met with stiff resistance from the Bar. Section 307 of the Act settles the question of the SEC's power to regulate attorney professional responsibility in favor of the SEC. Section 307 not only authorizes but requires the SEC to create and enforce "Rules of Professional Responsibility for Attorneys" for those practicing before the SEC.

IV. THE SCOPE OF SECTION 307 AND THE FINAL RULES

The Act applies to those companies registered under section 12 or required to file reports under section 15(d) of the Securities Exchange Act of 1934. The Federal Reserve is clear that any bank, bank holding company, state member bank, or foreign bank that is subject to these provisions of the Securities and Exchange Act of 1934 is also subject to the Act, including section 307, and any related rules adopted by the SEC. Section 307 of the Act places certain attorneys (those "appearing or practicing" before the SEC) under the SEC’s rules and enforcement of professional conduct. These attorneys also remain subject to the rules of their jurisdiction to the extent the jurisdiction’s rules “impose additional obligations” and are not unethical or improper professional conduct; or

(iii) To have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

Id.


52. Cf. Reich & Wirtner, supra note 5, at 39 (discussing the passage of the Act and the existing rules regarding attorney reporting of client misconduct).

53. Id.


55. See id. The Federal Reserve also notes that while “[b]anking organizations that are not public companies generally are not covered by the provisions of the Act . . . [they] may be subject to similar requirements under other laws or Federal Reserve or FDIC regulations.” Id. at 46,812.

inconsistent with the SEC’s Final Rules. The authority granted the SEC by section 307 is broad with minimal limitations on the agency’s power to regulate. The exact scope of authority conferred on the SEC by section 307 is not clear from the language of the provision. In addition to the general mandate to establish rules of professional conduct, section 307 requires an SEC rule compelling lawyers who practice before the SEC “to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation” to higher authorities within the corporation. The reporting rule is based on a standard the SEC has attempted to implement in the past.

A. “Appearing and Practicing Before the Commission”

Because the phrase “practice before the commission” is not defined in section 307 of the Act, the SEC created its own

57. See Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296, 6320 (Feb. 6, 2003) (to be codified at 17 C.F.R. § 205.1). If the SEC Rule “set[s] a more rigorous standard,” the SEC Rules will preempt the state rules. Jonathan D. Glater, S.E.C. Adopts New Rules for Lawyers and Funds, N.Y. TIMES, Jan. 24, 2003, at C1. The Final Rules further state that “[a]n attorney who complies in good faith with the provisions of this part shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices.” Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6323 (to be codified at 17 C.F.R. § 205.(c)). The SEC goes on to clarify, however, that this protection does not apply where the attorney’s jurisdiction imposes “additional requirements . . . that are consistent with the Commission’s rules.” Id. at 6314.

58. See Cramton, supra note 56, at 178. “The phrase ‘minimum standards of professional conduct’ characterizes all professional rules of conduct. The only constraints are the limitation to lawyers practicing federal securities law and the requirements that the rules serve the public interest and protect investors.” Id.

59. Cf. id. (noting that “[t]he many questions that will arise concerning the scope of SEC authority . . . are important matters”).


61. Id.

62. Cramton, supra note 56, at 179.

In essence, it is a version of the standard that the SEC has been pushing for years: in-house and outside counsel who become aware of facts strongly suggesting that an agent of a corporation is involved in securities fraud must take steps, designed to be effective, to ensure that the board understands what the lawyer has discovered and must take steps to encourage the board to take action to disclose what it has discovered to the SEC and investing public.

Id. at 179-80.
An attorney appears or practices before the SEC in instances including:

(i) transacting any business with the Commission, including communications in any form;
(ii) representing an issuer in a Commission administrative proceeding or in connection with any Commission investigation, inquiry, information request, or subpoena;
(iii) providing advice in respect of the United States securities laws or the Commission's rules or regulations thereunder regarding any document that the attorney has notice will be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the Commission, including the provision of such advice in the context of preparing, or participating in the preparation of, any such document; or
(iv) advising an issuer as to whether information or a statement, opinion, or other writing is required under the United States securities laws or the Commission's rules or regulations thereunder to be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the Commission . . .

"In the representation of an issuer" is defined as "providing legal services as an attorney for an issuer, regardless of whether the attorney is employed or retained by the issuer."

The Final Rules cover attorneys who provide "legal services to an issuer within the context of an attorney-client relationship."

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64. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296, 6320 (Feb. 6, 2003) (to be codified at 17 C.F.R. § 205.2(a)(1)).
65. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6521 (to be codified at 17 C.F.R. § 205.2(g)).
relationship" whether or not the attorney is employed in the issuer's legal department. Attorneys retained by the issuer to investigate material violations reported under the Final Rules are themselves bound by the reporting requirements. The Final Rules narrowed the meaning of “appearing and practicing” from the Proposed Rules to respond to commentator concerns about applying the rules to those attorneys who are “admitted to practice” but are “employed in non-legal positions and do not provide legal services.”

Section 307 “makes no distinction between inside and outside counsel advising a reporting company.” The Proposed Rules, however, set forth clear provisions that would affect in-house and retained counsel in different ways if the reporting attorney did not receive an appropriate response from the client’s

66. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6298. The Proposed Rules’ definition was very broad and would have encompassed attorneys not employed in the legal department of an issuer and even attorneys who were not acting as attorneys, but who nevertheless transacted business with the SEC or assisted in preparation of documents filed with or submitted to the SEC. See Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,675-76. Attorneys licensed in foreign jurisdictions fell into the scope of the Proposed Rules. Id. at 71,676. The Final Rules clarify that in order to be bound by the Final Rules, the “attorney must have notice that a document he or she is preparing or assisting in preparing will be submitted to the Commission.” Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6298. The Final Rules also limit application to foreign attorneys. Id. at 6303-04.

67. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6322 (to be codified at 17 C.F.R. § 205.3(b)(5)).

68. Id. at 6301. See id. at 6297-98.

69. HAZEN & RATNER, supra note 23, at 398 n.6.

70. See Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,676-77. The Proposed Rules defined an appropriate response as one that provides “a basis for an attorney reasonably to believe: (1) [t]hat no material violation . . . is occurring, has occurred, or is about to occur; or (2) [t]hat the issuer has, as necessary, adopted remedial measures . . . .” Id. at 71,676. The Final Rules kept these basic provisions and added a third option. Floyd Norris, No Positives in This Legal Double Negative, N.Y. TIMES, Jan. 24, 2003, at C1. If the reporting attorney is satisfied that the issuer, with appropriate consent, has retained counsel to review the matter and: 1) “[h]as substantially implemented any remedial recommendations made by” the attorney after “reasonable investigation and evaluation of the reported evidence” or 2) “[h]as been advised that such attorney may, consistent with his or her professional obligations, assert a colorable defense on behalf of the issuer . . . in any investigation or judicial or administrative proceeding relating to the reported evidence of a material violation.” Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6320 (to be codified at 17 C.F.R. § 205.2(b)(3)). The SEC does not intend that this third option will “encompass all defenses” but only those defenses an attorney may assert consistent
directors or his supervising attorney. The Proposed Rules, in the case of an ongoing or impending violation, would have compelled an attorney retained by the issuer to: 1) withdraw from the representation, stating "professional considerations" as the reason for withdrawal; 2) within one business day give notice of withdrawal to the SEC, stating "professional considerations" as the reason for withdrawal; and 3) disaffirm any material that the attorney was involved in preparing that is to be filed with or submitted to the SEC "that the attorney reasonably believes is or may be materially false or misleading." An attorney who is "in-house" would not have to resign his position, but he would be required to: 1) notify the SEC that he intends to disaffirm any materially false or misleading statements and 2) thereafter promptly disaffirm any such material he had a part in preparing.

In both cases, the attorney would only need to notify the SEC if the violation is impending or ongoing and the violation is "likely to result in substantial injury to the financial interest or property of the issuer or of investors." In the case of past violations, retained or in-house counsel would be permitted, but not required, to follow the withdrawal and SEC notification procedures described. The "noisy withdrawal" provision of the Proposed Rules drew much criticism from the members of the profession. Others believed that the negative response to the "noisy withdrawal" requirements was unwarranted because the

with his professional obligations. Id. at 6301. The perceived effect is quite different. "'Colorable' is a very low standard.... All this makes it unlikely that any lawyer will ever be forced by this rule to consider quitting." Norris, supra.

71. See Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6323 (to be codified at 17 C.F.R. § 205.4). A supervisory attorney is one that supervises or directs an attorney "who is appearing and practicing before the Commission in the representation of an issuer." Id. (to be codified at § 205.4(a)). Once the supervising attorney has received evidence of a material violation from a subordinate attorney, it is the supervising attorney's responsibility to comply with the reporting requirements of § 205.3. Id. (to be codified at § 205.4(c)).


73. Id. at 71,688-89.
74. Id. at 71,688.
75. See id. at 71,690.
76. Glater, supra note 57.
SEC also provided an “opt-out” provision. The SEC postponed implementing the “noisy withdrawal” requirements to allow for further public comment. Part of the SEC’s revised proposal would require the client company, not the attorney, to report the attorney’s resignation to the SEC. The Final Rules do, however, contain a provision under which an attorney covered by the rules

may reveal to the Commission, without the issuer’s consent, confidential information related to the representation to the extent the attorney reasonably believes necessary: (i) to prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors; (ii) to prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, suborning perjury, or committing an act proscribed in 18 U.S.C. 1001 that is likely to perpetrate a fraud upon the Commission; or (iii) to

77. See Letter from Richard W. Painter, Visiting Professor of Law, University of Michigan Law School, Ann Arbor, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, at http://www.sec.gov/rules/proposed/s74502/rwpainter1.htm (Dec. 12, 2002). Under the Proposed Rules, if an issuer formed a qualified legal compliance committee (“QLCC”), an attorney fully fulfilled his reporting obligations by giving his “evidence” to the QLCC. See Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,687-88. The SEC retained the QLCC option in the Final Rules. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296, 6322 (Feb. 6, 2003) (to be codified at 17 C.F.R. § 205.3(c)). A QLCC is a committee: 1) whose members consist of “at least one member of the issuer’s audit committee” (or “an equivalent committee of independent directors” if the issuer does not have an audit committee) and two or more members who are not employed by the issuer, and who are not otherwise interested parties; 2) has a written policy for responding to evidence reported under the Final Rules; and 3) has authority to report up the corporate ladder, investigate, and recommend an appropriate response to evidence. Id. at 6321 (to be codified at 17 C.F.R. § 205.2(k)). The QLCC’s authority must include authority to notify the Commission in the event that the issuer fails in any material respect to implement an appropriate response” recommended by the QLCC. Id. (to be codified at 17 C.F.R. § 205.2(k)(4)). If the issuer has established a QLCC, a reporting attorney needs do nothing more than report the evidence of material violation to the QLCC. Id. at 6309. The burden of complying with the Final Rules falls to the QLCC. See id.


rectify the consequences of a material violation by
the issuer that caused, or may cause, substantial
injury to the financial interest or property of the
issuer or investors in the furtherance of which the
attorney’s services were used.80

Many attorneys will be affected by section 307 of the Act and the
Final Rules, from in-house counsel advising the client to outside
counsel putting client-provided information into proper form for
SEC filing or shareholder distribution.81

B. “Material Violation of Securities Law or Breach of
Fiduciary Duty or Similar Violation by the Company or
Any Agent Thereof”

An attorney need not report client conduct unless the
violation is “material.”82 Section 307 does not define a “material
violation” of securities law, fiduciary duty, or a “similar violation”
that would require an attorney to climb the corporate ladder.83

80. Id. at 6323 (to be codified at 17 C.F.R. § 205.3(d)(2)) (emphasis added). The
proposed version of this rule was much criticized as undermining the attorney-client
relationship and therefore an interference with an attorney’s ability to perform his
job effectively. Id. at 6310. Others offering comments on the Proposed Rules “noted
that at least four-fifths of the states now permit or require such disclosures as pertain
to ongoing conduct.” Id. at 6311. The SEC saw no reason to delay implementing this
rule. Id. at 6312.

providing legal services to an issuer who have an attorney-client relationship with the
issuer, and who have notice that documents they are preparing or assisting in
preparing will be filed with or submitted to the Commission”). For a sampling of the
comments sent to the SEC regarding the Proposed Rules, see Comments on
Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys,
Indicative of the broad reach of the Proposed Rules, the SEC received comments
from the Japan Federation of Bar Associations, the Council of Bars and Law
Societies of the European Union, and attorneys in Brazil and Venezuela. See id.

82. See Implementation of Standards of Professional Conduct for Attorneys, 67

83. Cf. Cramton, supra note 56, at 179 (noting that, “[u]ntil the SEC provides
more guidance, securities lawyers will have to make difficult judgment calls: . . .
When is a violation ‘material’?”).
The Final Rules do not define "material." In the Proposed Rules, the SEC defined "material" as "conduct or information about which a reasonable investor would want to be informed before making an investment decision." This definition of materiality also has been adopted by the courts in determining corporate liability for fraudulent or misleading disclosure to shareholders.

The SEC's Proposed Rules set forth common law definitions of breach of fiduciary duty with no special definitions of breach of fiduciary duty. The common law definition includes, but is not limited to, "misfeasance, nonfeasance, abdication of duty, abuse of trust, and approval of unlawful transactions." The Final Rules accept these definitions and incorporate language that makes clear that violations of federal or state statutes regarding fiduciary duties are also covered.

The SEC has not defined what constitutes a "similar violation," but is clear that it interprets "similar violation" to be a third category in addition to breach of fiduciary duty and violations of securities laws (state and federal). "[T]o the extent the Act contemplates sanctions against lawyers who fail to comply, due process concerns may arise. How can liability flow from an ambiguous term . . . if it is not defined?"


88. Id.


C. Required and Sufficient Evidence

Section 307 of the Act requires that attorneys climb the corporate ladder when they have "evidence" of a violation.\(^92\) Section 307 does not, however, explain what type of "evidence" is required and sufficient to trigger the attorney's responsibility to report.\(^93\) The SEC has been clear in prior decisions, however, that "a lawyer, no more than others, can escape liability for fraud by closing his eyes to what he saw and could readily understand."\(^94\)

The Proposed Rules were similar to ABA Model Rule 1.13, but the ABA Model Rule limits reporting to violations relating to the attorney's representation and section 307 of the Act's internal reporting requirements contains no such limitation.\(^95\) Section 307 appears to require, and the Proposed Rules would have required, the attorney to report evidence of any material violation, even if the suspected violation is not directly related to the representation by the corporate attorney and even if the violation is not actually known.\(^96\)

Initially, the SEC felt that ABA Model Rule 1.13 was too narrow because of the "knowledge" requirement and therefore would not allow attorney reporting in enough cases to fulfill the Act's goal of protecting the public interest.\(^97\) In short, the Proposed Rules would have required the corporate attorney to do more than accept his client's representations at face value and to


\(^93\) Cramton, supra note 56, at 179 (recognizing the question of "[w]hen does a lawyer have sufficient 'evidence' of a violation?").

\(^94\) SEC v. Frank, 388 F.2d 486, 488-89 (2d. Cir. 1968) (noting further that, at least in the case of non-technical information, an attorney may not simply rely on information provided by his client).

\(^95\) Cf. Implementation of Standards of Profession Conduct for Attorneys, 67 Fed. Reg. at 71,682. "The ABA's Model Rule 1.13 includes a similar but narrower reporting requirement for attorneys representing an organization, applicable only when the attorney knows that a violation is occurring or going to occur that is likely to result in substantial injury to the organization." Id.


\(^97\) See Implementation of Standards of Professional Conduct for Attorneys, 17 Fed. Reg. at 71,682. But see id. (stating that the "reporting obligation is not triggered until the attorney can be sure that the officer or employee will actually pursue an illegal course of action").
be alert to potential violations even if such matters arise outside the scope of the representation.

In fact, the SEC adopted a very complex standard for determining when to report up the ladder. Under the Final Rules, an attorney must report up the ladder when he has "credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur." The complexity of this standard's language will make it difficult for the SEC to discipline an attorney for failure to comply with the rules.

Another significant aspect of the evidentiary requirement is whether the attorney who has suspicions of fraud or other illegal activity must undertake an investigation before reporting. The SEC believes that since section 307 does not require actual knowledge of the violation, there generally is no duty to investigate evidence of a material violation before reporting the potential violation.

If material corporate misconduct does occur and the attorney has not internally reported violations, the attorney's decision not to report should be analyzed in light of the evidence that the attorney actually had or had reason to know at the time of action or inaction. But even though attorneys are to be judged on the facts known or those facts that could reasonably be known at the time, later disclosed facts "will inevitably color a fact-

98. Glater, supra note 57.
100. See Glater, supra note 57. While the "noisy withdrawal" proposal drew criticism from many lawyers, the changed standard for internal reporting has drawn harsh criticism from the public. See Norris, supra note 70 (asserting that this and other changes made in adopting the final rules "make it less likely that the rule will ever produce a report"). The SEC, however, maintains that the revised language was adopted to "clarify aspects of the objective standard that the Commission sought to achieve in the definition originally proposed." Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6301.
101. See Cramton, supra note 56, at 146. Cramton, supra note 56, at 146 (noting that a "lawyer's conduct should not be judged on the basis of facts learned at a later time").
Attorneys engaged in a public corporation representation or as in-house counsel should use more than usual care in looking for potential violations when engaged in aggressive or creative lawyering.

V. PROTECTION FOR THE WHISTLEBLOWING ATTORNEY?

What happens to the attorney who does climb the corporate ladder in compliance with section 307 of the Sarbanes-Oxley Act? Does the attorney receive any protection from discharge or retaliation by the company? The answers to these questions are not uniform.

Under ABA Model Rule 1.13, if the corporation's management refuses to act to rectify the situation as described by the attorney, the reporting attorney may resign from the corporate representation. If the attorney is discharged before he can resign, he faces the reality that courts show a general reluctance to recognize claims of retaliatory discharge or wrongful discharge in violation of public policy in favor of in-house lawyers terminated for whistleblowing. Some courts have, however, held the door ajar for attorneys seeking protection if they are discharged after an attempt to uphold the legal profession's standards. Section 307 requires a new set of professional standards. While whistleblower protections are not enunciated in section 307, section 806 of the Act is a provision to protect persons who, in furtherance of the Act's overall goals, report corporate wrongdoing. This provision provides protection to employees

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104. Id. at 147 (noting further that "the hindsight bias, in the civil fraud context, makes defendants appear more culpable than they may be").
105. Id. at 147.
106. See Reich & Wirtner, supra note 5, at 43.
108. E.g. Reich & Wirtner, supra note 5, at 43. But see, e.g., Crews v. Buckman Lab. Int'l, 78 S.W.3d 852, 853 (Tenn. 2002) (holding that an in-house attorney has a claim for retaliatory discharge if his discharge results from his attempt to uphold a professional duty that amounts to "a clear and definitive statement of public policy").
109. See, e.g., Crews, 78 S.W.3d at 853; Kelly v. Hunton & Williams, 1999 WL 408416, at *1 (E.D.N.Y. June 17, 1999) (refusing summary judgment against plaintiff attorney who claimed he was "forced out" of the firm for questioning a partner's billing practices).
who assist in investigations of violations of federal laws that aim to prevent fraud against shareholders or violations of SEC rules and regulations.\textsuperscript{111} The provision’s protections are limited, however, to instances when a federal enforcement agency, a congressional committee or a congressman, or a person in a supervisory position conducts the investigation.\textsuperscript{112} Section 806 does not explicitly state that it protects employees (or attorneys) who are conducting the investigation themselves or who report the information in the absence of a formal investigation.\textsuperscript{113}

Additionally, section 806 of the Act provides protection for any employee who initiates or participates in a proceeding against his employer about an alleged violation of SEC regulations or federal rules relating to frauds on shareholders.\textsuperscript{114} Consistently vague, this section of the Act does not define a protected “proceeding” and it is not clear that an attorney’s reporting up the corporate ladder is a protected action.\textsuperscript{115} The Final Rules do explicitly allow an attorney to use information regarding his report “in connection with any investigation, proceeding, or litigation in which the attorney’s compliance” with the rules is at issue.\textsuperscript{116}

VI. CONCLUSION

Regulation of attorney ethics has been the traditional province of bar organizations and state courts,\textsuperscript{117} but the mandate given to the SEC to regulate attorney conduct under section 307 is quite broad.\textsuperscript{118} Section 307 leaves the SEC free to craft its own code of ethics restricted only by the mandate that the rules require attorneys to climb the corporate ladder in cases of material

\begin{itemize}
\item[111.]
See id.
\item[112.]
See id.
\item[113.]
See id.
\item[114.]
See id.
\item[115.]
See id.
\item[116.]
Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296, 6323 (Feb. 6, 2003) (to be codified at 17 C.F.R. § 205.3(d)(1)). This provision is meant to correspond to ‘‘self-defense’ exceptions to client-confidentiality rules in every state.” Id. at 6310.
\item[117.]
Becker, supra note 1.
\item[118.]
Cramton, supra note 56, at 179.
\end{itemize}
violations of the law. At a minimum, however, attorneys will have to report evidence of wrongdoing that, if disclosed, would have an effect on an investor’s decision to purchase or sell stock in the company or would have a detrimental effect on the company.

Even though there are examples of prior existing administrative ethics regulations, some believe that the legal profession’s historical regime of self governance is threatened. The ABA submitted a lengthy response to the SEC’s call for comments, including requests for postponements or revision of certain sections of the Proposed Rules. The SEC did revise or postpone implementing some of the most contentious provisions. While section 307 creates no private cause of action, such a proposal was made during the bill’s passage through Congress. Furthermore, the SEC has reserved the right to supplement or amend the rules in the future.

Given the current political and social climate resulting from multiple corporate scandals and the legal profession’s failure to provide adequate safeguards, guidance, and means of reporting client wrongdoing, the legal profession could be in danger of losing its privilege of self-regulation. While the SEC postponed enactment of the “noisy withdrawal” provisions, the issue is by no means dead. The legal profession must take a warning from the

119. Id. at 178.
120. See supra notes 82 through 91 and accompanying text.
121. See Reich & Wirtner, supra note 5, at 39, 43.
123. Schroeder, supra note 78.
124. Reich & Wirtner, supra note 5, at 40. In addition, the authors note that, twenty years ago, Sen. Arlen Specter proposed criminal liability for lawyers who failed to disclose evidence of their clients’ prospective crimes, as well as some past crimes. Id.
126. See Reich & Wirtner, supra note 5, at 39.
127. Bilodeau, supra note 9. SEC Commissioner Harvey Goldschmid continues to be a vocal proponent of a “noisy withdrawal” requirement. Id. Indicative of the complete divergence of concerns between the SEC and the legal profession, Commissioner Goldschmid asserts that

“[T]he absolute emphasis on client confidentiality found among so
hard-line Proposed Rules and address these perceived problems from within. The federal government has shown its willingness to regulate the profession if the profession will not regulate itself.

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many” lawyers who opposed noisy withdrawal “is incomprehensibly out of balance…. It is contrary to duties we place on accountants and directors…. How can an absolute emphasis on confidentiality be reconciled with the commission’s traditional mandate to protect investors in the public interest?”

Id.