

Capital Markets and Securities

A bulletin prepared by the Capital Markets Group at Vedder Price designed to keep corporate executives and investment banking professionals informed on major developments in the securities industry.

Spring 2003

THE SEC ATTORNEY CONDUCT RULES

The SEC has adopted new rules that establish standards of professional conduct for all attorneys who handle securities law matters on behalf of public companies. These standards, mandated by the Sarbanes-Oxley Act of 2002, take effect on August 5, 2003.

The attorney conduct rules are yet another safeguard designed by the SEC to protect the integrity of U.S. capital markets in the post-Enron era. Having previously addressed perceived problems with public company boards, executive management and independent auditors, the SEC's attention has shifted to the legal community.

Public company directors and executives have always looked to securities lawyers for counseling and advice on matters of disclosure and SEC reporting. The attorney conduct rules now establish specific guidelines a securities lawyer must follow when representing a public company.

Securities lawyers will be obligated to adhere to "up the ladder" reporting if there are legitimate concerns about a public company's compliance with the securities laws. Up the ladder reporting under the rules works as follows:

- An attorney who believes there is evidence of a material violation of the federal securities laws must report it to the company's chief legal officer, and possibly the chief executive officer
- If the chief legal officer or chief executive officer does not provide a response considered appropriate by the attorney, the attorney must

carry the purported violation "up the ladder" to the company's audit committee, the independent directors or the full board of directors

- The attorney must then detail the purported violation and explain why the company has not made an appropriate response

The SEC is debating whether to also require "noisy withdrawal." This will force an attorney to resign from representing a company and notify the SEC of his or her withdrawal if the attorney is not satisfied with the company's ultimate response to the purported violation.

The SEC estimates that nearly 18,200 companies will be affected by the new attorney conduct rules.

"The SEC estimates that nearly 18,200 companies will be affected by the new attorney conduct rules."

Evidence of a Material Violation

At the heart of the new conduct rules is the attorney's duty to report evidence of a material violation of the federal securities laws. Evidence of a violation must be credible, not based on office gossip or innuendo. The obligation to report arises when, based on the credible evidence, it is unreasonable under the circumstances for an attorney not to conclude that it is reasonably likely a violation occurred. The determination whether a violation is reasonable likely falls somewhere between the conclusion that the violation is "a mere possibility" and "more likely than not" to have occurred. Certainty is not required. The belief that there is

a reasonable chance that a violation occurred will trigger “up the ladder” reporting.

Evidence of a material violation of the federal securities laws relates not only to a violation that has occurred, but also to any violation that is continuing or is likely to occur.

Duty to Report

If an attorney becomes aware of evidence of a material violation, the attorney must report the violation to the company’s chief legal officer (or equivalent) or both the chief legal officer and the chief executive officer (or equivalent).

“The new SEC conduct rules apply to any attorney appearing and practicing before the SEC in the representation of an issuer.”

Company Investigation and Response

Once informed that an attorney believes a material violation has occurred, the chief legal officer must make an inquiry into the allegations. Once an investigation is completed, the chief legal officer must respond appropriately, *i.e.*, take reasonable steps to correct the problem or inform the reporting attorney that no violation was in fact found. It is up to the reporting attorney to then determine whether the response is reasonable.

“Up the Ladder”

If the attorney is not satisfied with the response from the chief legal officer, the attorney must take the matter higher up in the organization and report the violation to one of the following:

- the audit committee of the board of directors
- if there is no audit committee, then to a committee of independent directors
- if there is no committee of independent directors, then to the full board

If from the outset of the process an attorney believes that it is futile to approach the company’s chief legal officer or chief executive officer, the attorney can take the matter

directly to the audit committee, the independent directors or the full board, as the situation dictates.

“Noisy Withdrawal?”

Yet to be decided are the ultimate steps an attorney must take if the attorney has exhausted up the ladder reporting and is still

not satisfied with the company’s response. The SEC is presently considering whether to impose a “noisy withdrawal” requirement. This would require an outside attorney to:

- resign from representing the company
- notify the SEC of the withdrawal indicating it is based on professional considerations
- disaffirm documents filed with the SEC that the attorney prepared or assisted in preparing

An in-house attorney would not need to resign from the company, but instead would notify the SEC that he or she intends to disaffirm filed documents and then proceed to in fact disaffirm such documents.

If a violation is ongoing or about to happen and it is likely to result in substantial injury to the financial interests or property of the company or investors, the attorney must give one business day notice to the SEC of the withdrawal or intent to disaffirm filings, as the case may be, and then promptly act.

As alternatives to noisy withdrawal, the SEC is considering whether to make SEC notice permissive instead of mandatory or simply drop the SEC notice requirement altogether. The SEC is also looking at requiring the company itself to file a notice of withdrawal or disaffirmation with the SEC on Form 8-K. The SEC is soliciting comments on these proposals through April 7, 2003.

Qualified Legal Compliance Committees

An attorney has the option of reporting material violations of the federal securities laws to a qualified legal compliance committee (QLCC) of the board of directors if the company has established one. This would be in lieu of up the ladder reporting. If a report is made to a QLCC, the attorney does

not have to take the matter any further and is not required to assess the company's response to the reported violation. The QLCC assumes full responsibility for the matter, which may include notifying the SEC of a violation and the company's failure to respond to it.

A QLCC must consist of one member of the audit committee and two or more independent directors.

Confidential Information

The new SEC attorney conduct rules address situations where an attorney is permitted (but not required) to disclose confidential information without the consent of the company. This would include reports prepared by the attorney in any proceeding where the attorney's compliance with the new SEC conduct rules is at issue. It also includes any information the attorney reasonably believes necessary:

- to prevent the company from committing a material violation that the attorney reasonably believes is likely to result in substantial injury to the financial interests or property of the company or investors
- to prevent the company from perpetrating a fraud upon the SEC
- to rectify the consequences of the company's material violations that caused or may cause substantial injury to the company's financial interests or property

These provisions are generally considered consistent with most codes of ethics for attorneys under current state law.

What Attorneys are Subject to the New Rules?

The new SEC conduct rules apply to any attorney appearing and practicing before the SEC in the representation of a company. Certainly, any securities lawyer that represents a company in an SEC administrative proceeding or provides federal securities law advice or services for a public company, including advising on whether information or a statement need be included in a filing with the SEC, will be subject to the conduct rules. However, any attorney who has notice that a document he or she is preparing for a public company client will be filed with the SEC will also be covered.

Safe Harbor

The new SEC attorney conduct rules do not give rise to a private right of action against an attorney, law firm or company for compliance or non-compliance with the rules. Thus, the conduct rules contain a "safe harbor" from civil suits. The SEC is the only party authorized to bring actions under the new rules.

Sanctions and Discipline

The SEC can impose sanctions on attorneys violating the new conduct rules as it would any other violators of the federal securities laws and, when appropriate, initiate disciplinary proceedings. The SEC can censure or temporarily or permanently enjoin an attorney from practicing before the SEC for failing to adhere to the standards established by the new rules.

Capital Markets and Securities bulletin is published by the law firm of Vedder, Price, Kaufman & Kammholz. It is intended to keep our clients and interested parties informed on developments in corporate finance and securities matters. It is not a substitute for professional advice.

© 2003 Vedder, Price, Kaufman & Kammholz. Reproduction of this bulletin is permitted only with credit to Vedder, Price, Kaufman & Kammholz. For an electronic copy of this newsletter, please contact us at info@vedderprice.com

If you have any questions regarding material in this issue of *Capital Markets and Securities* or suggestions for a specific topic you would like addressed in a future issue, please contact the executive editor, Steven J. Gray at 312/609-7528 or at sgray@vedderprice.com.

VEDDER, PRICE, KAUFMAN & KAMMHOLZ

About Vedder Price

Vedder, Price, Kaufman & Kammholz is a national, full-service law firm with more than 200 attorneys in Chicago, New York City and Livingston, New Jersey. The attorneys in the firm's Capital Markets Group regularly represent corporations and investment bankers, both foreign and domestic, in a wide variety of matters, including:

- debt and equity offerings, including initial public offerings, structured debt financings, aircraft securitizations, dual-class equity structures, and sophisticated preferred stock instruments;
- capital formation for initial capitalization, financing ongoing operations, and acquisitions;
- corporate disclosure, periodic reporting, proxy solicitations, and insider trading and beneficial ownership compliance matters;
- private placement of securities, including Rule 144A and Regulation S transactions;
- tender offers, mergers and acquisitions, and recapitalizations and restructurings;
- international offerings of securities and compliance by foreign issuers with the U.S. securities laws;
- litigation and administrative and arbitration proceedings involving various securities fraud claims, disclosure issues, and regulatory enforcement matters; and
- municipal bond financings.

Principal Members of the Capital Markets Group:

Steven R. Berger (<i>New York</i>)	212/407-7714
John T. Blatchford	312/609-7605
Thomas P. Desmond	312/609-7647
Jennifer R. Evans	312/609-7686
Robyn B. Goldman	312/609-7662
Steven J. Gray (<i>Chair</i>)	312/609-7528
Jennifer Durham King	312/609-7835
James W. Morrissey	312/609-7717
Meeghan O'Donnell	312/609-7529
Jason K. Zachary	312/609-7757

Participating Members of the Capital Markets Group:

James A. Arpaia	312/609-7618
William J. Bettman	312/609-7776
Deborah B. Eades	312/609-7661
Karin Jagel Flynn	312/609-7805
Dean N. Gerber	312/609-7638
Dan L. Goldwasser (<i>New York</i>)	212/407-7710
Douglas M. Hambleton	312/609-7684
John T. McEnroe	312/609-7885
Daniel C. McKay II	312/609-7662
Maureen A. Miller	312/609-7699
Robert J. Moran	312/609-7517
Michael A. Nemeroff	312/609-7858
Cathy G. O'Kelly	312/609-7657
Daniel O'Rourke	312/609-7669
John R. Obiala	312/609-7522
Ronald Scheinberg (<i>New York</i>)	212/407-7730
Guy E. Snyder	312/609-7656
Robert J. Stucker	312/609-7606
David A. Sturms	312/609-7589
Dalius F. Vasys	312/609-7623
Donald A. Wassall (<i>New York</i>)	212/407-7707
Richard L. Williams	312/609-7588

Chicago

Vedder, Price, Kaufman & Kammholz
A Partnership Including Vedder, Price, Kaufman & Kammholz, P.C.
222 North LaSalle Street
Chicago, Illinois 60601
312/609-7500
Fax: 312/609-5005

New York

Vedder, Price, Kaufman & Kammholz
805 Third Avenue
New York, New York 10022
212/407-7700
Fax: 212/407-7799

New Jersey

Vedder, Price, Kaufman & Kammholz
354 Eisenhower Parkway, Plaza II
Livingston, New Jersey 07039
973/597-1100
Fax: 973/597-9607

www.vedderprice.com