January 3, 2003

VIA E-MAIL & FEDERAL EXPRESS

Jonathan G. Katz,
Secretary
Securities & Exchange Commission
450 5th Street NW
Washington, DC 20549-0609

RE: Comments on Proposed Rules Regarding Implementation of Standards of Professional Conduct for Attorneys
Release Nos. 34 46868, IC 25829
File No. 33-8150.wp, S7-45-02

Dear Sir:

I.
PRELIMINARY

On November 21, 2002, the Commission, in response to the mandate set forth in Section 307 of the Sarbanes-Oxley Act of 2002 (the “Act”), published rules dealing with proposed standards of professional conduct for attorneys practicing before the Commission.

It is the opinion of the undersigned that the proposed rules overreach the limited directive set forth in Section 307 of the Act and have imbedded within their provisions numerous conceptual and practical problems.

It is unlikely that the problems with the rules can be cured by modest tinkering. A thorough and comprehensive overhaul is required.

The main new authority for the rules is language in Section 307 to the effect that the Commission shall issue rules setting forth “minimum standards of professional conduct for attorneys . . .”[1]

The Staff appears to have construed the words “minimum

[1] As is discussed subsequently, it is questionable as to whether Section 23 of the Securities Exchange Act of 1934 (the “1934 Act”) empowers the Commission to enact the far reaching changes the Staff now proposes.

standards" to imply a broad authorization to federalize and significantly alter the rules of professional responsibility.

This federalization, however, represents a massive shift in the traditional allocation of responsibility for attorney conduct. Traditionally such matters have been left to the states or bar associations.

Nothing in the history behind Section 307 suggested that Congress had this earthquake in mind.

Section 307 was largely prompted by an amendment proposed by Senator Edwards.

In synopsis, Senator Edwards made two points.

The first was that the public should be protected from conduct that violated the legal standards of the profession.

The second was that information as to material violations be reported to the appropriate personnel within the company.

In short, the Act mandated the development of a system for reporting <u>within</u> the issuer. The Senator's remarks did not suggest that Congress desired to give the Commission an open-handed mandate to completely overhaul standards developed on a case-by-case basis by the 50 states and the ABA over the past several generations.

Unless the term "minimum" in the phrase "minimum standards" is to be taken entirely away from its normal meaning, the basis for the new standards cannot be justified.

The proposed rules may also not be justified on the ground that recent corporate scandals have created a special crisis demanding draconian measures.

Nowhere does the proposing release suggest that the recent frauds were insulated from detection by restrictions in the existing case law or existing standards of conduct pertaining to attorneys.

Indeed, if the recent Ninth Circuit case of *SEC v. Fehn*, 97 F.3d 1276 (9th Cir. 1995), is any indication, complicit institutional law firms which represented and supervised SEC filings of the corporations presently under investigation would have had responsibilities under traditional aiding and abetting doctrine to either withdraw from their representation or take other action respecting their clients' activities.

The fact that many law firms neither corrected the conduct of their clients nor withdrew from their representation may say more about the current culture of such law firms and the lack of focus upon such firms by the Commission's enforcement arm than it does about the necessity for new rules governing the attorney-client relationships.

These comments should also not be construed as a request for special consideration for practitioners in the corporate or securities area. The opposite is true. The comments are made with the belief that practitioners in all areas of the law deserve equal treatment and the rules governing conduct should not vary depending on the area of specialty.

Time constraints have not allowed a complete analysis of the proposed rules. Some, however, of the more serious problems are discussed in Sections II and III hereof.

II.
SPECIFIC PROBLEMS PRESENTED

(1) The Definition of "Practicing Before the Commission" Set Forth in Section 205.2 is Overly Broad

The Rule 205.2(a)(5)(i) contains a definition of "appearing and practicing before the Commission" breathtaking in scope and which requires modification.

It sweeps within the definition of "practice before the Commission" any attorney who advises, for example, that an exemption from the securities laws applies and, therefore, the issuer need not file a Registration Statement with the Commission.

Under the proposed definition any attorney in small town America, who advises the mom and pop owners of the local hot dog stand that the issuance of shares to themselves and their children is a private offering and does not, therefore, require the filing of a Registration Statement with the Commission will be deemed to be practicing before the Commission.

Very little in Section 307 of the Act or the comments of Senator Edwards justifies the sweep of this definition.

Moreover, the breadth of the definition is unnecessary.

Most attorneys swept within its parameters do not deal with reporting issuers and there is little, if any, policy justification for a definition which then submits them to theoretical Commission jurisdiction.

The proposed definition can best perhaps be measured by comparison with the rules, for example, of the Federal Courts.

Most Federal Courts have local rules governing the practice of counsel who appear before them. Invariably, however, these rules are limited to the regulation of conduct of attorneys who do business with the Court.

No Federal Court has by local rule purported to regulate the conduct of attorneys who only interpret Federal law and do not make appearances before the Court.

The proposed rule also has the intended or unintended consequence of making attorneys who do not appear before the Commission informal policemen of their clients' actions.

By way of example, an attorney representing a reporting issuer who has advised that a proposed offering was exempt and therefore did not have to be registered with the Commission would not, under a normal definition, considered himself to have appeared before the Commission.

If that attorney, however, subsequently received information to the effect that the issuer was committing a material violation of the Act, even though the violation was not connected to the subject of the attorney's representation, the attorney, under the proposed rules, would be mandated to send the Commission notice of his or her withdrawal of representation.

The notice of withdrawal in this instance may not be justified on the grounds that it protects the Commission's processes because, by definition, the attorney had not appeared. It can only be justified as a "whistle-blowing" device. Very little, however, in the legislative history of the Act suggest that whistle-blowing was addressed by Congress, let alone resolved in the manner proposed by the new rules.

A narrowing of the scope of its definition of "practicing before the Commission" will also not impair the Commission's enforcement program.

Presumably, if an attorney, through failure of understanding or otherwise, consistently issues erroneous opinions to the effect that filings with the Commission are not required, this attorney may be subject to discipline by means of the Commission's general power to seek an injunction in the District Court, a power of the

Commission which extends to all individuals or entities whether or not they "appear before" the Commission.

(2) Proposed Rules 205.2(a) and 205.3(d) Improperly Mandates Withdrawal of Counsel and Notification to the Commission When the Continued Representation Does Not Aid and Abet the Violation and/or Does Not Involve Commission Processes.

The proposed requirement that an attorney who believes that a material violation is occurring and has not been corrected must withdraw <u>and notify the Commission</u> is believed to have had its genesis in aiding and abetting cases in which an attorney continued to assist an issuer in filing false documents even though the attorney knew or had reason to know that the documents were false and thus knew that his representation was facilitating a continuing fraud. Under such circumstances, however, attorneys have always been held liable under traditional aiding and abetting concepts. See, e.g., *SEC v. Fehn* 97 F.3d 1276 (9th Cir. 1995).

As drafted, however, the proposed rules go far beyond aiding and abetting.

For example, an issuer could be the subject of a Commission investigation for selling instruments which the Staff believes are a security. In the course of that investigation, the company hires an attorney to protest the breadth of a subpoena or assert a special defense. In the interim the company continues its activities.

Representation of the client by the attorney under such circumstances has generally been accepted as constitutionally permissible and not aiding and abetting.

Nonetheless, the proposed rules as drafted would require the attorney to withdraw.

Rule 205.2(a) defines "practicing before the Commission" as defending an investigation or a Commission administrative proceeding and Rule 205.3(a) causes the internal reporting and/or withdrawal process to occur when the attorney becomes aware of evidence of a material violation.

<u>The rule does not require a nexus between the representation and the material violation</u> but only that the attorney be representing the issuer, that he be appearing before the Commission and that he become aware of information as to the material violation for which a satisfactory response has not been received.

There is little, if any, precedent for this approach and nothing cited in its support by the proposing release.

The approach is also inconsistent with present Commission rules and the Administrative Procedure Act, 5 U.S.C. 1, et. seq. (the "APA").

Section 6 of the APA states that individuals or organizations appearing before an administrative agency have a right to counsel and Rule 102(b) of the Commission's Rules of Practice allows a person to be represented by an attorney when in a proceeding before the Commission.

Neither Section 6 of the APA nor Rule 102 of the Commission's Rules of Practice contain an exception stating that the right to counsel must be suspended when the client or its agents persist in a potential violation unrelated to the subject of the representation.[2]

To the best knowledge of the undersigned, no federal agency, exclusive of the Commission, has adopted or has proposed to adopt rules of this breadth. And, if such rules are to be adopted, would they not be best adopted after there has been an amendment of the APA accompanied by a full and ranging Congressional discussion.

(3) Rule 205.3(e)(2) Improperly Suggests That an Attorney Appearing and Practicing Before the Commission May, Without the Issuer's Consent, Reveal Client Confidences.

Proposed Rule 205.3 (e)(2) in part states:

[2] To the knowledge of the writer, the ABA, under such circumstances, makes withdrawal discretionary with counsel. From time to time in the past, suggestions similar to the proposed rules have been made by representatives of the Department of Justice. To best knowledge of the undersigned, these suggestions have failed to find support in the bar.

> "(2) An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary; . . ."

Little in support of the proposed rule has been cited and the proposing release does not deal with the problem that if adopted, the conduct of counsel complying with the above provision will place counsel (at least in California) squarely in violation of state statutes and/or rules governing disclosure of client confidences.

The confidentiality rules had their origin in Roman and canon law. The overriding concept was that society was best served by undermining the lawyer's duty of loyalty and allowing the lawyer to "betray" his client. See, discussion, Muller & Fitzpatrick, Law of Evidence, pgs. 357-358 (Little Brown & Co. 1995 Ed.).

Page 47 of the proposing Release cites, as support for the rules, Rules of Professional Conduct in New Jersey, Florida and Wisconsin.

It is unlikely, however, that the rules of the three states cited by the Staff as opposed to the 47 states whose rules were not cited can be relied upon as the basis to determine a "minimum standard" within the meaning of Section 307 of the Act.

California Business and Professions Code 6068(e), however, a substantive statute, provides that an attorney shall at every peril preserve his client's confidences.

Formal Opinion 1996-146 of the California State Bar, Standing Committee on Professional Responsibility and Conduct amplifies this admonition by stating that, notwithstanding the attorney's perception that financial harm to third parties may occur, the attorney is obligated to preserve the client confidences.

California Courts have not regarded Section 6068(e) lightly.

In *In Re Robert Jordan Jr.*, 7 Cal.3d 930, 940 (1972), the California Supreme Court stated:

> " . . . Thus the protection of confidences and secrets is not a rule of mere professional conduct, but instead involves public policies of paramount importance which are reflected in numerous statutes. . . ."

In *Dixon v. State Bar*, 32 Cal.3d 728, 187 Cal.Rptr. 30, 37 (1982), one of the counts against an attorney in a disbarment proceeding involved his inappropriate disclosure of client confidences.

Similarly, in *Goldstein v. Lees*, 46 Cal.App.3d 614, 120 Cal.Rptr. 253 (1975), an attorney was subject to an adverse Court opinion for his disclosure of client confidences even though one of the arguments asserted that the disclosures were for the benefit of the corporation or its shareholders.

Federal law does not differ. The United States Supreme Court, in the context of a regulatory setting, stressed the importance of the confidentiality rules. See, *United States v. Lewisville and Nashville Railway Co.*, 236 U.S. 318, 336, 35 S.Ct. 363 (1915).

The new proposed rules stretches to the outer limits the rule making authority set forth in Section 23 of the 1934 Act. Section 23(a)(1) of the 1934 Act granted the Commission authority to promulgate rules necessary to implement the provisions of the title for which it is responsible. Notwithstanding the breadth Section 23, it is questionable as to whether Congress intended to authorize the Commission to issue rules which specifically overruled contrary state statutes. Certainly, the seminal case, *Touche Ross & Co. v. SEC*, 609 F.2d 570 (2nd Cir. 1979), did not come anywhere near this issue.

The proposed rule also shows a dismaying disregard for recent history.

In 1972, in connection with the proposed adoption of the Federal Rules of Evidence, rules were proposed which were intended to supersede the common law. Thirteen specifically (and narrowly defined) federal privileges were proposed.

After a significant outcry in Congress the proposed rules were withdrawn and a Rule 501 adopted which preserved existing common law. See, discussion, Advisory Committee Notes, FRE 501.

Notwithstanding this history the new rule would propose to develop entirely new standards notwithstanding the absence of strong precedent or any strong Congressional mandate in this area.[3]

Finally, in the experience of the undersigned, the justification for the proposed rule proceeds on an overly romantic premise.

Under this premise an upstanding and ethical attorney feels impelled to do the right thing and disclose client confidences to prevent financial harm to others. The process is impelled by a crisis of conscience.

Would that this were so. The more usual situation occurs when the attorney not only becomes aware of a Commission investigation but also notes that he or she may be a subject or target.

The attorney then decides that his personal well-being is best served by disclosing what he can to the Staff while hoping against hope that he or she will not be named in an enforcement proceeding.

The Commission's Rules of Practice should not encourage this situation.

Put another way, a license to practice law involves a modicum of courage. The rules of practice should not alter statutes or rules governing the protection of client confidences to both allow the government to pressure an attorney and then provide a way out for the attorney by permitting him or her to obtain favorable treatment at the cost of being permitted, with impunity, to give up client confidences.

A rejection of the proposed provision will not encourage attorney participation in client frauds. Under such circumstances the crime-fraud exception to the attorney-client privilege would,

[3]Those drafting the proposed rule were well aware of the absence of supporting authority. The Staff, on page 7 of the proposing release, commented that the proposed rule "incorporates several corollary provisions that are not explicitly required by Section 307."

after an appropriate (and in camera) showing to the Court, make the necessary information available to the government or others.

(4) Rule 205.3(e)(3) Proposes to Have the Commission Adopt as a Rule the Discredited Concept of "Selective Waiver" of the Attorney-Client Privilege.

Under this concept, confidential information disclosed to the Commission would not constitute a waiver of the attorney-client privilege as to third parties.

This approach has been advocated by the Staff for many years. Notwithstanding Staff advocacy, however, it is contrary to the existing federal common law of waiver.

Many of the cases on this subject are summarized in *In Re Columbia/HCA Health Care,* 293 F.3d 290, (6th Cir. 2002), cited by the Staff in the proposing release.

Unfortunately, the release, while citing *Columbia/HCA*, took pains only to cite the dissent, not the central holding. The central holding rejected the concept advanced by the Commission and in so doing listed a large number of holdings squarely contrary to the position presently advocated by the Staff.

The following additional cases have also rejected the concept of selective or limited waiver:

1. *Westinghouse Elc. Corp. v. Republic of the Philippines*, 951 F.2d 1414 (3d Cir. 1991);

2. *Permian Corp. v. United States*, 665 F.2d 1214 (D.C. Cir. 1981);

3. *United States v. Massachusetts Inst. of Tech.*, 129 F.3d 681 (1st Cir. 1997); and

4. *In Re John Doe Corp.*, 675 F.2d 482 (2d Cir. 1982).

One may also question the necessity for adoption of the selective-waiver doctrine.

In 1979 over 425 corporations took part in the SEC voluntary disclosure program despite the absence of a limited waiver doctrine. See, Note, the Limited Waiver Rule, Creation of an SEC-Corporation Privilege, 36 Stanford Law Review 789 (1984).

The proposed limited waiver rule also cannot be harmonized with the history behind Rule 501 of the Federal Rules of Evidence.

Rule 501 was only adopted after considerable tension between the drafting committee for the Federal Rules of Evidence and Congress. Originally, in 1972, narrowly circumscribed federal privileges were proposed for the Federal Courts. After the predictable Congressional outcry the proposed rules on privilege were withdrawn and Rule 501 adopted.

Rule 501 provides that issues of privilege in matters involving Federal law are to be decided on the basis of reason and experience. This implies a case by case judicial determination.

Given this history and the slender basis in the Act for adoption of new rules of privilege or evidence, it is unlikely that a careful Federal Court would feel comfortable in asserting that the Commission had a mandate to overrule prior case law.

(5) The Proposed Rules Requiring Withdrawal and Notification to the Commission in the Event of a Resignation Go Far Beyond the Mandate of the Act and are Questionable as a Matter of Policy.

Rule 205.3(d) mandates, when an acceptable response has not been forthcoming, withdrawal of the attorney from representation of the issuer and the giving of written notice to the Commission <u>within one business day</u> of the withdrawal.

The Act required that rules be developed to have careful reporting of a material violation **within the issuer.** The Act did not set forth a mandate for withdrawal or reporting the withdrawal to the Commission.

On a second level, there is little authority for the proposition that the attorney must indicate that the withdrawal "<u>is based on professional considerations.</u>" As utilized in the rule, the words "on professional considerations" represent a code for advising the Commission that something is seriously wrong.

Sometimes an attorney may have an obligation to withdraw. It is, however, questionable as to whether this obligation then extends to notifying the Commission by code words that something is seriously wrong.

The code words are particularly inappropriate when one considers that to date the Commission (unlike many Courts) has not adopted rules requiring withdrawing attorneys to give a reason for their withdrawal. Typically attorneys withdraw by sending a brief letter to the Staff or the Commission. For 60 years a more formal procedure has not been required. One must question, therefore, the purpose of Subsection (d)(i)(A) of the rule.

Special problems are also presented by provisions requiring that notice be given to the Commission within one day of the withdrawal.

In *Carter-Johnson*, the Commission emphasized the importance of a continuing dialog between counsel and the issuer.

A withdrawal by counsel is drastic and may, under many circumstances, cause a client to reconsider its prior position. Nonetheless this reconsideration cannot occur once notification has been given to the Commission and the one day period specified for notification to the Commission does not give either the client or the attorney time to effectively reconsider his or her actions.

In addition, when the triggering event is not a violation of the securities laws but a simple breach of fiduciary duty, reporting to the Commission makes no sense whatsoever. The Commission may administer the securities laws but it does not (yet) police breaches of fiduciary duty.

The Staff release also does not discuss how this provision of the proposed rules will interface with *Santa Fe Industries v. Green*, 430 U.S. 462; l97 S.Ct. 1292 (1977), where the Supreme Court stated that breaches of fiduciary duty are matters for state law and do not per se violate the securities laws. It is unclear why a breach of fiduciary duty should prompt notification to the Commission when, by definition, the breach would not involve a violation of laws administered by the Commission.

The above problems are also compounded by the requirement that, where documents were filed, the attorney must specify the exact area where the problems occurred.

It is one thing for an attorney to withdraw and quite another thing for an attorney, in withdrawing, to point the Commission to the exact page and paragraph where problems were perceived to have occurred.

The specificity required by this paragraph goes far beyond the mandate of the Act and breaches the attorney-client privilege far beyond what is necessary to either accomplish a noisy withdrawal or to avoid aiding and abetting liability.

(6) The Proposed Definition of a “Client” in Rule 205.3 Does

Not Address the Joint Defense Privilege.

Rule 205.3(a) broadly asserts that the issuer is the client of the attorney.

Of itself, this provision is unexceptional as it simply restates the common law of attorney-client relationships.

The last sentence, however, of Rule 205.3(a) contains potential for considerable mischief. This sentence states:

> " . . . That the attorney may work with and advise the issuer's officers, directors, or employees in the course of representing the issuer does not make such individuals the attorney's clients."

Under many circumstances, the above may be true. However, in numerous instances, and in particular in Commission enforcement proceedings, the parties with concern are not only the issuer but also the issuer's officers and directors.

Often such individuals enter into a joint defense agreements with the issuer. Under such circumstances, the joint defense privilege would preclude the revealing of confidences unless both parties to the agreement so stipulated. See, e.g., *Continental Oil Co. v. United States*, 330 F.2d 347 (9th Cir. 1964); *Hunydee v. United States*, 355 F.2d 183 (9th Cir. 1965).

The proposing release suggests this problem was not overlooked.

More specifically, the Staff, on page 19 of the proposing release, stated:

> " . . .Fairness and candor between co-clients regarding matters of common interest normally preclude any expectation of confidentiality regarding communications with their attorney, even regarding a communication of which one co-client was unaware at the time it was made."

The full impact of this language must be understood. It means that under many circumstances, the issuer, in order to obtain favorable treatment, may desire to abrogate a joint defense agreement and, under those circumstances, according to the proposed release and the rule as presently drafted, the attorney could disclose confidences previously obtained.

It is respectfully submitted that this represents a change from the present law and should not be allowed.[4]

Little also will be lost by discarding of this portion of the proposed rule.

It is, in the main, a trap for the unwary.

A corporation can only act through its officers and directors and most officers will assume, without questioning the concept, that information they convey to the attorney will be held confidential.

The ethical attorney must, upon adoption of this rule, tell such officers and directors that the confidentiality of information conveyed is limited at best. Under those circumstances the sophisticated officer or director may well either avoid the attorney (particularly if the attorney is embarking on an internal investigation), insist upon a special agreement preserving the confidentiality of communications or obtain separate counsel.

The main effect of the rule will, therefore, fall upon only those who lacked the wit to insist upon protective devices.

The rule in practice will do little to advance public policy except to trap the unwary.

III.
THE PROPOSED SANCTIONS FOR VIOLATIONS OF THE RULES ARE UNDULY DRACONIAN

[4] This portion of the proposed rules also appears to resurrect the old Rule 503(d)(5) of the Federal Rules of Evidence dealing with joint clients. Such a rule was proposed in conjunction with the enactment of the Federal Rules of Evidence many years ago and rejected after an outcry in Congress..

Proposed Rule 205.6(a) provides that a violation of the 205 sub-set of rules will be treated for all purposes as a violation of the 1934 Act, 15 U.S.C. 78(a), et seq.

One has to wonder if the impact of this section was carefully thought through.

Section 32 of the 1934 Act, 15 U.S.C. 78(f)(f), provides that any person who wilfully violates any provision of the 1934 Act or any rule or regulation thereunder is subject to criminal liability and may be fined not more that $1 million or imprisoned not more that 10 years, or both.

In short, a violation of the 1934 Act is a crime and a felony at that.

In practice, attorneys are often called upon to make a series of delicate and difficult judgments. The judgment calls are palatable to the client because, at least in California, it is assumed that the client operates from a duty of undivided loyalty. The client cannot be expected to have confidence in the attorney's loyalty when he knows that the attorney is viewing every judgment call through the lense of his or her personal potential criminal liability if he guesses wrong.

Nothing in the Act suggests that Congress had this result in mind.

IV.
CONCLUSION

For the reasons set forth herein, it is respectfully submitted that the proposed rules be withdrawn.

Very truly yours,

SHELDON M. JAFFE

SMJ:ca