**THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK
42 WEST 44TH STREET
NEW YORK, NY 10036-6689
FAX # (212) 398-6634
WWW.ABCNY.ORG**

April 7, 2003

VIA E-MAIL: mailto:rule-comments@sec.gov

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Comment to File No. S7-45-02

I. PRELIMINARY STATEMENT

The Sarbanes-Oxley Act of 2002 (the "Act") was passed to address the recent wave of corporate misconduct and to restore investor confidence in the regulation of the securities markets. To respond to the public's expectations and fulfill its obligation under Section 307 of the Act, the Securities and Exchange Commission ("SEC" or the "Commission" or the "Agency") proposed rules on November 21, 2002. The proposal required an attorney to report evidence of material violations of securities law or breaches of fiduciary duty by the company or its agents to the chief legal counsel or officer ("CLO") or chief executive officer ("CEO"). These rules provided that if such reports failed to produce an appropriate response, then the attorney would be required to "go-up-the-ladder" within the company by reporting the problem to the directors. These proposed regulations were supported by the Association of the Bar for the City of New York ("CityBar") in the December 16, 2002 comments it submitted on the proposed regulations.

The November 21, 2002 draft rules also would have required that an attorney, under certain circumstances, resign from his or her representation of a client, publicly disclose this act, and disavow certain prior SEC client filings, often called a "noisy withdrawal." The CityBar, in its December 16, 2002 comment letter, opposed the adoption of the noisy withdrawal provisions. In fact, the Commission has acknowledged that "a greater number of commenters opposed the 'noisy withdrawal' provisions." The chief reasons for these objections were: (i) Section 307 does not require the Commission to mandate noisy withdrawals; (ii) noisy withdrawals would conflict with longstanding requirements under state ethics-setting bodies, and in some cases would force attorneys to violate the laws of their home jurisdiction; and (iii) requiring noisy withdrawal would not further the Commission's goals, because it would cause clients to exclude attorneys from meetings where sensitive information was exchanged that could lead an attorney to think a material violation had been committed.

On January 23, 2003, the Commission voted to approve the up-the-ladder reporting rules, with some modifications suggested by the CityBar and others, and deferred adoption of the noisy withdrawal provisions. The SEC also offered alternative proposals to the original noisy withdrawal provisions. Additional comments were solicited by the Commission on the original noisy withdrawal provisions and views on the alternative proposal were sought. The CityBar's view of the original proposal remains unchanged and, unfortunately, the SEC's new alternative proposed rules do not resolve the concerns that the CityBar and others previously raised about noisy withdrawal.

Despite the SEC's attempt to mitigate the effect of the withdrawal requirements in the alternative proposal by mandating that issuers, rather than their former attorneys, disclose the attorney withdrawal, the alternate proposal will still result in a chilling of attorneys'

relationships with their clients. Both proposals will turn advocates into potential adversaries of their clients. We also note that the provision allowing issuers not to disclose the withdrawal in certain circumstances will likely not work.

We therefore urge that the Commission give the recently adopted up-the-ladder reporting system a chance to demonstrate its efficacy before adopting additional regulations governing attorney conduct. Accordingly, we request that the SEC defer action on the new provisions.

We reiterate, but do not repeat, the views expressed in our prior comments with respect to noisy withdrawal, and focus our comments in this letter on the new proposal. Specifically, the CityBar addresses the following topics in this letter:

- The SEC should give “up the ladder” reporting an opportunity to work before any other far-reaching rules are implemented.
- Because the Act does not authorize the adoption of a “noisy withdrawal”rule, the rule is incorrectly premised on the assumption of its supremacy over state regulations.
- The SEC, as a prosecutorial body, should not regulate the attorneys who are defending cases brought by the Commission.
- A new requirement that counsel not assist an issuer in making a misstatement is unnecessary. Moreover, attorney withdrawal is well regulated by the states.
- The attorney-client relationship is different than the auditor-client relationship, calling for different disclosure rules.
- Requiring reporting outside the issuer’s organization creates issues with the attorney-client privilege, whether the report is made by the lawyer or the issuer.
- A Commission decision to adopt a rule requiring issuer disclosure of an attorney resignation will not further its ultimate goal of protecting investors. The possibility that the issuer will have to make such disclosure will have a detrimental impact on the attorney-client relationship, and will offer little benefit to the public because such disclosure is likely to contribute to market volatility.

- The exception to the proposed section 205.3(e) is impracticable because of the extraordinarily short deadline for disclosure of an attorney withdrawal, which limits the time independent counsel would have to perform an investigation into complex issues.

II. GENERAL CONCERNS

A. The Commission should give "up the ladder" reporting an opportunity to work before other, far-reaching changes are implemented.

The legislative history of Section 307 indicates that Congress sought to ensure that "attorneys are responsible for fully informing their corporate client of evidence of material violations of Federal securities laws."[1] Part 205, as currently adopted, establishes a strict framework pursuant to which attorneys appearing and practicing before the Commission in the representation of an issuer must report "evidence of a material violation" to the CLO or the CEO and CLO and, in the event an "appropriate response" is not forthcoming, to the full board of directors or a one of its committees. This provision─particularly when viewed in light of the enhanced corporate governance requirements established by the Act, as well as those proposed by the major securities exchanges and NASDAQ─achieves the full objectives of Section 307. Indeed, the Commission has recognized that it has already promulgated all the rules that Section 307 requires.[2] As a result of the adoption of Part 205 and related reforms, responsible decision-makers, both in the executive ranks and at the board level, will be fully informed of potential corporate wrongdoing of which an attorney subject to Part 205 becomes aware. These decision–makers will be in a position where it would be foolhardy, in light of the significant personal and corporate consequences arising from a failure to act, not to address appropriately any evidence of a material violation reported to them.

---

[1] 148 CONG. REC. § 6554 (daily ed. July 10, 2002) (statement of Sen. Enzi).

[2] In the final rule adopted by the Commission on January 23, 2003, the Commission stated that it believed that the "final rule responds fully to the mandate of Section 307 …" (Executive Summary). In the alternative proposal the SEC reiterated this, stating that corollary provisions to the up the ladder rules were "not explicitly required by Section 307." (Background).

Even if the Commission has the power to go beyond the Congressional mandate and adopt a reporting out provision—which we think it does not—the Commission should only do so if such a rule would further the ultimate goal of protecting investors. Given the inevitable adverse consequences to the attorney-client relationship resulting from a reporting out provision (as discussed at great length in our December 17, 2002 comment letter and further discussed below), adoption of such a mechanism now is ill-advised. Both forms of the noisy withdrawal proposal would create a situation where a lawyer withdrawal would require a reporting out of this action, either by the lawyer or by the client. This control over the client's destiny by its counsel will result—based on the client's recognition of the potential adverse consequences that could result from a withdrawal even if the client believes its position is reasonable—in a fundamental shift in the client's perception of the attorney. Instead of being viewed as a trusted advisor and confidant, the attorney will be viewed by the client as a potential adversary—one to be given as little information as possible. As clients become less likely to entrust important information to their counsel and less likely to seek legal advice for fear their lawyers will raise concerns regarding potential material violations, the ability of attorneys to provide the type of fully-informed guidance issuers need to comply with the law will be undermined.

Accordingly, we urge the Commission to forego adoption of any "reporting out" requirement at this time and to allow compliance mechanisms based upon the existing rules to develop and be tested. The Commission will then be in a position to determine whether the existing rules sufficiently protect investors while avoiding any complex, controversial and damaging transformation of long-held notions of the attorney-client relationship.

B. The legislation does not authorize the rule and it is incorrectly premised on SEC supremacy over state rules.

In response to the SEC's request for comments on proposed Part 205 of the SEC's Rules of Practice, a number of commenters–including the CityBar–questioned whether the SEC possessed the authority under the Act to promulgate "noisy withdrawal" requirements.[3]

Despite the indisputable importance of this question, in adopting release 34-47276, the SEC scarcely addresses the question. Indeed, in the 73-page adopting release, the SEC never confronts the question head-on, and instead places almost exclusive reliance on a comment letter (the "Koniak letter"),[4] which, according to the SEC, concludes that "duly adopted Commission rules will preempt conflicting state rules."[5] The SEC then simply "reaffirms that its rules shall prevail over any conflicting or inconsistent laws of a state. . . "[6] The analysis in the Koniak letter, however, is not persuasive.

1. Comment Letters Questioning the SEC's Authority to Promulgate, and the Advisability of Adopting, Noisy Withdrawal Requirements

Several comment letters argued that the SEC lacks authority under Section 307 of Sarbanes-Oxley to promulgate noisy withdrawal requirements.[7] One letter termed "serious understatement" the SEC's concession that its proposed noisy withdrawal requirements "are not explicitly required by Section 307" and go "beyond what the Act expressly directed the Commission to do."[8] This letter observed that, "[t]he reality is that not a single word in the text

---

[3] *See, e.g.*, Comments of The Association of the Bar of the City of New York, at 28-30; Comments of Eleven Persons or Law Firms, at 2-6; Comments of Skadden, Arps, Slate, Meager & Flom LLP, at 19; Comments of Weil, Gotshal & Manges LLP, at 2.

[4] *See generally* Comments of Susan P. Koniak, *et al.*

[5] *See* Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. pt. 205 (S.E.C. 2003).

[6] *Id.*

[7] *See supra* note 1.

[8] Comments of Eleven Persons or Law Firms, at 2.

of the Sarbanes-Oxley Act or in the relevant legislative history even hints that Congress contemplated granting to the Commission authority to impose 'noisy withdrawal' requirements."[9]

Given this reality, this letter pointed out that, in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976), the Supreme Court cautioned the SEC that the "rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law," but is instead only "the power to adopt regulations to carry into effect the will of Congress as expressed by the statute" (internal quotations omitted).[10] Furthermore, as this letter also observed, Section 3(a) of the Act does not provide any jurisdictional predicate for the SEC to promulgate noisy withdrawal requirements, because Section 3(a) only authorizes adopting rules "in furtherance of [the] Act," not rules beyond the Act's contemplation.[11]

Finally, this comment letter noted that federalism concerns – which the SEC had long subscribed to – cut against the SEC's proposed noisy withdrawal requirements.[12]

---

[9] *Id.*

[10] *Id.* at 3.

[11] *Id.*

[12] *Id.* at 4. In March 2002, then SEC General Counsel, David Becker, explained that the SEC had not promulgated rules of professional responsibility for lawyers for many years, pointing to the "strong view among the bar that these matters [rules regulating lawyer conduct] 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." Letter from David M. Becker, General Counsel, U.S. Securities and Exchange Commission, to Professor Richard Painter, *et al.* (March 28, 2002). Other comment letters similarly questioned the SEC's authority to adopt the noisy withdrawal requirements. *See, e.g.*, Comments of Weil, Gotshal & Manges LLP, at 2 ("Mandating 'noisy withdrawal' also raises substantial issues concerning the scope of the authority granted to the Commission under the Act to regulate attorney conduct. This is particularly the case given the long-established policy of the Congress to favor state regulation of professional conduct, and the notable absence from the Act of any specific provision making an exception to this policy.").

2. The Analysis in the Koniak Letter Cannot Support the SEC's Position

In the adopting release, the SEC's primary response was to point to the Koniak letter. The Koniak letter, however, is a thin reed that cannot support the SEC's proposed noisy withdrawal requirements. The conclusion in that letter that the Act gives the SEC authority to promulgate noisy withdrawal requirements and that these requirements preempt state law is not convincing.

The linchpin of the analysis adopted by the Commission is that "[w]hile the bill was in conference, the ABA sent a letter to the conferees arguing, inter alia, that federalism either mandated or counseled the legislators to declare that any Commission rules issued under § 307 would yield to state ethics codes. The conferees rejected the ABA's pleas."[13] From this, the conclusion is drawn that the SEC would be abrogating Section 307's mandate if it permitted state codes to govern attorney conduct.[14]

This argument is contrary to the principles of both preemption and statutory interpretation. It is beyond peradventure that Sarbanes-Oxley is silent on preemption. Silence, however, has never been a recognized indicator of Congressional intent.[15] Furthermore, the question is not whether Sarbanes-Oxley is silent on preemption. Rather, the correct question is whether Congress delegated authority to the SEC to preempt state law and to promulgate noisy withdrawal requirements. Absent that Congressional delegation of authority, the SEC lacks the legal basis to do so. In a case squarely on point, the Supreme Court has held:

---

[13] Koniak Letter, at 24.

[14] *Id.* at 23.

[15] *See, e.g., United States v. Wells,* 519 U.S. 482 (1997) ("We thus have at most legislative silence on the crucial statutory language and we have 'frequently cautioned that it is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law.'") (*quoting NLRB v. Plasters'*, 404 U.S. 116, 129-130 (1971).

> [A] federal agency may pre-empt state law only when and if it is acting within the scope of its congressionally delegated authority. . . First, an agency literally has no power to act, let alone pre-empt . . . unless and until Congress confers power upon it. Second, the best way of determining whether Congress intended the regulations of an administrative agency to displace state law is to examine the nature and scope of the authority granted by Congress to the agency.[16]

Here, there is no evidence that Congress delegated authority to the SEC to promulgate noisy withdrawal requirements, much less have those requirements preempt state law.

The Koniak letter also argues:

> As long as the federal government has authority under the Constitution to regulate in a particular area, the Supremacy Clause of the Constitution makes it clear that state law that conflicts or interferes with federal regulation must yield. We have already asserted that the general power of the federal government to regulate securities is indisputable, so the question is whether there is something about lawyer regulation that forces a different conclusion.[17]

The letter misses the point, because there is no doubt about what Congress can do in theory. Rather, the correct inquiry is whether Congress, in this instance, delegated the necessary authority to the SEC. Congress unquestionably did not.

C. The SEC, as a prosecutorial body, should not be regulating the attorneys who are defending cases brought by the agency.

The SEC plainly has the power to regulate the procedures which those attorneys who practice before it must follow. It is not so apparent, however, that the Commission also may, or should, dictate the substance of the relationship that issuers have with their counsel. In fact, the proposed noisy withdrawal and related requirements place the SEC, which is a prosecutorial

---

[16] *La. Pub. Serv. Comm'n v. F.C.C.,* 476 U.S. 355, 374 (1986) (emphasis added). *See also Medical Soc. Of New York v. Cuomo*, 976 F.2d 812, 818 (2d Cir. 1192) *(citing California Fed. Savings & Loan Ass'n v. Guerra,* 479 U.S. 272, 287-88 (1987) ("When Congress remains silent regarding the preemptive effect of its legislation on state laws it knows to be in existence at the time of such legislation's passing, Congress has failed to evince the requisite clear and manifest purpose to supersede those state laws").

[17] Koniak Letter, at 24.

agency, in the extraordinary and anomalous position of regulating the counsel of its adversaries.

As Richard Hall of Cravath, Swaine & Moore has cogently observed:

> The SEC is frequently and quite properly the adversary of private citizens. In those circumstances, private citizens turn to lawyers to represent them and advocate their case to the SEC, before the SEC and, if necessary, against the SEC in court proceedings.
>
> Viewed from this perspective, it is quite extraordinary that the SEC should be given the broad power to regulate the conduct of attorneys in matters bearing upon the enforcement of laws against their clients. While it is clearly appropriate for the Commission to regulate the conduct of attorneys in formal proceedings that take place before it or its administrative law judges, Section 307 and the SEC's proposed rules go much further. The SEC's power under Section 307 to regulate attorneys means that it now has the power to regulate and discipline the advocate of its adversary.
>
> * * *
>
> As policeman the SEC's ability to regulate the conduct of attorneys is also remarkable. One can quite legitimately ask why it is that a government agency charged with the detection of wrongdoing should seek to discharge that responsibility by forcing the lawyer for the potential wrongdoer to inform on his or her own client. If the issue is the lack of practical enforcement ability on the part of the SEC, it seems disingenuous to remedy that deficiency in the guise of lawyer ethics.[18]

III. THE MANDATORY WITHDRAWAL REQUIREMENTS ARE NOT APPROPRIATE

While we recognize that the proposed alternative Section 205.3(d)(1) responds to some of the issues raised about the original "noisy withdrawal" provision, it remains a deeply flawed effort to regulate the conduct of attorneys, in particular through mandated withdrawal. The effort is superfluous. State laws not only are the more appropriate regulatory vehicle, but also are more than sufficient to accomplish the Commission's goals in this area. In addition, the Commission already has the ability under Rule 2(e)(1)(ii) of the Commission's Rules of Practice, 17 C.F.R. § 201.102(e)(1), to address the situation where an attorney assists or facilitates the commission of a

[18] Richard Hall, *Why the SEC is Unfit to Regulate Lawyers*, 21 Int'l Fin. L. Rev. 16 (2002).

securities violation. The question of required or permissive withdrawal therefore should be left to state licensure authorities.

The essence of the alternative Section 205.3(d)(1) is that when retained counsel becomes aware of substantial evidence that leads him or her to believe that (a) an issuer-client is engaged in a material violation of the securities laws that is either on-going or is about to occur and (b) that possible violation is likely to cause substantial injury to the investing public or the issuer, the attorney is required to inform the issuer's of his or her concerns in the manner set forth in Section 205.3(b). If retained counsel finds the issuer's response lacking or if there is no response within a reasonable time, then counsel must withdraw from representing the issuer, report the withdrawal to the issuer's management in writing, and state that the withdrawal is for professional reasons. Retained counsel is not required to withdraw if, after seeking leave to withdraw, he or she is legally barred from doing so. An attorney employed by the issuer is required to cease forthwith participating or assisting in the matter concerning the alleged violation, and is required to make the same internal notification.

The alternative proposed rule raises a number of issues.

First, it appears that the rule would require counsel to resign from representing the issuer-client in all matters, and not just those which pertain to the alleged material violation. The effect of retained counsel's across-the-board resignation may lead to disruption in unrelated matters, with adverse consequences for third parties and the judicial and administrative process. For example, the rule may require retained counsel to withdraw from representing the issuer in a patent case entirely unrelated to any material violation of the securities laws. Counsel's withdrawal from that case, in the first instance, would be subject to court approval. Withdrawal,

if granted, would probably delay the resolution of the case and waste scarce judicial resources. While it may be appropriate for counsel to withdraw from representing the issuer–client in all matters, such a decision should be for client and counsel to make and not the Commission. There simply is no basis for the Commission to attempt to regulate an attorney-client relationship in a patent case that is unrelated to the alleged material violation of the securities law. Clearly, no such authority is conferred upon the Commission by Section 307.

To the extent that the Commission appropriately may regulate counsel's conduct, any such regulation should be limited to the harm that the Commission seeks to forestall: counsel's participation in or facilitation of a material violation of the securities laws. To the extent that a practitioner has engaged in alleged professional misconduct in his or practice before the Commission, the Commission has the authority through a Rule 2(e) proceeding to address any established wrongdoing. *See also* DR 7-102, New York Code of Professional Responsibility. The newly proposed section 205.3(d)(1) is not necessary to prevent such inappropriate behavior by counsel.

Second, a Commission-mandated resignation of representation by retained counsel may give rise to serious ethical issues for counsel under applicable state law rules. In particular, state rules almost universally impose a duty to avoid unnecessary harm or prejudice to the client that may result from withdrawal. *See, e.g.,* DR 2-110(a)(2), New York Code of Professional Responsibility. There is no reason why counsel should be precluded from complying with that mandate.

Third, the Commission has not made the case that state ethics rules, such as DR 2-110, have failed to address when withdrawal should occur. Further, state rules, such as DR 7-102,

defining an attorney's responsibility when he or she has a reasonable belief that the client is engaging in fraudulent conduct, are more than adequate to meet such situations. Because, as mentioned, Commission rules already afford the Commission the power to discipline counsel who knowingly further the commission of a fraud, there is no justification for additional SEC regulation.

Fourth, the proposal creates the very real potential for disputes with the Commission over what constitutes a "reasonable" amount of time for the issuer to respond to counsel's reporting an alleged on-going or future material violation after which withdrawal is mandated. That issue will very much depend on the facts of each individual case. The judgment, however, is one that could be second-guessed by the Commission, placing counsel in an untenable position. It would therefore be appropriate, were the Commission to adopt regulations on withdrawal, that the Commission create a safe harbor for the attorney and the issuer. An attorney should not be required to withdraw based on timeliness of a response if the issuer has advised that it has engaged counsel to review the report and counsel and the issuer are considering the matter. The attorney, of course, must not have a reason to doubt that this is true. If the lawyer is thereafter advised that the counsel considering the matter has determined that the issuer can assert a defense in good faith, this should eliminate any need to withdraw. Should an attorney nonetheless choose to withdraw under these circumstances, there should be no need to report this fact given the existence of a defense.[19]

[19] We believe that this is a better way to permit an issuer to avoid the need to disclose a resignation—by preventing the resignation—than the exception to disclosure of withdrawal proposed by the Commission. *See infra*, Part IV.D. The standard, the possibility of the assertion of a defense in good faith, is more workable that the Commission's proposed standard in the exception, an opinion that the attorney is unreasonable or that the company has implemented an appropriate response.

IV. REQUIRING THE ISSUER TO GIVE NOTICE DOES NOT SOLVE THE PROBLEMS CREATED BY NOISY WITHDRAWALS

The alternative "noisy withdrawal" proposal, which would create a duty to report for issuers, rather than their (former) attorneys, should not be adopted. The functional difference between the two "noisy withdrawal" proposals is slight. The major distinction between the two proposals lies in the identity of the reporting party, which is merely formalistic. The imposition of a duty to report upon an issuer, rather than an attorney, does not address, in any meaningful way, the concerns expressed in our December 16, 2002 letter about the harmful effects of the imposition of a "noisy withdrawal" requirement upon the relationship between the issuer and its lawyers.

The alternative proposal also suggests that the SEC might consider certain exceptions to the duty to report. Those exceptions, which may fairly be characterized as procedural protections, do not provide significant comfort.

A. The attorney-client relationship is different than the auditor-client relationship.

Some may view the alternative issuer notification proposal as analogous to the rule requiring an issuer to notify the public of the resignation of its auditor. Such an analogy can not be drawn because the roles of attorneys and auditors are very different. One important distinction is that the product of the auditor's work—the audit report and the audited financial statements—is intended to be relied upon by public investors. The resignation of an auditor, therefore, is information that understandably should be communicated to the public because it could affect the public's reliance on such work product. On the other hand, a company's attorneys, in general, do not provide advice intended for public investors. The attorneys' role is to serve as the issuer's advocate. Since the public is not relying on a particular attorney's work

product or advice, there is not the same expectation of, or reason for, public notice of withdrawal.

A trusting attorney-client relationship is absolutely critical to the provision of quality legal services to ensure compliance with the law. The alternative proposal, in essentially the same way as the noisy withdrawal proposal, would fundamentally alter this relationship. The end result would be that overall legal compliance would diminish, which will cause investor confidence in companies and the markets to suffer.

B. Mandatory disclosure of counsel's withdrawal to the SEC will undermine the attorney-client privilege.

We are convinced that the imposition of any duty to report the attorney's withdrawal outside the issuer's organization, whether it be to report just the fact of the withdrawal or the withdrawal and its attendant circumstances, would chill the relationship between the attorney and the issuer. Our chief concern with both "noisy withdrawal" proposals is with their effect upon the attorney-client privilege. As the Supreme Court has observed, "the loss of evidence admittedly caused by the privilege is justified in part by the fact that without the privilege, the client may not have made the communications in the first place."[20]

The alternative proposal, which would impose a duty to report the fact of the issuer's receipt of notice on a publicly available Form 8-K, remains generally inconsistent with the attorney-client privilege. There is no uniform rule of attorney-client privilege which is applicable in all jurisdictions, contexts and proceedings.[21] Thus, the imposition of a duty to

---

[20] *Swidler & Berlin v. United States*, 524 U.S. 399, 408 (1998).

[21] For instance, the federal courts have rejected the "control group" test for determining when conversations between employees of the issuer and the issuer's lawyer are privileged. *Upjohn Co. v. United States*, 449 U.S. 383, 393-394 (1981). On the other hand, a number of states continue to apply the "control group" test. *See* Brian E. Hamilton, *Conflict, Disparity, & Indecision: The Unsettled Corporate Attorney-Client Privilege*, 1997 Ann. Survey Am. Law. 629, 630 n.8 (citing cases); Stephen E.

report, coupled with the varying approaches to the corporate attorney-client privilege taken by federal courts and the courts of the fifty states, would result in uncertainty in the application of the attorney-client privilege, particularly in determining when, or if, the privilege has been waived. This uncertainty would take many years, the expenditure of significant and scarce judicial resources, as well as enormous expense for issuers and others, to resolve. Even then, given that different jurisdictions might, and likely would, reach different conclusions, it would be difficult for issuers to have confidence that their communications with their attorneys would remain sacrosanct.

We do not know how courts would ultimately resolve the complex thicket of issues raised if this proposal were adopted. We do know, however, that adopting a regulation that adversely affects the attorney-client privilege would harm issuers. Issuers would react to such a regulation by turning to attorneys less often. In other instances, issuers would give attorneys less information upon which to formulate legal advice, with the resulting advice being inevitably less valuable. Receiving less legal advice and advice of diminished value would hurt issuers, the securities markets, and the economy.

The potential impact of noisy withdrawal requirements on internal investigations could be particularly significant.[22] The attorney-client privilege enables company counsel to conduct a thorough internal investigation of evidence of misconduct. At the outset of an internal investigation, company counsel informs employees and officers that the company, and not the

---

Saltzburg, *Corporate & Related Attorney-Client Privilege Claims: A Suggested Approach*, 12 Hofstra L. Rev. 279, 280-281 (1984) (same).

[22] "The internal investigation serves a vital purpose for a company faced with allegations or evidence of illegal behavior. The company cannot fully evaluate the scope of employee wrongdoing or its potential liability without undertaking such an investigation. Companies know their own business operations, employees and records far better than the government. They know where to look, what results are anomalous, and which employees can be trusted. Moreover, the *in terrorem* power of the corporate general counsel to compel obedience to law and corporate policy is largely a function of his or her ability to conduct an effective internal investigation of possible violations." Judson W. Starr & Brian L. Flack, "The Government's Insistence on a Waiver of Privileges," White Collar Crime 2001, at J-3-J4 (2001).

individual, holds the privilege that attaches to interviews conducted in the course of the investigation, and that the company alone may choose to waive this privilege.[23] In most instances, after receiving this information, employees and officers cooperate fully in these interviews, primarily because of the assurance that the corporate attorney-client privilege and work-product protections will prevent disclosure of the information outside of the company. If these employees and officers understand that company counsel conducting the investigation on behalf of the company may be required by the SEC to waive the privilege—and thus, in effect, the lawyers may be forced to be government informants—they would be less willing to speak freely in these interviews. This, in turn, would prevent counsel from discovering past misconduct, taking remedial action, and ensuring that the company take steps to prevent inappropriate acts from occurring in the future.[24]

For these reasons, requiring notification of the fact of an attorney's withdrawal would harm the relationship between the attorney and the issuer. To go further, as one iteration of the alternative proposal does, and require that the issuer also report the "circumstances" of an attorney's withdrawal, would only exacerbate the harmful effects upon the privilege.

C. There will be little benefit to the public from the proposed alternatives.

With respect to the benefits of such a rule, it is our view that the imposition of a new duty to report withdrawal would not provide significant additional investor protection and, in fact, could contribute to stock price volatility. Thus, the proposed rule would do little to increase public confidence in the securities markets. There are other actors—chiefly the issuer's board of

---

[23] This is called an "*Upjohn* warning," referring to the Supreme Court's discussion of the corporate privilege in *Upjohn v. United States*, 449 U.S. 383 (1981).

[24] *See United States v. Chen*, 99 F.3d 1495, 1499 (9th Cir. 1996) (the service of "counseling clients and bringing them into compliance with the law cannot be performed effectively if clients are scared to tell their lawyers what they are doing, for fear that their lawyers will be turning into government informants").

directors and its officers—and other tools—regulatory, civil and criminal—that are available to deter and detect significant corporate malfeasance.

In fact, the legislative and regulatory responses to recent corporate scandals have added new tools designed to improve the detection and increase the deterrence of corporate malfeasance. To this end, the Act itself, and the Commission's regulations implementing the provisions of the Act that do not relate to lawyer conduct, add significant new protections for investors. These corporate governance and accounting reforms will have a direct and beneficial effect upon the securities markets and upon public confidence in them; the proposed "noisy withdrawal" rule, on the other hand, would do little to protect investors and would do great harm to the attorney-client relationship.

As described above, the original noisy withdrawal and the alternative proposals suffer from the same principal defect—they will have an adverse impact on the attorney-client relationship. The alternative proposal, however, suffers from a further defect—one that also may prove injurious to the investing public. The requirement contained in proposed section 205(e) and the related amendments to Forms 8-K, 20-F and 40-F mandate that the issuer publicly disclose an attorney's written notice of withdrawal. Public notification of withdrawal would, in virtually all cases, provoke an immediate and potentially unjustified sell-off of the issuer's stock. The noisy withdrawal proposal, notwithstanding its many infirmities, requires notification only to the Commission. It thus affords an issuer the initial opportunity to make its case to the Commission before any public disclosure, thus potentially avoiding the need for public disclosure and public over reaction.

Application of the attorney conduct rules necessarily will involve a significant number of cases in which issuer and counsel perspectives and judgments on close questions will differ. The requirement of public notice of an attorney's withdrawal could subject an issuer to substantial damage in its stock price and market reputation simply because the attorney disagrees with the appropriateness of the issuer's response and withdraws, even in close cases. The short timeframe that a company has between withdrawal and the time it must provide public notice of counsel's resignation would preclude an issuer from being able to explain the facts and circumstances to the Commission and would likely lead to an immediate market overreaction to the notice by provoking a "sell now, ask questions later" mentality among investors. In this way, the proposed amendments to Forms 8-K, 20-F and 40-F will likely contribute to the volatility of markets as they react to news before it is fully digested and understood. The proposed requirement has the potential to generate market reaction that is not commensurate with the circumstances of withdrawal, particularly where the withdrawal is over a close question. These consequences would not serve to further the goals of investor protection.

Alternatively, if reporting out becomes relatively common and a number of cases prove to be the result of "mole hills" built into "mountains" by attorneys engaged in defensive thinking due to their fear of being second-guessed by the Commission, investors may actually become immune to an attorney's notice of withdrawal. This result can be easily avoided by requiring notice to the Commission rather than a public filing of a Form 8-K, 20-F or 40-F. In fact, if numerous public disclosures turn out to be the result of nothing more than over-anxious lawyers allowing their conservatism to result in disagreements with clients resulting in public disclosure, clients as a whole will become more and more leery of working with, or disclosing information to, cautious counsel and the risk of failures to comply with laws will only increase.

We note that another of the recent reforms, the "up the ladder" reporting requirement for attorneys appearing before the Commission, will ensure that attorney conduct and good corporate governance go hand in hand. On the other hand, we believe that to adopt a "noisy withdrawal" requirement has little benefit, but significant cost. Thus, while we supported the "up the ladder" reporting requirement, we oppose the "noisy withdrawal" requirement, in either the original or the alternative version.

D. The exception to disclosure – independent director review - does not work.

Although we support the spirit of the contemplated exception to proposed section 205.3(e), the CityBar believes that this concept is unworkable as a practical matter. The proposal would allow an issuer to refrain from disclosing an attorney's withdrawal where:

> a committee of independent directors of the issuer's board determines, based on the advice of counsel that was not involved in the matters underlying the reported material violation (i) that the attorney providing such written notice acted unreasonably in providing such notice, or (ii) that the issuer has, subsequent to such written notice, implemented an appropriate response.

This exception would allow the issuer to seek the objective advice of a lawyer not involved in the alleged underlying material violation before being compelled to disclose an attorney's withdrawal. However, the extraordinarily short deadline for disclosure of an attorney withdrawal mandated by section 205.3(e)—a mere two days—and the difficult standard of review by other counsel—unreasonableness—completely nullifies the proposal's utility.

The issuer's independent counsel could not perform the requisite investigation in the short time frame afforded. Inquiries into complex commercial transactions, accounting matters and other issues that would underlie an alleged material violation routinely take weeks, or even months, to complete. For an independent lawyer called on to evaluate the transaction to fulfill his or her own duties of due diligence and responsibility to his or her client would typically

require the lawyer to examine large volumes of documents and to interview many witnesses. Certain witnesses may not be amenable to a prompt interview, particularly if they are not employees of the issuer, but of the issuer's accountants, consultants or other professionals.

Indeed, even the Commission's own investigations routinely take months to complete. Some of the more prominent corporate scandals that prompted the passage of the Act are still under investigation, and even those that have closed involved many lawyer-months of full time dedication. For example:

- Media reports indicate that the SEC investigation of Enron began in August 2001. *See Enron Woes Became Focus of Andersen Trial*, The Houston Chronicle, May 9, 2002. Yet just last month, in the middle of March, 2003 the Commission filed charges against certain Merrill Lynch executives relating to work they performed for Enron. *See* Kurt Eichenwald, *Four at Merrill Accused of an Enron Fraud*, N.Y. Times, March 18, 2003.

- The Commission commenced an investigation into alleged wrongdoing at Tyco International in July 2000. *National Law Journal*, July 8, 2002 at A13. However, Tyco executives were not named by the Commission in a civil fraud complaint until September 2002, more than two years later. *See* Jeff Smith, *Targeting Ill-Gotten Gains; SEC uses New Tool to Get Execs. to Repay Investors*, Rocky Mountain News, March 8, 2003, at 4C.

- The Commission launched its investigation of Qwest in March 2002, and did not file its disgorgement action against Qwest executives until approximately one year later. *See Business Briefing*, The San Diego Union-Tribune Feb. 12, 2003 at C-2; Smith at 4C.

Independent counsel's investigations, even with the client's full cooperation (although without the Commission's subpoena power), similarly take a long time to complete. Thus, section 205.3(e)'s two-day time limit renders this exception a dead letter.

Accordingly, because we do not believe that the proposed exception's investigation can be conducted within the two-day window provided by section 205.3(e), the CityBar concludes that the proposed exception to issuer reporting of attorney withdrawal under the Act should not be implemented. We also believe that should the Commission seek to regulate withdrawal—

which we believe it should not—a viable alternative exists that should permit issuers to avoid the resignation of counsel in most instances (no withdrawal is mandated while the issuer is investigating the report with the assistance of counsel and no resignation is required if that counsel advises that a defense in good faith exists, *see* Part III, *supra*).[25]

*   *   *   *   *

We thank you for the opportunity to comment on these proposed rules. We hope that the Commission will defer adoption of these or any additional rules under Section 307 until after the Commission has had the opportunity to observe and assess the actual impact of the rules it has already adopted. We would be pleased to meet with the Commission or its staff to discuss or amplify the comments in this letter.

Drafting Committee

Paul Dutka	Professional Responsibility Committee
Joseph M. Heppt	Professional Responsibility Committee
David G. Keyko, Chair	Professional Responsibility Committee
Yasho Lahiri	Professional Responsibility Committee
Arnold Levine	Committee on Corporation Law
Matthew J. Mallow	Securities Regulation Committee
William B. Pollard, III	Professional & Judicial Ethics Committee
William Sushon	Professional & Judicial Ethics Committee
James Walker	Professional Discipline Committee

Chairs of the Participating Committees

Barbara S. Gillers	Professional & Judicial Ethics Committee
Hal R. Lieberman	Professional Discipline Committee

[25] As set forth in footnote 19, *supra*, we also do not think that the standard is an appropriate one. It is quite possible that a good faith defense may exist, even though the reviewing attorney may not be willing to opine that the withdrawing attorney's position is unreasonable. Because the existence of such a defense should obviate any need to disclose a withdrawal, we do not think that one attorney should be called upon to question the reasonableness of a decision to withdraw made by another attorney.

Richard Maltz	Professional Responsibility Committee
Charles M. Nathan	Securities Regulation Committee
Mark Wojciechowski	Committee on Corporation Law