
Jennifer Wheeler
SECURITIES LAW: SECTION 307 OF THE SARBANES-OXLEY ACT: IRRECONCILABLE CONFLICT WITH THE ABA’S MODEL RULES AND THE OKLAHOMA RULES OF PROFESSIONAL CONDUCT?

JENNIFER WHEELER*

I. Introduction

An attorney has many roles in society — client representative, officer of the legal system, and public citizen responsible for justice, to name a few.1 Now, thanks to a group of forty law professors, a former plaintiffs’ attorney, and a Congress faced with a disillusioned public in an important election year, an attorney representing clients before the Securities and Exchange Commission also has another title: corporate snitch.

A wave of corporate scandals that began in 2001 with the collapse of Enron2 and continued into 2002 with disclosures of accounting discrepancies at Qwest Communications3 and bankruptcy filings by Adelphia,4 Global Crossing,5 and WorldCom,6 culminated in 2002 in the most sweeping corporate governance legislation in recent memory. In response to the numerous scandals and the investing public’s growing suspicion of corporate America, both the Senate and the House of Representatives passed corporate governance legislation aimed at restoring the public’s faith in the business markets.

* Senior associate, McAfee & Taft A Professional Corporation, Oklahoma City, Okla. J.D., 1997, University of Oklahoma; B.A., 1994, University of Tulsa.

The Senate and the House hastily adopted their respective corporate governance bills, anxious to demonstrate their commitment to ending widespread moral decay and flagrant abuses of power, even if only among corporate executives. Just as hastily, Congress agreed to combine the two bills into a single piece of legislation that purports to “protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws.” On July 30, 2002, President George W. Bush signed the bill into law, enacting the Sarbanes-Oxley Act of 2002 (the Act), legislation widely regarded as containing “the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt.”

Although the Act did not necessarily restore investors’ shaken confidence or improve their depleted portfolios, it had, and will continue to have, a dramatic effect on the lives and businesses of three character-types that inevitably appear in each corporate scandal: the corporate executives, the accountants, and the attorneys. Bypassing the numerous provisions in the Act that address accounting-firm oversight, executive-officer liability, and financial disclosure requirements, this Article focuses on section 307 of the Act, “Rules of Professional Responsibility for Attorneys.”

Section 307 and the rules promulgated by the SEC in accordance with it have prompted concerns about their consequences on the relationships between attorneys and their corporate clients. Notwithstanding this widespread concern, in-house legal departments and law firms serving as outside counsel to companies subject to the Act can avoid any negative repercussions from the Act and the SEC’s related rules by adopting certain precautionary measures and, more importantly, by simply remembering who the client is.

To begin discussing the impact of the SEC’s rules under section 307 on the relationships between attorneys and their corporate clients, Part II of this Article reviews the text of section 307 and examines the limited legislative history of the provision. Specifically, Part II details the impetus behind section 307 and explores the roles of those who contributed to its enactment — including the surprisingly small role that the American Bar Association played in passing the legislation.

Part III of this Article compares section 307 and the related SEC rules with the existing ABA Model Rules of Professional Conduct that address

10. The companies discussed in this Article are assumed to be “issuers” as defined in the Sarbanes-Oxley Act of 2002.

https://digitalcommons.law.ou.edu/olr/vol56/iss2/22
attorneys' professional responsibilities. Part III examines recommendations by the ABA to amend the Model Rules and suggests that any conflicts between the SEC's rules and the Model Rules are reconcilable.

Part IV discusses how the SEC's rules affect attorneys in Oklahoma and correlate with Oklahoma's Rules of Professional Conduct. Part IV discusses critical issues that in-house legal departments and law firms representing companies as outside counsel should examine in connection with section 307 and the related SEC rules when deciding how best to conduct their corporate practices in the post-Sarbanes-Oxley environment.

II. Section 307 — Rules of Professional Responsibility for Attorneys

A. Section 307 and the SEC's Related Rules

Section 307 of the Act requires the SEC to issue rules establishing minimum standards of conduct for attorneys who represent corporate clients before the SEC.\(^\text{11}\) Section 307 instructed the SEC to require attorneys to "go up the [corporate] ladder"\(^\text{12}\) in reporting violations of securities laws and breaches of fiduciary duties that occur within the corporations they serve. In the event of a reportable violation, section 307 requires that an attorney (1) disclose the violation to either the general counsel or chief executive officer of the company, and (2) if the violation is not properly addressed by the general counsel or chief executive officer, report the violation to members of the company's board of directors.\(^\text{13}\) When adopting the rules required by section 307, the SEC did not deviate significantly from the congressional


\(^{13}\) Specifically, section 307 provided:

[T]he Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including 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 (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), 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.

directive set forth in the legislation. In addition to satisfying the specific requirements of section 307, however, the SEC also defined terms that Congress failed to define in the legislative text of section 307 and provided guidance to attorneys regarding how in-house and outside counsel should address the reporting obligations introduced by section 307.  

B. The Background of Section 307

1. Legislative History

Congress drafted and approved the Act and the President signed it into law in just over six months. Representative Michael Oxley (R.-Ohio) began drafting the House version of the corporate-governance bill immediately after Enron collapsed in December 2001. The House of Representatives approved House Bill 3763, the Corporate and Auditing Accountability, Responsibility and Transparency Act of 2002, on April 24, 2002. The Senate approved Senate Bill 2673, the Public Company Accounting Reform and Investor Protection Act of 2002, proposed by Senator Paul Sarbanes (D.-Md.), on July 15, 2002. While the two bills addressed similar governance issues, the Senate advocated much more rigorous provisions. When finalizing the compromise version, the conference committee preserved most of the Senate provisions. Although neither bill originally included the specific language contained in section 307 of the Act, the text ultimately came entirely from Senate Bill 2673.

As originally drafted, Senate Bill 2673 failed to include any provisions addressing attorneys' professional responsibilities. Several Senators added the text of section 307 to the Senate bill as an amendment from the floor mere hours before the Senate unanimously approved the bill. Senator John Edwards (D.-N.C.), a former plaintiffs' attorney, together with Senators

14. The SEC's rules, as well as some suggestions regarding how best to comply with them, are discussed in Part IV of this Article.
19. The only provision in House Bill 3763 that addressed the professional responsibilities of attorneys required the Comptroller General to determine the adequacy of the ABA and SEC professional conduct rules. H.R. 3763 § 19 ("Study of Model Rules for Attorneys of Issuers").
Michael Enzi (R.-Wyo.) and Jon Corzine (D.-N.J.), sponsored the amendment in Senate Bill 2673 that served as the predecessor to section 307 of the Act.22

2. Senator Edwards’ Proposal

Senator Edwards introduced the amendment addressing attorneys’ professional responsibilities to their corporate clients in a speech to the Senate on July 10, 2002. In his speech, Senator Edwards expressed concern that the Senate had failed to address “an important player in the problem we have had with corporate misconduct in this country.”23 The “player” that Senator Edwards felt the Senate overlooked in the rush of corporate reform efforts was, of course, the corporate attorney. “One of the problems we have seen occurring with this sort of crisis in corporate misconduct,” Senator Edwards lamented, “is that some lawyers have forgotten their responsibility.”24

Senator Edwards, a practicing attorney for twenty years, advised the Senate that an attorney representing a corporate client has a responsibility to represent the company, which means the attorney must also represent the shareholders of the company.25 According to Senator Edwards, attorneys needed to be reminded that they owe duties of responsibility and loyalty to the company and the shareholders, rather than the executive officers with whom they have lunch and talk daily.26 “Anybody who works in corporate America knows that wherever you see corporate executives and accountants working, lawyers are virtually always there looking over their shoulder,” said Senator Edwards.27 “If executives and/or accountants are breaking the law,” he concluded, “you can be sure that part of the problem is that the lawyers who are there and involved are not doing their jobs.”28

According to Senator Edwards, attorneys have failed to report internal violations of law to authorities within the companies they represent. Senator Edwards said:

One of the most critical responsibilities that those lawyers have is, when they see something occurring or about to occur that violates

24. Id.
25. Id.
26. Id.
27. Id.
28. Id.
the law, breaks the law, they must act as an advocate for the shareholders, for the company itself, for the investors. They are there and they can see what is happening. They know the law and their responsibility is to do something about it if they see the law being broken or about to be broken.  

Senator Edwards proposed that the Senate compel attorneys to fulfill their responsibilities to corporate clients by including a provision in its corporate governance bill addressing minimum standards of professional conduct. The text of the professional responsibility provision proposed by Senator Edwards substantially resembles the final text of section 307 of the Act. As Senator Edwards stated on the Senate floor, section 307 “acts in a very simple way. It basically instructs the SEC . . . to start enforcing this up-the-ladder principle.”

3. Senator Edwards’ Letter to the SEC

When Senator Edwards introduced his provision to the Senate on July 10, 2002, it was not the first time he had raised the issue. On June 18, 2002, nearly a month before he proposed that the professional responsibility provision be included in the Senate’s corporate governance bill, Senator Edwards shared with the Senate a letter he had written to SEC Chairman Harvey Pitt.

Before reading his letter to the Senate, Senator Edwards criticized the SEC and the ABA for their lack of initiative in addressing the responsibilities of corporate attorneys. “The American Bar Association ought to take a leading role here,” Senator Edwards stated, “something they have not done thus far.” Additionally, Senator Edwards blamed the ABA for the SEC’s inaction, claiming that the SEC “gave up the fight in part because the American Bar Association opposed their efforts.” According to Senator Edwards, during the 1970s and 1980s, the SEC instituted proceedings to enforce minimum ethical standards for attorneys practicing securities law, yet stopped bringing those types of actions largely because of ABA opposition.

29. Id. at S6552.
30. Id.
In his letter to the SEC, Senator Edwards asked the commission to "renew the SEC's enforcement of corporate lawyers' ethical responsibility to go up the ladder." 35 According to Senator Edwards, it was imperative that SEC action be revived because the ABA's Model Rules of Professional Conduct had proven ineffective in that it "[has] not recognized mandatory and unambiguous rules of professional conduct for corporate practitioners, and rules at the state level are varied and often unenforced." 36

When he wrote his letter to the SEC, Senator Edwards knew that the SEC had already received a similar letter from a number of law professors expressing concern about attorneys failing to satisfy their professional responsibilities and asking the SEC to take action. In his own letter, Senator Edwards reminded the SEC that

[forty legal scholars wrote a letter to you suggesting, among other things, that the Commission require a lawyer representing a corporation in securities practice to inform the corporation's board of directors if the lawyer knows the corporation is violating the Federal securities laws and management has been notified of the violation and has not acted promptly to rectify it. 37

The letter referenced by Senator Edwards was written to the SEC on March 7, 2002, by a group of forty law professors. 38 The professors' letter strongly influenced Senator Edwards' letter and led to his amendment of the Senate corporate governance bill, resulting in section 307 of the Act. 39 The SEC's response to the professors' letter — indicating that the SEC would not take any action on the matter absent congressional action 40 — prompted Senator Edwards to act on his own. He concluded his letter with two questions:

1. Absent further congressional action, does the SEC plan to act to enforce a minimum standard of professional conduct for lawyers in securities practice along the lines I have suggested?

35. Id. at S5652 (daily ed. June 18, 2002) (statement of Sen. Edwards)
36. Id. (Letter from John Edwards, Senator, 107th Cong., to Harvey Pitt, Chairman, Securities and Exchange Commission (June 18, 2002)).
37. Id. (Letter from John Edwards, Senator, 107th Cong., to Harvey Pitt, Chairman, Securities and Exchange Commission (June 18, 2002)).
2. If your answer to the preceding question is no, would you be willing to assist me in carefully crafting legislation to impose this duty on lawyers?41

Almost a month later, when Senator Edwards proposed to amend the Senate bill to include the professional responsibility language of section 307, the SEC had not yet responded.42

4. The Letter from the Law Professors

The position expressed in the law professors’ letter can be traced to a 1996 article co-authored by Professor Richard W. Painter, who initiated the law professors’ letter to the SEC.43 The article, written in response to the Private Securities Litigation Reform Act of 1995, argued that Congress should have imposed disclosure obligations on attorneys similar to those it imposed on accountants under the same act.44

Picking up in 2002 where Professor Painter’s article left off in 1996, the forty law professors advised the SEC that

[while] regulation of accountants has been discussed extensively at the SEC, in Congressional hearings and in the press, we believe that attention should also be given to the role of lawyers in representing public corporations, and in particular to whether lawyers should inform a client corporation’s directors about violations of the securities laws.45

In what has become a familiar refrain, the professors encouraged the SEC to require attorneys to report violations of securities laws in the event that management failed to rectify the violation.46

The letter urged the SEC to amend SEC Rule 102(e), which authorizes the SEC to disbar an attorney or suspend an attorney from practicing before the

44. The Private Securities Litigation Reform Act of 1995 amended the Securities Exchange Act of 1934 to include Section 10A, which requires an auditor to report illegal activity to management first, and then to the audit committee or board of directors, if management fails to act, and then to the SEC if the directors fail to act.
45. Letter from Richard W. Painter et al. to Harvey L. Pitt, supra note 38; see also Bruce Rubenstein, Lawyers Debate Line Between Attorney and Whistleblower, 12 CORP. LEGAL TIMES 28 (2002).
46. Letter from Richard W. Painter et al. to Harvey L. Pitt, supra note 38; see also Hamermesh, supra note 22, at 737.

https://digitalcommons.law.ou.edu/olr/vol56/iss2/22
Commission if the attorney "violates the securities laws, assists in someone else's violation or otherwise engages in unprofessional conduct."\(^{47}\) The professors proposed that the SEC amend Rule 102(e) to expressly require an attorney representing a corporate client in connection with its securities law compliance to inform the client's board of directors if the attorney knows that the client is violating the securities laws and senior management does not promptly rectify the violation.\(^{48}\)

In its letter responding to the professors, the SEC elected not to amend Rule 102(e) and defended its lack of recent action, arguing that "[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."\(^{49}\) According to the SEC, any decision to address attorney misconduct through the SEC, rather than through state ethics rules, "should be undertaken in the context of Congressional legislation, as opposed to agency rulemaking."\(^{50}\)

In response to the SEC's comments, Senator Edwards prompted Congress to act on the matter. Section 307 of the Act incorporated the law professors' recommendation that attorneys be required to report violations "all the way to the board of directors."\(^{51}\) Additionally, section 602\(^{52}\) codified SEC Rule 102(e), authorizing the SEC to prohibit attorneys from practicing before it in certain circumstances.\(^{53}\) Four months after the professors' initial letter to the SEC, Congress enacted their recommendations by adopting the Act.

5. ABA Recommendations Ignored

Unlike the forty law professors, the American Bar Association had no noticeable influence on the adoption of section 307 of the Act and the subsequent SEC rules under section 307. The ABA lobbied against inclusion in the Senate's corporate governance legislation of any provision addressing attorneys' professional responsibilities. Its lobbying efforts failed.

\(^{47}\) Rubenstein, supra note 45, at 28; Letter from Richard W. Painter et al. to Harvey L. Pitt, supra note 38.

\(^{48}\) Letter from Richard W. Painter et al. to Harvey L. Pitt, supra note 38.

\(^{49}\) Letter from David Becker to Richard W. Painter, supra note 40; see Hamermesh, supra note 22, at 737-38.

\(^{50}\) Letter from David Becker to Richard W. Painter, supra note 40.

\(^{51}\) Letter from Richard W. Painter et al. to Harvey L. Pitt, supra note 38.


As part of its early opposition to legislation governing attorneys’ responsibilities, the ABA created its Task Force on Corporate Responsibility (the Task Force).54 Upon appointing the task force, ABA President Robert Hirshon directed it to “‘examine systemic issues relating to corporate responsibility’ and to ‘examine the framework of laws and regulations and ethical principles governing the roles of lawyers, executive officers, directors, and other key participants.”55

Although the ABA created the Task Force to “allow the ABA to contribute its perspectives to the dialogue now occurring . . . on legislative and regulatory reform to improve corporate responsibility,”56 the ABA’s efforts were too little too late. The ABA did not create its Task Force until late March 2002, nearly three weeks after the law professors’ letter to the SEC. Thus, before the ABA task force could contribute its views concerning corporate attorneys’ professional responsibility, Congress was already well on its way to deciding the issue.

In the weeks before the Act became law, the ABA made a final effort to suppress Senator Edwards’s amendment to the Senate’s corporate governance bill. The ABA focused these late efforts on Senator Sarbanes, the author of the Senate’s original bill, arguing against the legislation in a letter to him and insisting that “[s]ince the ABA’s Model Rules were approved by the ABA, the vast majority of state supreme courts have adopted professional standards based on the Model Rules, and these state court ethical codes have served the public well over time.”57

The ABA argued that the legislation could result in inconsistent and conflicting ethical rules for attorneys practicing before the SEC. According to the ABA, the pre-emptive authority granted to the SEC pursuant to Senator Edwards’ provision addressing standards of conduct for attorneys’ professional responsibilities could detrimentally interfere with the attorney-client relationship.58 The ABA also argued that Congress had enacted


58. Id.
unnecessary legislation because the Task Force had already started addressing issues relating to attorneys’ professional responsibilities to corporate clients. 59

The ABA also contended that section 307 of the Act was unnecessary in light of the Task Force’s pending recommendations. The ABA’s Task Force did not issue its recommendations until July 16, 2002, the day after the Senate adopted its corporate governance bill including Senator Edwards’ provision directing the SEC to address attorneys’ professional responsibilities. At the time of its letter to Senator Sarbanes, the ABA could offer the Senator only the assurance that the Task Force proposals would be released “in the near future,” and that “if” the proposals were adopted by the ABA, then “it is likely that most state courts” would also adopt the proposed changes. 60 Not surprisingly, the assurances failed to convince Senator Sarbanes. He endorsed, and Congress overwhelmingly approved, the Act, including section 307’s provisions establishing minimum standards of conduct for attorneys representing corporate clients before the SEC. 61

III. Irreconcilable Differences Between the ABA’s Model Rules and Section 307?

A. When the Client is More than a Person

1. Model Rule 1.13: Organization as Client

Rule 1.13 of the ABA’s Model Rules of Professional Conduct resembles section 307 and the related rules promulgated by the SEC. 62 To a certain extent, Senator Edwards’ amendment to the Senate’s corporate governance bill, the law professors’ letter to the SEC, the obligations described in section 307, and the subsequent SEC rules are based on the core value expressed by Rule 1.13: remember who the client is.

Senator Edwards’ reminder that “[i]f you are a lawyer for a corporation, your client is the corporation” 63 is reminiscent of Rule 1.13, which states “[a] lawyer employed or retained by an organization represents the organization.” 64 In addition, Senator Edwards’ admonishment that corporate attorneys represent the company rather than the company’s executives mirrors the

59. Id.
60. Id.
64. MODEL RULES OF PROF’L CONDUCT R. 1.13 (2003).
comment to Rule 1.13, which emphasizes that, although a corporate client may act through its officers, directors, and employees "[t]his does not mean . . . that constituents of an organizational client are the clients."65

It is clear that Senator Edwards and the law professors agreed with the basic premise of Rule 1.13; it is equally clear, however, that the Senator and the professors believed that the rule falls well short of the desired mark. Congress adopted section 307 of the Act to address the shortcomings in the Model Rules. Although section 307 and the related SEC rules reflect the fundamental elements of Model Rule 1.13, the SEC's rules under section 307 actually go beyond the ABA's rule. Model Rule 1.13 and the SEC's rules under section 307 differ primarily because Rule 1.13 is permissive, while the SEC's rules are mandatory.

The SEC's rules require an attorney to report material violations of securities law, material breaches of fiduciary duty, and similar material violations up a company's "chain of command," potentially all the way up to the company's board of directors.66 By contrast, Model Rule 1.13 requires no action at all unless the attorney knows that a violation exists and the violation in question relates to the matter for which the attorney was retained.67 Rule 1.13 provides:

If a lawyer for an organization knows that an officer, employee or other person associated with the 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.68

In addition to creating no duty to "report up" within a corporation unless the attorney knows about a violation that relates to the attorney's representation of the company, Rule 1.13 requires only that an attorney proceed "as is reasonably necessary in the best interest of the organization."69

65. Id. cmt. 2.
69. Id.; see Francis G. X. Pileggi, Congress Passes New Ethics Rules for Lawyers, DEL. L.
Additionally, unlike section 307 of the Act and the SEC’s related rules, Rule 1.13 does not specify any particular course of action that an attorney must take when reporting a violation. Instead, Rule 1.13 provides:

In determining how to proceed, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer’s representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters and any other relevant considerations.70

If an attorney determines, after “due consideration,” that a violation within a corporation is sufficiently serious to warrant action by the attorney, Rule 1.13 provides only guidance regarding the course of conduct the attorney should pursue. While Rule 1.13 suggests possible courses of action, it prohibits the attorney from taking action that is too drastic. Rule 1.13 requires:

Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such measures may include among others: (1) asking for reconsideration of the matter; (2) advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and (3) referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act on behalf of the organization as determined by applicable law.71

Although Rule 1.13 permits “referring the matter to higher authority,”72 it does not require the attorney to take such action. Indeed, the ABA’s comment to Rule 1.13 specifically provides that “[c]lear justification should exist for seeking review over the head of the constituent normally responsible for it.”73

2. Law Professors Find Fault with Rule 1.13

Not surprisingly, the law professors who so strongly influenced section 307 of the Act disagreed with several aspects of ABA Model Rule 1.13. Generally, the law professors argued that the rule fails to adequately address

71. Id.
72. Id.
73. Id. cmt.
the responsibilities that an attorney owes a corporate client. In addition to disagreeing with the requirement that an attorney take action only if he believes that the violation in question "is likely to result in substantial injury to the organization,"\(^74\) the professors disagreed with the permissive nature of the rule. In their letter to the SEC, they argued that an attorney should be required, rather than simply permitted, to disclose illegal conduct to a corporate client's board of directors if the company's senior management refuses to address the illegal activity.\(^75\)

Relying on Model Rule 1.4, which requires an attorney to "communicate with a client concerning the subject matter of the representation," the professors argued that "[a] lawyer who represents a corporation in turn is ethically bound to communicate with the corporation's directors about matters concerning the representation of which they should be aware."\(^76\) According to the letter, pursuant to Rule 1.4, it is insufficient for an attorney to limit communication to members of a corporate client's management, particularly if management refuses to respond appropriately upon learning of illegal activity. The letter argued that, in such circumstances, the attorney is duty-bound to inform the directors that the company is violating the law.\(^77\) Although the SEC failed to act upon the law professors' letter, Senator Edwards and Congress did when drafting the text of section 307 of the Act.

3. ABA Task Force Recommends Changes to Rule 1.13

The ABA Task Force agreed with the professors that Rule 1.13 is inadequate in that it does not require an attorney to report misconduct up the corporate ladder. In particular, the task force disagreed with the ABA's comments to Rule 1.13, discouraging an attorney from seeking review by a higher authority within the company.\(^78\) The comment requires clear justification "for seeking review over the head of the constituent normally responsible."\(^79\) Echoing Senator Edwards' remarks from the Senate floor, the Task Force, in its report, found that "the lawyer's duty to protect the corporate client from harm requires the lawyer to serve the interests of the corporation

\(^{74}\) Id.

\(^{75}\) Letter from Richard W. Painter et. al. to Harvey L. Pitt, supra note 38. The law professors were spurred into action as a result of the ABA's refusal to adopt changes to its Model Rule 1.13 in February 2002. See Rubenstein, supra note 45, at 28.

\(^{76}\) Letter from Richard W. Painter et al. to Harvey L. Pitt, supra note 38.

\(^{77}\) Id.; see Hamermesh, supra note 22, at 737.


\(^{79}\) Id. at 28 (quoting MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. (2002)).
and its shareholders rather than the interests of the individual officers or employees who are acting for the corporation.**80**

The preliminary recommendations issued by the Task Force on July 16, 2002 included a provision supporting disclosure obligations similar to those set forth in the SEC's rules promulgated under section 307 of the Act. According to the Task Force:

[I]t would promote corporate responsibility to adopt practices in which both outside and inside counsel to the corporation have a direct line of communication through which counsel may proceed in circumstances in which the lawyer reasonably believes that the corporate client is involved in a violation or potential violation of law or in a breach of duty that will adversely affect in a material manner the interests of the corporation.**81**

Despite agreeing in principle with the objectives of section 307 and the resulting SEC rules, the Task Force objected to granting the SEC the authority to implement or enforce professional responsibility standards applicable to attorneys representing clients before the SEC. Instead, the Task Force recommended amending the Model Rules and developing a set of "best practices" guidelines for law firms and corporate legal departments.**82**

The Task Force recommended amending Rule 1.13 to **require** an attorney to disclose criminal and fraudulent misconduct by a company's officers, directors, and agents to a higher authority in the company, rather than merely permitting such disclosure.**83** Pursuant to the Task Force's proposal, an attorney discovering illegal activity during the course of his representation would not have the option to withdraw from representation. Instead, as required by section 307 and the related SEC rules, the amended rule would have required the attorney to report misconduct up the corporate ladder, to the highest authority in the company if necessary.**84** The Task Force also recommended amending Rule 1.13 to **require** an attorney to report illegal activity regardless of whether the misconduct "relates" to the attorney's representation.**85**

---

80. *Id.* at 27.
82. ABA PRELIMINARY REPORT, *supra* note 78, at 25.
83. The task force recommendation is similar to a proposal rejected by the ABA in 1998 that would have required attorneys to report corporate misdeeds to the board of directors. See Caher, *supra* note 12, at 15.
84. ABA PRELIMINARY REPORT, *supra* note 78, at 26.
85. *Id.*
Essentially, the Task Force recommended that the ABA amend Rule 1.13 to require the same disclosure obligations contained in the SEC's rules under section 307 of the Act. Unfortunately for the ABA, the recommendations came too late, giving Congress time to act in the interim. As a result, Congress and the President signed the Act into law and neither the ABA nor its Task Force had a significant impact on section 307 of the Act or the SEC's related rules.

B. When Communication Should Go Beyond the Client

1. Model Rule 1.6: Confidentiality of Information

One of the ABA's original objections to section 307 of the Act was that it could interfere with state confidentiality rules "designed to encourage open and frank" discussions\(^{86}\) between attorneys and their clients. Section 307, however, does not require disclosure of confidential information beyond that already permitted by ABA Model Rule 1.6, "Confidentiality of Information."\(^{87}\) Likewise, the SEC's rules issued pursuant to section 307 do not require disclosure prohibited by the confidentiality restrictions of Rule 1.6.

Rule 1.6 provides that, except in very limited circumstances, an attorney "shall not reveal information relating to the representation of a client."\(^{88}\) The confidentiality of such information is one of the most sacred aspects of the attorney-client relationship. Although situations may arise that create exceptions to the strict rule of confidentiality, the circumstances in which Rule 1.6 allows an attorney to disclose confidential information are extremely narrow. Rule 1.6 permits an attorney to disclose confidential information only to the extent the lawyer reasonably believes necessary

(1) to prevent reasonably certain death or substantial bodily harm;

(2) to secure legal advice about the lawyer's compliance with [the ABA's Model] Rules;

(3) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

---

86. Letter from Robert D. Evans to Paul S. Sarbanes, supra note 57.
87. Legal ethics expert Stephen Gilleers, Vice Dean, New York University Law School stated, "It is not a 'whistleblower' rule because it does not envision the lawyer going outside the client." Caher, supra note 12, at 15.
88. MODEL RULES OF PROF'L CONDUCT R. 1.6 (2003).
(4) to comply with other law or a court order.89

The SEC’s rules under section 307 do not require an attorney to disclose confidential information to anyone outside the corporation; accordingly, the SEC’s rules do not violate Model Rule 1.6. According to Rule 1.13, an attorney representing an organization “represents the organization acting through its duly authorized constituents.”90 The SEC’s rules require disclosure only to the company’s chief executive officer, general counsel, or directors, each of whom is a “duly authorized constituent” of the company.91 Thus, no direct conflict exists between Rule 1.6 and the requirements of the SEC’s rules issued under section 307 of the Act.

The Act did not specifically limit the SEC’s rule-making authority under section 307, but the legislative history of the provision fails to indicate that Congress intended section 307 to “empower the SEC to cause attorneys to breach their attorney/client privilege.”92 The SEC could have issued rules requiring disclosure of confidential information in certain situations without creating a conflict with state ethics rules following Rule 1.6 because the Rule specifically provides that confidential information may be disclosed if reasonably necessary “to comply with other law.”93 Any SEC rule requiring disclosure of confidential information beyond that otherwise permitted by the Model Rules would have fallen within this provision of Rule 1.6, and therefore, the SEC rule would have created no conflicts.

Although the SEC chose not to require attorneys to disclose confidential information to individuals outside of the corporation at the time the SEC first issued its rules, some state bar associations had already taken the initiative to expand their confidentiality rules beyond the disclosures permitted under Rule 1.6. Despite the ABA’s assertion that its Model Rules are a “comprehensive and uniform set of ethical standards for lawyers,”94 only a small minority of states follows Model Rule 1.6.95 Whereas Model Rule 1.6 prohibits permissive disclosure of confidential information to prevent anything less than “death or substantial bodily harm,”96 many states either permit or require an attorney to disclose confidential information to prevent a client from

89. Id. 1.6(b).
90. Id. 1.13.
91. Such disclosures are commonly referred to as “friendly disclosures” because they remain within the corporate client. See Burger, supra note 62, at 22.
93. MODEL RULES OF PROF’L CONDUCT R. 1.6(b)(4) (2003).
94. Letter from Robert D. Evans to Paul S. Sarbanes, supra note 57.
95. See ABA PRELIMINARY REPORT, supra note 78, at 32.
96. MODEL RULES OF PROF’L CONDUCT R. 1.6(b)(1) (2003).
perpetrating a criminal fraud.\textsuperscript{97} Indeed, some states require disclosure of confidential information to rectify loss resulting from a crime or fraud that involved the attorney’s services.\textsuperscript{98} In contrast to the ethics rules of many states, the SEC’s rules do not require disclosure of confidential information to individuals outside a corporation in any circumstances.

\textbf{2. A Surprising Stance by the ABA Task Force}

Surprisingly, no suggestion that the ABA revise Rule 1.6 to reflect the prevailing view adopted by a majority of the states appeared in section 307, nor did the SEC, the law professors, or Senator Edwards propose it. Instead, the Task Force recommended amending Rule 1.6 to permit disclosure of confidential information in circumstances other than those narrowly outlined in the rule.

In a move that exceeded anything addressed in section 307 of the Act or the related SEC rules, the Task Force recommended revising Rule 1.6 to require attorneys to disclose confidential information to prevent a crime or fraud if the consequences are reasonably certain to result in substantial injury to the financial interests or property of another.\textsuperscript{99} In its report, the Task Force adopted a recommendation that the ABA had rejected in February 2002\textsuperscript{100} that a lawyer be permitted to reveal information relating to the representation to the extent necessary to prevent the client from committing a crime or fraud reasonably certain to result in substantial economic loss, but only when the lawyer’s services have been or are being used in furtherance of the crime or fraud. Use of the lawyer’s services for such improper ends constitutes a serious abuse of the client-lawyer relationship. The client’s entitlement to the protection of [Rule 1.6] must be balanced against the prevention of the injury that would otherwise be suffered and the interest of the lawyer in being able to prevent the misuse of the lawyer’s services.\textsuperscript{101}

The Task Force recommended taking the February 2002 proposal one step further and mandating disclosure “to prevent client conduct known to the

\textsuperscript{97} ABA PRELIMINARY REPORT, supra note 78, at 32. \textit{But see} Pileggi, supra note 69, at 4 (discussing Delaware rules of professional conduct).

\textsuperscript{98} ABA PRELIMINARY REPORT, supra note 78, at 32.

\textsuperscript{99} \textit{Id.}; see Hamermesh, supra note 22, at 745.

\textsuperscript{100} The ABA House of Delegates rejected the February 2002 proposal by the ABA Commission on Evaluation of the Model Rules of Professional Conduct to amend Model Rule 1.6(b)(2), permitting a lawyer to disclose client fraud. Veasey, supra note 67, at 16.

\textsuperscript{101} ABA PRELIMINARY REPORT, supra note 78, at 31.
lawyer to involve a crime."\textsuperscript{102} The Task Force limited its recommended disclosure requirement, however, to only those instances in which "the client has used or is using the lawyer's services, and which is reasonably certain to result in substantial injury to the financial interests or property of another."\textsuperscript{103}

In light of the corporate scandals that preceded the Task Force's recommendations, the ABA was not as quick to dismiss the proposed amendments to Rule 1.6 as readily as it did in February 2002. On August 12, 2003, as support for the previously rejected recommendation increased after additional corporate scandals unfolded,\textsuperscript{104} the ABA House of Delegates adopted an amendment to Model Rule 1.6 to permit an attorney to reveal confidential client information if the client is using the attorney's services to commit a crime or fraud that would cause financial harm to others.\textsuperscript{105}

\textit{IV. Issues Created by, and Precautionary Measures in Response to, Section 307}

\textit{A. The Practical Implications of the SEC's Rules Under Section 307}

\textit{1. General}

Unquestionably, section 307 of the Act and the related rules issued by the SEC raise important philosophical questions regarding federalism and the future of state-based ethics enforcement and corporate governance.\textsuperscript{106} Of greater importance to practitioners, however, are the practical implications of the reporting obligations imposed by the SEC's rules. Attorneys certainly will encounter a number of issues, ranging from decreased communication from corporate clients to increased oversight within law firms, as practitioners and firms throughout the country begin to incorporate the SEC's reporting obligations.

In accordance with section 307, the SEC's rules require an attorney to report up the corporate ladder if the attorney becomes aware of evidence of a material violation of the securities laws, a material breach of fiduciary duty,

\textsuperscript{102} Id. at 32.

\textsuperscript{103} Id.

\textsuperscript{104} Notwithstanding increased general support for the February 2002 proposed amendments to Model Rule 1.6, the American Corporate Counsel Association expressly stated that it did not support the proposed amendment to Rule 1.6. \textit{See} Written Submission of the ACCA to the ABA Task Force on Corporate Responsibility \textit{6} (Nov. 11, 2002), \texttt{http://www.abanet.org/buslaw/corporateresponsibility/hearings02/20021111/mcguckin_testimony.pdf}.


\textsuperscript{106} \textit{See} Veasey, \textit{supra} note 67, at 16.
or any similar material violation. In reporting “up the corporate ladder,” an attorney serving as outside counsel must disclose the suspected violation or breach to either the company’s general counsel or to both the company’s general counsel and its chief executive officer. Alternatively, if the corporate client maintains a Qualified Legal Compliance Committee, an attorney serving as outside counsel may report to the company’s Qualified Legal Compliance Committee instead of reporting to the company’s general counsel or general counsel and chief executive officer.

If the attorney reports evidence of a material violation or breach of fiduciary duty to the company’s general counsel or general counsel and chief executive officer, and if the person to whom the attorney initially reports fails to respond appropriately to address the matter, the attorney must report the evidence of the violation to the company’s audit committee, another committee of independent directors, or the company’s full board of directors. Upon reporting the suspected violation to the board of directors, however, the reporting attorney has not necessarily satisfied her legal obligations. If the attorney believes that the company has failed to address the reported violation, the attorney must approach the same people within the company to whom the attorney originally reported, and must explain why the attorney believes the company has responded inadequately. Additionally, the SEC is considering proposed rules that, if adopted, would require an attorney serving as outside counsel to withdraw from representation of the client and notify the company in writing that the withdrawal is based on professional considerations.

2. Impact in Oklahoma

a) Rule 1.13

As discussed earlier in this Article, the reporting obligations introduced by section 307 of the Act, and promulgated by the SEC in its related rules, reflect standards of conduct not entirely irreconcilable with the ABA’s Model Rules. Like ABA Model Rule 1.13, Rule 1.13 of the Oklahoma Rules of

108. Id. at 6306 (to be codified at 17 C.F.R. pt. 205.3(b)(1)).
109. Id. at 6309-10 (to be codified at 17 C.F.R. pt. 205.3(c)).
110. Id. at 6307 (to be codified at 17 C.F.R. pt. 205.3(b)).
111. Id. at 6308 (to be codified at 17 C.F.R. pt. 205.3(b)(9)).
Professional Conduct expressly states that an attorney "employed or retained by an organization represents the organization acting through its duly authorized constituents." As such, Model Rule 1.13, Oklahoma Rule 1.13 and the SEC's rules issued pursuant to section 307 of the Act share an underlying theme that representing a corporate client does not necessarily mean representing the interests of the officers, directors, or other individuals within the company with whom the attorney maintains a close relationship.

As with the ABA's Model Rule 1.13, however, Oklahoma's rule is not identical to the SEC's rule. The most important distinction between Oklahoma Rule 1.13 and the SEC's rules is that, while the Oklahoma rule permits "reporting up" within a corporation in certain instances, the SEC's rules require attorneys to report material violations of securities laws and breaches of fiduciary duties to higher authorities within the corporation.

Another requirement of section 307 may concern attorneys practicing law in Oklahoma. While the SEC's rules do not require attorneys to assume investigative responsibilities within the corporations they represent, the SEC's rules extend the circumstances in which attorneys must "report up."

Oklahoma Rule 1.13 requires an attorney to take action in response to a violation by a corporate client only if the attorney knows that a person within the company is engaged in a violation of a legal obligation to the company or a violation of law that may be imputed to the company. Even when an attorney knows that a violation has occurred, Oklahoma's professional conduct rules give the attorney absolute discretion in determining how or whether to address the violation.

Unlike Oklahoma Rule 1.13, the SEC's rules do not require that an attorney know that a material violation of securities law or breach of fiduciary duty exists before obligating her to act. Instead, the SEC's rules require an attorney to report a suspected violation up the corporate ladder if the attorney "becomes aware" of evidence of a material violation. As the SEC's rules define the phrase, "evidence of a material violation" means "credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is.

113. OKLA. RULES OF PROF'L CONDUCT R. 1.13(a) (2002).
114. Id. 1.13.
reasonably likely that a material violation has occurred, is ongoing, or is about to occur."

Confusion regarding the distinction between an attorney "knowing" that a person within a corporation she represents is engaged in violative conduct, and an attorney "becoming aware of evidence" of a material violation, may, in many instances, lead an attorney to overreport suspected violations within a company. Initially, attorneys may be inclined to be overly zealous in satisfying the SEC's reporting obligations, particularly while the corporate scandals of Enron, WorldCom and other companies are fresh in their minds. Attorneys may prefer to disclose a potential violation based on unsubstantiated evidence rather than fail to disclose a violation that proves to be financially disastrous for a company and its investors. Additionally, by reporting a suspected violation within a company, even if such a report is premature and ultimately proves to be untrue, an attorney may shift the burden of responsibility under the SEC's rules to the company's general counsel, chief executive officer, or Qualified Legal Compliance Committee.

Additionally, the SEC's rules under section 307 may affect the corporate practices of an Oklahoma attorney because, unlike Oklahoma Rule 1.13, the SEC's reporting obligations extend beyond matters relating to the attorney's representation of the corporate client. Instead, the SEC's rules require an attorney to "report up" within a company if the attorney becomes aware of evidence that any material violation of securities law or breach of fiduciary duty exists, even if the violation is entirely unrelated to the provision of legal services. An attorney concerned about fulfilling the SEC's reporting obligations beyond the scope of her services may deliberately attempt to limit her exposure to aspects of the client's business not directly related to the representation. By limiting exposure to a client's business in an attempt to avoid additional reporting obligations, the attorney will limit the effectiveness of her representation. Alternatively, an attorney serving as outside counsel may become so concerned with investigating the various aspects of a corporate client's business to avoid exposure to penalties under section 307 that the attorney may cease to provide effective representation. While attorneys do not have investigative duties under section 307, they should not avoid exposure to additional aspects of their clients' businesses in order to

117. Id. at 6301 (to be codified at 17 C.F.R. pt. 205.2(e)).
118. The American Corporate Counsel Commission makes a similar argument against the ABA Task Force's recommendation that the standard in the ABA's Model Rule 1.13 be changed from "knows" to "reasonably should know." Written Submission of the ACCA to the ABA Task Force on Corporate Responsibility 5-6 (Nov. 11, 2002), http://www.abanet.org/buslaw/corporateresponsibility/hearings02/20021111/mcguckin_testimony.pdf.
119. See Schacter, supra note 62, at 12.
avoid circumstances that arouse suspicions of potential violations of securities law or breaches of fiduciary duty. Attorneys must remember that, regardless of the reporting obligations imposed by the SEC’s rules under section 307, an attorney’s primary objective is effective representation.

b) Rule 1.6

Like many states, Oklahoma Rule 1.6 does not follow the Model Rule. Oklahoma Rule 1.6 permits an attorney to disclose confidential information in certain circumstances beyond those narrowly outlined in the Model Rule. In addition to permitting the attorney to disclose confidential information “to prevent reasonably certain death or substantial bodily harm,”\(^\text{120}\) as set forth in Model Rule 1.6, the Oklahoma Rules permit, but do not require, an attorney to reveal confidential information “to disclose the intention of the client to commit a crime and the information necessary to prevent the crime.”\(^\text{121}\) Oklahoma’s ethics rules also permit, but do not require, disclosure of confidential information to rectify the consequences of what the lawyer knows to be a client’s criminal or fraudulent act in the commission of which the lawyer’s services had been used, provided that the lawyer has first made reasonable efforts to contact the client but has been unable to do so, or that the lawyer has contacted and called upon the client to rectify such criminal or fraudulent act but the client has refused or is unable to do so.\(^\text{122}\)

Despite the ABA’s objections that section 307 could require attorneys to violate states’ ethics codes, compliance with the SEC’s rules under section 307 does not violate Oklahoma Rule 1.6 because the SEC’s rules under section 307 do not require attorneys to disclose confidential information to parties who are not connected with their corporate clients. The rules adopted require only that attorneys report information to constituents of the corporate client.\(^\text{123}\)

---

122. \textit{Id.} 1.6(b)(2).
123. Even as it was originally proposed, the SEC’s rule requiring an attorney to engage in a “noisy withdrawal” under certain circumstances would not have violated Rule 1.6 because it did not require disclosure of confidential information. \textit{See} Implementation of Standards of Professional Conduct for Attorneys, Sarbanes-Oxley Act of 2002 Release No. 33-8185, 68 Fed. Reg. 6296, 6296 n.2 (Feb. 6, 2003).
The SEC's rules require attorneys to "report up" only to the highest authority within the corporation.\textsuperscript{124} As a result, the SEC's rules simply require attorneys to take the same actions that are otherwise permitted by Oklahoma Rule 1.13. No provision in section 307 or any rule issued by the SEC under section 307 requires attorneys to disclose confidential information to parties outside of the corporation. Accordingly, complying with the reporting obligations set forth in the SEC's rules under section 307 of the Act will not cause an attorney to violate Oklahoma Rule 1.6.

Additionally, although the rules issued by the SEC pursuant to section 307 permit disclosure of confidential information in certain circumstances beyond those currently outlined in Model Rule 1.6, the instances in which the SEC's rules permit disclosure of confidential information resemble circumstances in which attorneys in Oklahoma are already permitted to make such disclosures. Like the Oklahoma Rules of Professional Conduct, the SEC's rules permit, but do not require, an attorney to disclose confidential information related to the attorney's representation. The attorney may disclose "confidential information relat[ing] to the representation to the extent the attorney reasonably believes necessary."\textsuperscript{125} The SEC's rules permit an attorney to disclose a corporate client's confidential information in order to: (1) Prevent the company from committing material violation of securities law or breach of fiduciary duty "that is likely to cause substantial injury to the financial interest or property" of the company or investors;\textsuperscript{126} (2) Prevent the company "from committing perjury, . . . suborning perjury, . . . or committing any act . . . that is likely to perpetrate a fraud" upon the SEC;\textsuperscript{127} or (3) "[R]ectify the consequences of a material violation by the [company] that caused, or may cause, substantial injury to the financial interest [of the company or investors] in the furtherance of which the attorney's services were used."\textsuperscript{128}

The circumstances in which the SEC's rules permit an attorney to disclose confidential information resemble the circumstances in which Oklahoma Rule 1.6 permits disclosure of a corporate client's confidential information. In certain instances, however, the Oklahoma rules permit more disclosure than the SEC's rules. The SEC's rules permit disclosure of confidential information to prevent a material violation only in the specific instances discussed above.\textsuperscript{129} Oklahoma Rule 1.6, however, permits disclosure of "the intention of the client to commit a crime and the information necessary to

\begin{thebibliography}{99}
\bibitem{124} Id. at 6307 (to be codified at 17 C.F.R. pt. 205.3(b)(3)).
\bibitem{125} Id. at 6310 (to be codified at 17 C.F.R. pt. 205.3(d)(2)).
\bibitem{126} Id.
\bibitem{127} Id.
\bibitem{128} Id.
\bibitem{129} Id.
\end{thebibliography}
prevent the crime,” regardless of whether the crime will result in financial injury or property damage to the company or the company’s investors, or whether the crime is against the SEC. Additionally, even if the SEC’s rules permitted disclosure of confidential information beyond the disclosures permitted by the Oklahoma Rules, an attorney practicing in Oklahoma could still comply with the SEC’s rules without violating the Oklahoma Rules because Oklahoma Rule 1.6 includes a specific provision stating that an attorney “shall reveal . . . information when required by law.”

B. Practicing Law Under the New Reporting Obligations

Although neither section 307 nor the related SEC rules require an attorney to disclose a corporate client’s confidential information to anyone outside the client’s organization, a legitimate concern exists that the SEC rules under section 307 may have a chilling effect on communications between an attorney and the attorney’s primary contacts within a represented corporation. Officers, employees, and other individuals within a corporation may be less forthcoming about matters material to the company when talking to a company’s in-house or outside attorneys if they fear that the SEC’s rules under section 307 will compel the attorney to report the conversation to a higher corporate authority. Attorneys cannot be effective advocates for their corporate clients if they receive incomplete or inaccurate information from the individuals within the companies they represent.

To ensure open communication and effective representation of a corporate client, an attorney must allay any fears that individuals within the company have about the attorney’s reporting obligations pursuant to the SEC’s rules under section 307. At the same time, however, the attorney must be forthright about the actions that the SEC’s rules require her to take if she suspects a material violation of securities law or breach of fiduciary duty.

Regardless of whether the attorney serves as a company’s in-house or outside counsel, the attorney should discuss with the company’s management the reporting obligations imposed by the SEC’s rules under section 307, impressing upon members of management the importance of communicating with the company’s employees and attorneys. Compliance with the SEC rules under section 307 of the Act requires that everyone within the company knows her individual duties to the company. Officers, employees, and other individuals within the company, including the company’s attorneys, must

130. OKLA. RULES OF PROF’L CONDUCT R. 1.6(b)(1) (2002).
131. Id. § 1.6(c).
133. Id.
know that they owe duties to the company, not to any particular director, officer, or attorney of the company. A company’s in-house counsel and attorneys representing the company as outside counsel should engage in frank discussions with one another about the roles that they and others within the company play under section 307.

1. Law Firms Serving as Outside Counsel

If an attorney serving as outside counsel fails to satisfy the reporting obligations imposed by the SEC’s rules, the rules provide that the attorney “shall” be subject to the civil penalties and remedies available to the SEC for violation of federal securities law. Additionally, section 602 of the Act essentially codifies existing SEC Rule 102(e), authorizing the SEC to initiate disciplinary proceedings against attorneys who lack integrity or competence, engage in improper professional conduct, or willfully violate securities laws. The sanctions available to the SEC in these circumstances include temporarily or permanently barring an attorney from practicing or appearing before the SEC. More importantly, however, the SEC’s authority under section 602 also extends to anyone who willfully aids and abets a securities law violation. Consequently, if an attorney within a law firm fails to satisfy the reporting obligations imposed by the SEC, the attorney’s firm could be subject to the penalties established in section 602 if circumstances indicate that the firm “aided and abetted” in the violation.

Although it is unlikely that the SEC would prohibit an entire law firm from practicing or appearing before it, the commission has imposed sanctions on entire accounting firms in proceedings against individual accountants under SEC Rule 102(e). The SEC could rely on a “failure to supervise” theory or evidence of firm-wide improprieties to hold a law firm accountable for “aiding and abetting” an attorney’s failure to satisfy the reporting obligations of the SEC’s rules under section 307.

Because of the potential for firm-wide repercussions resulting from an attorney’s failure to comply with the reporting obligations of the SEC’s rules

---


136. Id.

137. Id.


139. See id.
under section 307, all issues relating to disclosure pursuant to the obligations established in the SEC’s rules should be addressed at the law firm’s management level. A law firm should implement a written “disclosure compliance” policy outlining the measures the firm plans to enact if confronted with a situation that potentially triggers the firm’s reporting obligation pursuant to the SEC’s rules. As with any written policy, the law firm should carefully consider the practical aspects of enacting a disclosure compliance policy and avoid adopting a policy that contains detailed and burdensome requirements the firm is unlikely to follow. Although the SEC’s rules specifically provide that no private right of action exists against an attorney or law firm based upon compliance or noncompliance with the SEC’s rules, maintaining a difficult or impossible disclosure compliance policy establishes a standard of conduct that could harm the firm in a malpractice lawsuit or other claims not directly stemming from the Act.140

A law firm’s disclosure compliance policy should focus on education, communication, and supervision. A disclosure compliance policy serves two purposes. First, the policy should dictate the law firm’s actions in the event that a situation arises requiring the firm to determine whether its “reporting up” obligation has been triggered. Second, a consistently enforced disclosure compliance policy protects the law firm from allegations of failure to supervise and will prevent firm-wide improprieties with regard to the reporting obligations imposed by the SEC pursuant to section 307.141 A law firm can rely on its disclosure compliance policy to demonstrate that the firm does not condone or tolerate anything less than complete compliance with the obligations set forth in the SEC’s rules under section 307.142

Depending on the size and internal structure of the law firm, a firm should consider a disclosure compliance policy that includes a “disclosure

140. Ethics commentator Lawrence J. Fox refers to section 307 of the Act as the “Unlimited Lawyers’ Liability Act of 2002,” as a result of the potential lawsuits that may be brought against attorneys who fail to discover, and subsequently report, a violation within a corporate client. Burger, supra note 62, at 22.

141. One author suggests that law firms should react to the federal regulation of attorneys imposed by the Sarbanes-Oxley Act by establishing a full “loss-prevention program.” Such a program would include, among other things, appointing a professional responsibility partner and establishing quality control measures designed to ward off legal malpractice. Todd S. Lundy & Connelle K. Durvall, Law Firm Ethics Have Consequences, NAT'L L.J., Oct. 14, 2002, at D14.

142. The theory is similar to the approach adopted in 1991 in the U.S. Sentencing Commission’s Guidelines for the Sentencing of Organizations, which enables companies to reduce penalties for certain violations if they have an “effective program to prevent and detect violations of law.” BNA/ACCA COMPLIANCE MANUAL: PREVENTION OF CORPORATE LIABILITY ch. 1, § A1 (1995).
compliance committee” responsible for addressing suspected violations of securities law or breaches of fiduciary duty within a represented corporation that may give rise to the law firm’s “reporting up” obligation. The committee should strive to preserve the lead attorney’s relationship with the client, while also ensuring compliance with the SEC’s rules. In order to best achieve this goal, the firm’s disclosure compliance policy should require any attorney within the firm to notify the disclosure compliance committee if the attorney encounters evidence that may invoke the firm’s obligation to “report up.” To be effective, the members of the disclosure compliance committee must remain objective and unbiased when following up on a suspected violation. A committee member with a conflict of interest regarding a client should recuse herself from committee discussions about the law firm’s reporting obligations relating to the client.

Upon being advised of a situation that potentially triggers the law firm’s obligation to “report up,” the firm’s disclosure compliance committee must make a number of subjective determinations. The committee must initially determine whether the facts of the particular situation give rise to the obligation to report to a higher authority within the corporation. Among other things, the disclosure compliance committee must consider whether the evidence presented to the committee indicates a “material violation of . . . securities law, a material breach of fiduciary duty, . . . or a similar material violation.”143

If the firm’s disclosure compliance committee determines that the reported activity materially violates a securities law, breaches a fiduciary duty, or otherwise invokes the law firm’s reporting obligation pursuant to the SEC’s rules under section 307 of the Act, the committee next must address how to satisfy the firm’s reporting obligation. In deciding how to proceed, the disclosure compliance committee must make politically sensitive decisions that may have a significant detrimental effect on the law firm’s relationship with its corporate clients, especially with clients’ chief executive officers and general counsels.144 The determinations the committee must make include: (1) what attorney within the firm will be responsible for reporting the evidence of a suspected violation or breach to the client, (2) whether the matter should be addressed initially to the company’s general counsel, to both the general counsel and the chief executive officer, or to the company’s Qualified Legal Compliance Committee, if one exists, and (3) whether the


144. See Lundy & Durvall, supra note 141, at D14.
firm’s initial report of the evidence of a violation or breach should be oral or written.

Regardless of whether the firm communicates its initial report of a suspected violation by a corporate client orally or in writing, the law firm should carefully document and maintain all communications and actions during the course of a disclosure compliance investigation. Although the SEC rules do not specifically require the attorney or law firm reporting a violation by a corporate client to document the report and the company’s response, it will serve the best interest of the attorney and the law firm to maintain such records.

If a reporting attorney discloses evidence of a suspected violation to a company’s Qualified Legal Compliance Committee, the attorney and law firm have satisfied their responsibilities under the SEC’s rules. Upon an attorney reporting evidence of a suspected violation to the company’s general counsel, or general counsel and chief executive officer, however, the law firm’s disclosure compliance committee must determine whether the client responds appropriately to the matter. Pursuant to the SEC’s rules under section 307, a company’s response to a report of a violation within the company must provide a basis for the attorney who reported the matter to reasonably believe that either (1) no material violation has occurred, is ongoing, or is about to occur; (2) the company has adopted remedial measures that can be expected to prevent, remedy, or otherwise address the violation; or (3) the company has retained an attorney to review the reported evidence of a violation and has implemented remedial measures recommended by the attorney or been advised that the company has a defensible position.145

If the company’s general counsel or chief executive officer fails to adequately address a reported violation, the reporting attorney must report the violation to the company’s audit committee, another committee of independent directors, or the full board of directors. If, upon receiving a report of a violation within the company, the members of the company’s board of directors fail to respond appropriately in addressing the violation, the law firm’s disclosure compliance committee must ensure that the firm complies with the SEC requirements. Currently, the SEC’s rules merely require the attorney to explain to the company the reasons for believing that the company

has not made an appropriate response;\textsuperscript{146} however, the SEC has proposed rules that require the attorney to withdraw from representation.\textsuperscript{147}

Although the SEC has not adopted the proposed rules requiring noisy withdrawal, the proposed rule is still being considered by the SEC, and an alternative rule is also being considered. Pursuant to the rule originally proposed by the SEC, if an attorney reported a violation of law or breach of fiduciary duty within a corporate client to all of the corporate officials and board members the SEC required her to inform, and the company continued to fail to respond appropriately to address the reported violation, the SEC has proposed rules that, if adopted, would require that the attorney engage in a "noisy withdrawal" in certain circumstances.\textsuperscript{148} The proposed rules would require an attorney to engage in a noisy withdrawal if the company failed to respond appropriately to a report of a material violation that the attorney reasonably believed was ongoing or about to occur and was likely to result in substantial injury to the financial interest or property of the company or its investors.

If the SEC adopts the original rule as proposed, it would require an attorney engaging in a noisy withdrawal to: (1) withdraw from representing the corporate client, indicating that the withdrawal is based on professional considerations; (2) give written notice to the SEC within one day of the withdrawal, indicating that the withdrawal was based on professional considerations; and (3) promptly disaffirm to the SEC any document submitted to the SEC that the attorney prepared or assisted in preparing that the attorney reasonably believes is or may be materially false or misleading.\textsuperscript{149}

Pursuant to an alternative rule proposed by the SEC, a withdrawing attorney would not be required to notify the Commission of her withdrawal, nor would she be required to disaffirm documents filed with the Commission. Instead, the alternative rule, if adopted, would require the withdrawing attorney to notify the company in writing that the withdrawal is based on professional considerations. The company receiving such a notice from a withdrawing attorney would then to required to file a report with the SEC


\textsuperscript{149} Id.
providing information about the circumstances surrounding the withdrawal notice. If a company failed to report a withdrawal notice, the SEC’s alternative proposed rule would permit, but not require, the withdrawing attorney to inform the Commission that she provided the company with a withdrawal notice based on professional considerations.150

As discussed in Part III of this Article, many state ethics rules permit attorneys to disclose clients’ confidential information in circumstances beyond the limited circumstances set forth in ABA Model Rule 1.6. The Oklahoma Rules of Professional Conduct permit an attorney to make a noisy withdrawal if the client uses the attorney’s services in the course of criminal or fraudulent conduct.151 As part of a law firm’s attempt to “encourage” a corporate client to take appropriate action to remedy a reported violation, a firm’s disclosure compliance committee should consider advising the client that, unless the violation is addressed properly, the attorney may be obligated to withdraw in the manner set forth in the SEC’s proposed rules, if such rules are adopted, or as permitted by the Oklahoma Rules of Professional Conduct.152 Such a noisy withdrawal “sends up red flags for the world to see,”153 but enables the attorney to avoid disclosing confidential information to parties outside of the corporation.

In addition to making decisions and addressing matters related to evidence of securities law violations and breaches of fiduciary duties by a law firm’s corporate clients, a law firm’s disclosure compliance committee also must educate attorneys within the firm about the firm’s disclosure compliance policy and about the responsibilities of the firm and the individual attorney pursuant to the SEC’s rules under section 307 of the Act. In particular, a disclosure compliance committee must ensure that senior attorneys within the firm understand that they can and will be held responsible for the actions of the subordinate attorneys they supervise who appear and practice before the SEC. The SEC’s rules specifically require a supervising attorney to “make reasonable efforts” to ensure that a subordinate attorney complies with the SEC’s reporting obligations.154 Additionally, upon receiving a report from a

---


151. OKLA. RULES OF PROF’L CONDUCT R. 1.6 cmt. (2002).

152. The ABA comment to Model Rule 1.6 makes it clear that, in certain circumstances, the ABA rules permit an attorney to give notice of withdrawal, including withdrawing or disaffirming any opinion, document, or affirmation. Id.


subordinate attorney of evidence of a violation of securities law or breach of fiduciary duty within a represented corporation, the SEC’s rules require the supervising attorney to assume responsibility for complying with the SEC’s obligations to “report up” within the corporation.155

The SEC defines a subordinate attorney as one who appears and practices before the SEC under the supervision or direction of another attorney.156 As such, although a subordinate attorney must comply with the SEC’s rules, the rules deem a subordinate attorney to have satisfied the SEC’s reporting obligations if she reports evidence of a material violation or breach within a represented corporation to her supervising attorney. Although a subordinate attorney may report directly to a client’s general counsel, chief executive officer, or Qualified Legal Compliance Committee if the supervising attorney fails to satisfy the SEC’s reporting obligations, the SEC’s rules do not require that the subordinate attorney take such action.157

Nevertheless, a law firm’s disclosure compliance policy should require a subordinate attorney to report directly to the firm’s disclosure compliance committee, either in addition to reporting to the supervising attorney or instead of reporting to the supervising attorney. By requiring subordinate attorneys to report to the law firm’s disclosure compliance committee, the firm avoids the situation contemplated by the SEC’s rules in which a supervising attorney fails to act upon a subordinate attorney’s report, presumably because of the nature of the supervising attorney’s relationship with the corporate client. The law firm also avoids the untenable situation of having a subordinate attorney report a suspected violation directly to a corporate client. Intervention by the disclosure compliance committee ensures that the firm handles a subordinate attorney’s report of a suspected violation with both objectivity and the best interests of the firm in mind, rather than with the best interest of the supervising attorney in preserving her relationship with the client.

2. In-House Legal Departments

Because the reporting obligations imposed by the SEC’s rules under section 307 of the Act apply to in-house attorneys as well as to outside attorneys, a company’s general counsel should consider implementing a disclosure compliance policy similar to that proposed for an outside law firm.158 A

155. Id. (to be codified at 17 C.F.R. § 205.4(c)).
156. Id. (to be codified at 17 C.F.R. § 205.5(a)).
157. See id. (to be codified at 17 C.F.R. § 205.5(d)).
158. At least one chapter of the American Corporate Counsel Association even began considering the special procedures that should be adopted by in-house legal departments in connection with the reporting obligations introduced by Section 307 before the SEC issued its rules. Memorandum Provided by the ACCA Central Pennsylvania Chapter, Sarbanes-Oxley
company's disclosure compliance policy will serve the same purpose as a law firm's disclosure compliance policy, but a company's in-house policy should differ from a law firm's policy in at least two important ways. First, the company's policy should be company-wide, applicable to all employees, not just the attorneys. Second, the company's disclosure compliance policy should include specific obligations applicable to both in-house attorneys and attorneys representing the company as outside counsel.

The company's general counsel, assisted by other members of the company's senior management, should prepare the company's disclosure compliance policy, and the board of directors should review, approve, and adopt it. A company's disclosure compliance policy should require officers, employees, and agents of the company, including attorneys and accountants, to report to the general counsel in the event of a suspected material violation of securities law or breach of fiduciary duty within the company. The company's policy also should provide alternate means of reporting, such as establishing a system that encourages anonymous reporting of suspected violations. The policy should expressly require the company's general counsel to meet with the company's chief executive officer periodically to review all issues raised in connection with, and all reports made pursuant to, the company's disclosure compliance policy. The policy also should require the company's chief executive officer to report to the board of directors at least annually to discuss any reports made pursuant to the policy, even if the reports ultimately fail to prove that a violation occurred or is ongoing. In this manner, the chief executive officer and the board of directors can oversee the disclosure compliance process and ensure that the general counsel and the company's legal department address potential disclosure compliance issues in an appropriate manner.

In the event of a reported violation of securities law or breach of fiduciary duty, the disclosure compliance policy adopted by a company should reflect the specific requirements of the SEC's rules under section 307. When a company's general counsel receives a report of a material violation or breach within the company from an attorney who serves as outside counsel, the company's general counsel essentially has two options: (1) instigate an


159. Such a disclosure system could be incorporated into the procedures required by Section 301 of the Sarbanes-Oxley Act, pursuant to which a company's audit committee must establish procedures for the receipt, retention and treatment of complaints (including anonymous submissions) regarding accounting, internal accounting controls, or auditing matters. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 602, 116 Stat. 745, 776 (to be codified at 15 U.S.C. § 78d-3).
investigation of the evidence supporting the reported violation or breach; or (2) report the alleged violation to the company’s Qualified Legal Compliance Committee, if the company has established such a committee.\textsuperscript{160}

Alternatively, a company may implement a disclosure compliance policy that establishes a Qualified Legal Compliance Committee and requires the company’s general counsel to report any reported violations such committee. The SEC defines “Qualified Legal Compliance Committee,” under section 307 as a committee established by a company’s board of directors that is specifically authorized to investigate reported evidence of material violations of securities law or breaches of fiduciary duty within the company.\textsuperscript{161}

Pursuant to the SEC’s rules, a company’s Qualified Legal Compliance Committee must establish written procedures that enable it to receive reports of suspected violations within the company on a confidential basis.\textsuperscript{162}

If the general counsel chooses to investigate the reported violation and determines that no material violation exists, the general counsel must report its investigation and findings to the attorney who reported the suspected violation initially.\textsuperscript{163} If, upon completion of an investigation, the general counsel believes that a violation exists within the company, the general counsel must “take all reasonable steps” to ensure that the company adopts appropriate remedial measures.\textsuperscript{164} Furthermore, the general counsel must report the remedial measures adopted to the outside attorney who initially reported the suspected violation.\textsuperscript{165}

If a company establishes a Qualified Legal Compliance Committee before it receives a report of a suspected violation of securities law or breach of fiduciary duty, the company’s general counsel probably bears a lesser burden. If a Qualified Legal Compliance Committee exists, an outside attorney may report directly to it, instead of reporting to the company’s general counsel.\textsuperscript{166} Additionally, the general counsel may report a suspected violation to the committee, alleviating the general counsel’s obligation to investigate the suspected violation.

Upon establishing a Qualified Legal Compliance Committee, a company’s board of directors must grant the committee the authority and responsibility

\textsuperscript{161} Id. at 6304 (to be codified at 17 C.F.R. § 205.2(k)).
\textsuperscript{162} Id. (to be codified at 17 C.F.R. § 205.2(k)(2)).
\textsuperscript{163} Id. at 6307 (to be codified at 17 C.F.R. § 205.3(b)(2)).
\textsuperscript{164} Id.
\textsuperscript{165} Id.
\textsuperscript{166} Id. at 6309 (to be codified at 17 C.F.R. pt. 205.3(c)).

https://digitalcommons.law.ou.edu/olr/vol56/iss2/22
to inform the company’s general counsel and chief executive officer of any reported violation and to decide whether a report of a material violation requires an investigation.\footnote{167} Additionally, if a company’s Qualified Legal Compliance Committee determines that a reported violation requires investigation, the committee must have the authority and responsibility to take such action as may be necessary to ensure a proper investigation. The committee needs the authority and responsibility to: (1) notify the audit committee or full board of directors; (2) initiate an investigation to be conducted either by the company’s general counsel or by outside attorneys; and (3) retain additional experts if the committee deems it necessary.\footnote{168}

Moreover, the committee must have the authority and responsibility to recommend that the company adopt appropriate remedial measures to address the violation.\footnote{169} The committee also must inform the company’s general counsel and chief executive officer, as well as the company’s board of directors, of the results of the investigation and of the remedial measures recommended.\footnote{170} Finally, if the company fails to act upon the recommendation, the committee must have the authority and responsibility to take such action as is deemed appropriate by the majority of the committee, including notifying the SEC of the company’s failure to act upon the recommendation.\footnote{171}

Because the SEC’s rules under section 307 do not require that a company establish a Qualified Legal Compliance Committee, a company should consider carefully whether to create one. Some companies may prefer that the company’s general counsel bear primary responsibility for overseeing issues that arise in connection with the SEC’s reporting obligations. Other companies may decide that it is more appropriate, especially from an investor’s point of view, for the company to establish an independent committee responsible for ensuring compliance with the SEC’s reporting obligations. Establishing a Qualified Legal Compliance Committee provides an alternative means of reporting and investigating evidence of a violation within a company when either an attorney who serves as outside counsel or the company’s general counsel suspects that a violation of securities law or breach of fiduciary duty exists within the company. An outside attorney reporting a suspected violation may choose to report the violation to either the company’s general counsel, general counsel and chief executive officer, or to the company’s Qualified Legal Compliance Committee. Despite the apparent advantage of having multiple reporting alternatives, the fact that a company’s

\footnote{167}{Id. (to be codified at 17 C.F.R. § 205.2(k)(3)).}
\footnote{168}{Id.}
\footnote{169}{Id.}
\footnote{170}{Id.}
\footnote{171}{Id.}
Qualified Legal Compliance Committee must consist of at least one member of the company’s audit committee and two other independent directors may deter some companies from instituting such a committee. As a practical matter, it may be difficult for a company to find independent directors willing to serve on the committee because of the increased responsibilities and potential liabilities of the committee members. In determining whether to create a Qualified Legal Compliance Committee, a company should remember that the committee can comprise the same members as the company’s audit committee or another existing committee, provided that its members satisfy the SEC’s independence requirements.\textsuperscript{172}

Regardless of whether a company establishes a Qualified Legal Compliance Committee or relies on its general counsel to ensure compliance with the SEC’s rules, the key to a successful disclosure compliance process is communication. A company’s general counsel, chief executive officer, board of directors and, if established, Qualified Legal Compliance Committee, must make personnel at all levels aware of their individual duties. The company’s general counsel, however, ultimately bears the responsibility for creating and maintaining open lines of communication within the company.

The SEC’s rules deem a company’s general counsel to be a “supervising attorney.”\textsuperscript{173} Accordingly, the responsibility of ensuring compliance within the company’s legal department falls upon the general counsel. Thus, a large part of the general counsel’s role in connection with a company’s disclosure compliance policy relates to facilitating communication and providing opportunities for early detection of potential violations of securities law or breaches of fiduciary duty within the company. The general counsel should meet privately on a regular basis with the company’s officers, other in-house attorneys, the Qualified Legal Compliance Committee, if established, and, perhaps, the company’s board of directors.\textsuperscript{174} Frequent and relatively informal communication increases the likelihood that the general counsel will discover a potential violation of securities law or breach of fiduciary duty in its preliminary stages. The general counsel also should meet regularly with subordinate attorneys within the legal department to ensure that they comply with the SEC’s rules.

Although the general counsel owes a duty of loyalty to the company and not to the chief executive officer or any other officer or employee of the company, the nature of the general counsel’s relationship with company personnel — the chief executive officer, in particular — clearly creates the potential for an

\textsuperscript{172} \textit{Id.} (to be codified at 17 C.F.R. § 205.2(k)(1)).

\textsuperscript{173} \textit{Id.} at 6313 (to be codified at 17 C.F.R. pt. 205.4(a)).

\textsuperscript{174} See ABA PRELIMINARY REPORT, \textit{supra} note 78, at 36-39; see also Hamermesh, \textit{supra} note 22, at 748-49.
awkward situation during the course of an internal investigation about a suspected violation of securities law or breach of fiduciary duty. In some instances, the general counsel risks her job simply by investigating. Early detection of conduct or activities indicative of a potential violation creates an opportunity for the general counsel to conduct a preliminary investigation and possibly deter the violative conduct before it develops into a matter that must be reported.

When a company retains outside counsel, the general counsel should provide the attorney with a copy of the company’s disclosure compliance policy and emphasize that the policy governs not only the company’s obligations under the SEC’s rules but also the activities of the company’s outside counsel.\footnote{175} Additionally, the general counsel should inquire as to whether the outside attorney adheres to any other disclosure compliance policy that might conflict with the company’s policy. If the attorney serving as outside counsel indicates that she follows a law firm’s disclosure compliance policy, the company’s general counsel should request additional information about its terms. Certainly, the company’s general counsel will want to be advised if a law firm’s policy requires the firm’s attorney to make initial reports under section 307 to a person or committee other than the general counsel.

The company’s disclosure compliance policy also should require each outside attorney to provide an annual certification to the company’s general counsel stating that the attorney knows of no conduct that would trigger a reporting obligation under the SEC’s rules. Regardless of whether an outside attorney works with or directly reports to the general counsel, a company’s disclosure compliance policy must ensure that procedures exist that give all attorneys serving as outside counsel access to the general counsel, as well as the company’s chief executive officer, Qualified Legal Compliance Committee, or another independent committee of the board of directors, if necessary.\footnote{176}

\section*{V. Conclusion}

Although the SEC’s rules under section 307 of the Sarbanes-Oxley Act represent a significant shift in the oversight of attorneys’ professional responsibilities, the rules do not represent the end of the attorney-client

\footnotesize{175. See ABA PRELIMINARY REPORT, supra note 78, at 39-42.}

\footnotesize{176. This aspect of a company’s disclosure compliance policy will be particularly important if the SEC adopts the “noisy withdrawal” proposal. Implementation of Standards of Professional Conduct for Attorneys, Sarbanes-Oxley Act of 2002 Release No. 33-8186, 68 Fed. Reg. 6324 (Feb. 6, 2003).}
relationship between attorneys and their corporate clients. Nor do the rules under section 307 conflict irreconcilably with the ABA’s Model Rules of Professional Conduct. As discussed, the ABA is poised to adopt changes that would effectively eliminate any perceived conflicts that exist between the SEC’s rules under section 307 and the ABA’s Model Rules. In the meantime, as attorneys consider how best to comply with the specific requirements of the SEC’s rules under section 307, they should consider how to most effectively incorporate the spirit of the corporate reforms into their daily practices to avoid being prominently featured in a scandal similar to those that led to the enactment of the Act in the first place.