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Protecting the Perception of the Public Markets: At What Costs - The Effects of Noisy Withdrawal on the Long Standing Attoney-Corporate Client Relationship

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PROTECTING THE PERCEPTION OF THE PUBLIC MARKETS: AT WHAT COST? THE EFFECTS OF "NOISY WITHDRAWAL" ON THE LONG STANDING ATTORNEY-CORPORATE CLIENT RELATIONSHIP

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I. INTRODUCTION

"Sarbanes-Oxley," this phrase has echoed in the minds of corporate attorneys for almost two years now. Over this period of time, most corporate attorneys have come to recognize the general breadth of this Act. Aside from having a basic understanding, however, do corporate attorneys know the true effects this Act and the corresponding proposal will have on the legal profession and the companies they represent? The scope of this article is concerned with just that. Specifically, this examination concerns the U.S. Securities and Exchange Commission's proposed "noisy withdrawal" provision.[1] Briefly, noisy withdrawal refers to the final measures an attorney would be required to take after reporting concerns up the corporate ladder and receiving an inadequate response. As proposed, noisy withdrawal requires withdrawal from representation, disaffirmance of any related documents, and notification to the Commission of the attorney's withdrawal. Although this proposal has merit, as we approach a point in time when "Enron type" corporate scandals become relatively distant, corporate attorneys should take a moment to consider the far-reaching implications.[2] In an effort to garnish support, this proposal has

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1. The Securities and Exchange Commission (S.E.C.) will be referred to as the "Commission" in the textual discussion of the paper. For efficiency purposes, the term "noisy withdrawal" will no longer have quotation marks around it.

2. By no means is this article asserting that there are no more financial fraud cases lurking nearby. The term "Enron type" corporate scandals refers to scandals of such a magnitude that they are unlikely to be seen again, at least for some time. Accordingly, as some time has passed since these events occurred, corporate America, shareholders, and society should take a moment to consider the implications of the noisy withdrawal proposal. A recent Washington Post article highlights some of the issues that must be dealt with in the wake of "Enron type" disasters, suggesting that these distant memories are still inflicting concern. *See* Carrie Johnson & Ben White, *Trials & Tabulations: Shareholders, Insurers Cover Some Executives' Legal Fees*, WASH. POST, May 5, 2004, at E1 (displaying an image on the front of the business section, which depicted a few of the senior officers responsible for the Enron and Tyco events). The article is

been strategically attached to an Act deemed the long awaited and needed elixir, created to improve corporate governance and to heal the ailing securities markets.[3] Beneath the pretext of this administrative proposal lies the ultimate question that must be resolved before further steps are taken. As a matter of public policy, corporate attorneys must ask themselves whether the perceived need to protect investors by imposing a duty on attorneys to report evidence of corporate fraud outweighs the traditional protections afforded to the sanctity of the attorney-corporate client privilege. As this article suggests, the noisy withdrawal proposal should not be adopted because its negative effects on the long-standing relationship between attorney and corporate client far outweigh the likely benefits to the securities markets.

In the wake of corporate irresponsibility evidenced by the Enron fiasco and other corporate catastrophes, Congress prudently passed the Sarbanes-Oxley Act of 2002.[4] The Act is primarily concerned with preventing corporate fraud through increased accounting oversight.[5] As a secondary issue, the Act imposed new guidelines on corporate attorneys to ensure that they are vigilant in their representation of their corporate clients.[6] Congress entrusted the Commission with the implementation of this Act through its rulemaking authority.[7] Accordingly, the Commission issued final rule Part 205, requiring corporate attorneys who discover wrongdoing on the part of corporate management to report such malfeasance up the proverbial "ladder" until the attorney is provided with "an appropriate response."[8]

With fear that this rule, by itself, would not have the sharp teeth desired to bite down on corporate malfeasance, the Commission,

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concerned largely with the legal representation that these corporate tycoons are now receiving at the expense of shareholders and insurance companies in most cases.

3. *See* William H. Donaldson, *Testimony Concerning Implementation of the Sarbanes-Oxley Act of 2002*, (Sept. 9, 2003), *available at* http://www.sec.gov/news/testimony/090903tswhd.htm (last visited Oct. 31, 2004). Although the implementation of Sarbanes-Oxley has resulted in an increase in enforcement actions by the S.E.C. and is likely to deter future violations, the noisy withdrawal proposal is merely an attempt by the S.E.C. to ride on the coat tails of a much-needed ground breaking Act. It has been suggested that Sarbanes-Oxley will enable the government to use its full authority to expose corruption, punish wrongdoers, and defend the rights and interests of American workers and investors. *Id.*

4. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

5. *Id.*

6. *Id.* § 307.

7. *See* U.S. CONST. art. I, § 1.

8. 17 C.F.R. § 205.3 (b)(3) (2003). *See generally* Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities and Exchange Commission, Release No. 33-8185 (Jan. 29, 2003), *available at* http://www.sec.gov/rules/final/33-8185.htm (last visited Oct. 31, 2004) (commenting on the "up-the-ladder" reporting requirement of Part 205).

independent of explicit congressional support, proposed the noisy withdrawal provision.[9] Theoretically, this proposal may appear to be the solution to end all corporate malfeasance without any downside costs; however, an objective examination of its practical consequences reveals that it is not. Noisy withdrawal violates the attorney-corporate client privilege and "risk[s] destroying the trust and confidence many [corporations] have up to now placed in their legal counsel, creating divided loyalties."[10] Consequently, the attorney's duty to advocate zealously is likely to be negatively affected. Additionally, the client may be discouraged from seeking counsel's advice, leading to the exclusion of the attorney from client meetings; ultimately resulting in the corporate client's deteriorating compliance with securities laws. As will be demonstrated, noisy withdrawal, if implemented, will infringe on the sanctity of the attorney-corporate client relationship, ultimately leading to increased corporate malfeasance. Accordingly, Part 205, as adopted, appropriately balances the competing goals of protecting investors and the market with the long-standing attorney-client relationship. For these reasons, the noisy withdrawal proposal should not be implemented.

This article addresses important issues relating to the Commission's rule Part 205, as promulgated, and its noisy withdrawal proposal. The discussion focuses on the likely effects of noisy withdrawal on the attorney-corporate client relationship and asserts that its negative effects outweigh any perceived benefits. Part II provides background information on the development of the attorney-corporate client privilege and the role of the corporate attorney. It then describes the events leading to the enactment of the Sarbanes-Oxley Act of 2002. Part III examines final rule Part 205, the noisy withdrawal proposal, and its alternatives. Part IV addresses the implications of Part 205 on investors, corporate governance and the attorney-corporate client relationship. Part V examines the Commission's authority to promulgate noisy withdrawal. Additionally, it addresses the arguments in favor of noisy withdrawal and concludes with an analysis of the implications of noisy withdrawal if adopted. Part VI offers a proposed amendment to Part 205, which attempts to balance the competing interests of protecting investors against preserving the sanctity of the attorney-corporate client relationship.

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9. *See generally* Securities and Exchange Commission, *Implementation of Standards of Professional Conduct for Attorneys*, Release No. 33-8186 (Jan. 29, 2003), *available at* http://www.sec.gov/rules/proposed/33-8186.htm (last visited Oct. 31, 2004) (commenting on the "noisy withdrawal" proposal).

10. *The ABA and Corporate Governance*, ABA WATCH, Feb. 2003, at 9 (internal quotations omitted).

II. HISTORICAL BACKGROUND: THE ATTORNEY-CORPORATE CLIENT RELATIONSHIP BEFORE SARBANES-OXLEY

A. DEVELOPMENT OF THE ATTORNEY-CORPORATE CLIENT PRIVILEGE & ITS PURPOSE

Although the Sarbanes-Oxley Act is only a few years old, the attorney-client privilege dates back to Roman times.[11] During Roman times, it was well recognized that an attorney could not be called to disclose his client's confidences because betrayal of such magnitude was likely to "contravene their relationship" and "brand the attorney as an unsavory individual . . . ."[12] At its foundation, the privilege was based on an attorney's "oath and honor," as a gentleman to be bound by his word. Accordingly, it was deemed honorable for an attorney to protect client confidences and dishonorable to reveal them.[13] The original rationale for the privilege slowly evolved to resemble today's rationale of encouraging client candor with the result being full disclosure of pertinent information without fear of prosecution.[14]

For many years, controversy existed regarding whether the attorney-client privilege was limited to matters in litigation or whether it extended to general legal consultation and advice-seeking.[15] In 1870, a court resolved this issue in favor of extending the privilege to general legal advice, even when litigation is not imminent.[16] The determination that the privilege applies where an attorney acts in an advisory role provided the necessary groundwork for the extension of the privilege to the attorney-corporate client relationship.[17]

Confidentiality in an advisory setting is extremely important in the corporate atmosphere. In many instances, the key role of a corporate

11. JOHN WILLIAM GERGACZ, ATTORNEY-CORPORATE CLIENT PRIVILEGE, 1-4 (2d ed. 1990) [*hereinafter* GERGACZ].

12. *Id.*

13. *Id.* at 1-4, 1-5.

14. *Id.* at 1-5.

15. *Id.*

16. *Id.* (citing Minet v. Morgan, L.R. 8 ch. 361, 368 (1870)) (stating that communications are protected "if they pass as professional communications in a professional capacity").

17. *See id.* at 1-13 (recognizing that the application of the privilege in the attorney-corporate client setting went unchallenged for many years because of the development of the privilege in the attorney client setting); *See also* Upjohn Co. v. United States, 449 U.S. 383 (1981). *See generally* Radiant Burners, Inc. v. American Gas Ass'n, 320 F.2d 314 (7th Cir. 1963) (*en banc*). These cases expanded the reach of the attorney-client relationship to the corporate setting.

attorney may be to assess the legality of the corporation's current situation and to provide advice regarding the legal ramifications of the corporation's future actions. In fact, the enlargement of the privilege was largely based on the premise that clients are unaware of the significance of their actions.[18] As such, preventative measures were viewed as more economically and socially desirable than having the attorney engage in damage control once problematic actions were taken.[19] Additionally, courts grappling with the issue of confidentiality in this setting also understood that for clients to consider engaging an attorney, the relationship must encourage trust and confidence, which would hopefully result in complete client disclosure. Without trust and confidence in the attorney-client relationship, the attorney would be perceived as an adversary and a threat to the client's interests, inevitably leading to clients who do not retain counsel or who are less candid with their counsel.[20] As a corollary, corporate actors who are less candid are likely to receive deficient legal advice, leading to potential violations of the law.[21]

As time passed, the corporate existence came to being in most states.[22] Individuals incorporated their businesses because the corporate form offered them the opportunity for profitability without as much personal liability exposure. Although there is no question that the creation of the corporate entity was a great innovation, its emergence required the law to adjust to suit its distinctive composition.[23] Justice Marshall in *Dartmouth College v. Woodward* recognized a corporation's unique properties, when he eloquently stated:

> A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties, which the charter of its creation confers upon it, either expressly, or as incidental to its very existence. These are such as are supposed best calculated to effect the object for

18. GERGACZ, *supra* note 11, at 1-7.

19. *See id.*

20. *See* Note, *Functional Overlap Between the Lawyer and Other Professionals: Its Implications for the Privileged Communications Doctrine*, 71 YALE L.J. 1226 (1962) (stating that fifty percent of those surveyed stated that their communications with attorneys would be less candid without the attorney-client privilege).

21. *See* Duggin, *infra* note 39 (citing *Upjohn*, 449 U.S. at 393 n.2 (1981)).

22. An in depth study of the early development of corporations is beyond the scope of this article. *See* HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS 14-35 (3d ed. 1983) (discussing the development of the corporate being from Roman times to its present form). The enactment of general incorporation statutes by the individual states began as early as 1795: North Carolina (1795); Massachusetts (1799); New York (1811); Connecticut (1837). *Id.* at 25.

23. *See* GERGACZ, *supra* note 11, at 1-12 (stating that a corporation is distinguishable from the individual client and therefore the privilege doctrine needed to be tailored to the corporate client).

which it was created. Among the most important is immortality, and, if the expression may be allowed, individuality . . . .[24]

In order to provide confidence to those attracted to the corporate form, courts understood that corporations must receive some of the legal rights individuals receive.[25] Accordingly, and despite a corporation's existence as a mere legal fiction, the law ascribes many of the characteristics that individuals naturally possess to this entity.[26] One of these characteristics attributed to the corporate entity is its ability to be the client of an attorney.[27] This important characteristic allowed individuals to incorporate their businesses, thereby obtaining the benefit of limited liability, without having the corporate entity lose the protections afforded to individuals.

The unique attorney-corporate client relationship is further demonstrated by the fact that an attorney-corporate client privilege exists, yet no corporate client exists for the attorney to have communications.[28] Accordingly, the will of the corporation to invoke the privilege is accomplished through the will of its decision makers or its chief executive officer.[29]

Additionally, and despite the fact that the corporate attorney actually works with the corporate officers and not the corporate entity itself, an attorney owes his allegiance to the entity.[30] This distinction has not been a major source of debate in the common law despite its divergence from the traditional individual setting.[31] In actuality, "[i]t was generally assumed that corporations and other legal entities are entitled to the privilege just as much as individuals are."[32] In 1963, before the Supreme Court addressed the issue, the Seventh Circuit in *Radiant Burners, Inc. v. American Gas Ass'n*, confirmed this belief in holding that the attorney-client privilege applies to the corporate entity.[33] Eighteen years later, the Supreme Court in *Upjohn v. United States* removed any doubt and confirmed the extension of

24. Dartmouth College v. Woodward, 4 U.S. (Wheat.) 518, 636 (1819) (citing GERGACZ, *supra* note 11, at 1-11).

25. *See* GERGACZ, *supra* note 11, at 1-11.

26. *Id.*

27. *Id.*

28. *See id.* at 1-12.

29. *Id.*

30. *See id.*

31. *See generally* David Simon, *The Attorney-Client Privilege as Applied to Corporations*, 65 YALE L.J. 953 (1956).

32. *Id.*

33. Radiant Burners, Inc. v. American Gas Ass'n, 320 F.2d 314 (7th Cir. 1963) (holding that the attorney-client privilege applies to corporations).

the privilege to the attorney-corporate client relationship.[34]

The justification for this principle in both the individual and corporate contexts is that it encourages client candor. In the corporate setting, this increased candor results in the client's overall compliance with the law or at least a client, who through its actors, is making informed decisions.[35] As a result of the client's candor, the attorney is placed in a much more favorable position, as the attorney now has access to more information. Although the benefits of the attorney's legal advice alone should motivate corporate management to be forthright with counsel, without the privilege, the fear of the attorney later becoming their adversary would likely alter management's decision to confide in counsel.[36] Accordingly, the corporate privilege, like that of the individual privilege, is necessary, because it implicitly encourages legal compliance and without it, serious violations may result.[37] The Supreme Court in *Upjohn* acknowledged the particular importance of the attorney-client privilege in the corporate context.[38] Chief Justice Rehnquist stated, "corporations, unlike most individuals, constantly go to lawyers to find out how to obey the law, because corporate legal compliance is hardly an instinctive matter."[39] From this case and the evolution of the privilege, it is evident that the attorney-corporate client privilege exists and that it is needed to foster an environment of confidence and trust in the attorney-corporate client relationship.

B. THE ROLE OF THE CORPORATE ATTORNEY

In order to assess accurately the impact of noisy withdrawal on the attorney-corporate client relationship, it is critical to understand the role of the corporate attorney representing public companies before the

34. *See Upjohn*, 449 U.S. 383 (holding that the attorney client privilege protects communications to counsel by lower-echelon employees who are not in the control group, as long as the communications are within the scope of their corporate employment).

35. *See* GERGACZ, *supra* note 11, at 1-15.

36. *Id.* at 1-16.

37. *See infra* Part II, C discussing the Enron debacle. Without lessening the importance of the privilege in the individual client context, it is important to note that corporations fuel the United States economy and its financial markets. As such, a corporation's overall compliance with the law may have a much greater effect on society than an individual's failure to comply.

38. *Upjohn*, 449 U.S. 383 (holding that the attorney-client and work product privileges apply in the corporate context and protect the confidentiality of the attorney's communications with client representatives, and the notes and memoranda prepared by the corporate counsel during the internal investigation).

39. Sarah H. Duggin, *Internal Corporate Investigations: Legal Ethics, Professionalism and the Employee Interview*, 2003 COLUM. BUS. L. REV. 859, 895-96 (2003) (citing *Upjohn*, 449 U.S. at 392 (internal quotations omitted)). At the time the opinion was drafted, Chief Justice Rehnquist was not yet Chief Justice of the Supreme Court.

Commission. Corporations retain corporate counsel to ensure their compliance with legal obligations.[40] Depending upon the company and its particular needs, corporate counsel may be employed to perform an array of tasks. Generally speaking, a corporate counsel's duties may entail; conducting due diligence, assessing the consequences of an acquisition or merger, conducting an economic assessment, advising management on the legal ramifications of a decision or simply serving in an advisory role on day to day matters. Regardless of the particular role, corporate attorneys play a substantial part in shaping the corporation's future actions, specifically, its legal compliance. For example, pursuant to the Securities & Exchange Act of 1934, registered public companies have many disclosure requirements.[41] As such, public companies employ corporate counsel to ensure their overall compliance with the legal requirements of the Act and other securities rules and regulations.[42] Although these are only some of the tasks a corporate counsel may perform, they nevertheless demonstrate the integral role counsel serves in the overall effectiveness and well being of a corporation.

Depending upon the role of counsel in the particular organization, many of the legal issues that arise may be routine and manageable, while other issues may require a more in depth examination and a unique approach. In some instances, management may confront corporate counsel with an issue that falls into a grey area, meaning that the legal ramifications are not entirely clear. In these situations, the corporate counsel is entrusted with determining the best course of action for the company and or advising management on possible alternatives. Ultimately, management is free to exercise its business judgment and select a course of action that it believes is in the best interests of the corporation.[43] However, having sound legal advice informs management's decision and in most cases is likely to result in corporate compliance. Additionally, the corporation, investors and society are placed in a better position when corporate actors confide in counsel rather than venturing out into the legal atmosphere alone. Accordingly, any measure, such as the implementation of noisy withdrawal, which may have the cumulative effect of discouraging

40. This article addresses the impact on retained corporate counsel rather than in-house counsel. Although the impact on the relationship is similar in both settings, the proposal does not mandate withdrawal by the in-house counsel.

41. *See generally* Securities & Exchange Act of 1934, 15 U.S.C. § 78a (2000).

42. Public companies may have their in house counsel or outside counsel handle securities act compliance.

43. Corporate management is protected by the Business Judgment Rule. *See* JEFFREY D. BAUMAN, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS: STATUTES, RULES AND FORMS, §§ 8.30-8.31 (2002).

management's consultation with corporate counsel, is likely to have devastating effects on the overall well-being of the entity.[44]

C. EVENTS LEADING TO THE ENACTMENT OF SARBANES-OXLEY

The emergence of legislation aimed at corporate reform is the result of corporate malfeasance, which rocked our economy into a state of uproar, ultimately herding Congress up the Capitol steps and into legislative mode.[45] Specifically, the crisis that prompted congressional action arose from large public corporations abusing corporate reporting requirements, engaging in imaginative accounting procedures, and chiseling corporate ownership arrangements in such a way as to make illegal transactions appear facially legitimate.[46] Although the fraudulent acts of many companies spurred legislative action, none of them were as aggressive in their malfeasance as Enron.[47] Before analyzing the implementing legislation, a general understanding of the extent of the corporate greed is essential.[48]

Although the maneuvers employed by Enron personnel are in many cases very complicated, in actuality, the fraudulent measures taken may be captured by a single word, greed. Greed on the part of management, greed on the part of the C.E.O. and greed on the part of the corporate attorneys representing this beast of a company. Specifically, Enron's fraudulent accounting practices focused on hiding the company's losses while showcasing its imaginary gains.[49] This accounting tactic allowed the company to appear as if it was rapidly growing without downside risk.[50] Additionally, Enron, in its efforts to deceive the market, formed finance entities to hedge against declines in unstable energy stocks, which

44. This includes a corporation's financial well-being, which is directly related to its legal compliance.

45. *See* Ryan Morrison, Note, *Turn Up the Volume: The Need for "Noisy Withdrawal" in a Post Enron Society*, 92 KY. L.J. 279, 280-81 (2003-04).

46. Douglas M. McManamon, *Should Attorneys Be Footsoldiers in the War on Corporate Fraud?*, 38 U.S.F. L. REV. 163, 171 (2003) [hereinafter McManamon].

47. *See* Permanent Subcommittee on Investigations, The Role of the Board of Directors in Enron's Collapse, S. Rep. No. 107-70 at 2-4 (2002).

48. There is no question that greed by itself is perfectly legal, however, greed may reach a certain level where it transforms one's mere excessive behavior into fraud, malfeasance and or more severe illegal behavior. By using the term greed to describe the disposition of these corporate actors, this article attempts to demonstrate how an intrinsic element of human nature can easily become a cause of concern in the corporate setting. For this reason, independent legal reasoning is often needed to inform these greed seekers that their conduct crosses the line.

49. McManamon, *supra* note 46, at 172.

50. *Id.*

management called Raptors and Condors.[51] Although these entities were entirely owned by Enron, by using evasive accounting maneuvers, management was able to claim that they were independently owned, essentially creating a straw man to finance the working capitol for each entity.[52] As a result, Enron was fully exposed to the liability of the Raptors, but investors were left clueless because the information was not disclosed.[53] Additionally, Mr. Fastow, the C.E.O. of Enron, despite receiving legal advice to the contrary, engaged in a clear conflicting position by investing his own money in a partnership engaged in business with Enron.[54] As can be gleaned from these unscrupulous business practices, Enron management was motivated by personal short-term gain at the expense of the corporation's long-term success.

Although corporate counsel cannot be blamed for the occurrence of many of these fraudulent practices, as they were primarily financial measures handled by an accounting firm, it is nonetheless evident that some of the lawyers involved "forgot[] their responsibility."[55] Vinson & Elkins, the firm representing Enron, grossed $35.6 million in legal fees from Enron during 2001.[56] With regard to the questionable practices, members of the firm expressed reservations about the transactions to Enron's in-house attorneys, as required by Enron's protocol. Aside from expressing some concern, these attorneys failed to stand up to the fraudulent actors and, more importantly, failed to report their concerns to the board of directors, measures that, if taken, may have prevented the occurrence of some of these underhanded maneuvers.[57] The main factor causing the firm's reluctance to step up the ladder and inform the board was due largely in part to the amount of money it was making from its representation of Enron.[58] Although ultimately, professional responsibility concerns should have derailed the firm's profit-seeking motives from controlling its actions, the Model Rules of Professional Conduct did not, at that time, contain an "up the ladder" reporting requirement.[59] Such a

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51. *Id.*; *see* Kathryn Kran, *Following the Trail: As Enron Inquiry Intensifies, Midlevel Players Face Spotlight*, WALL ST. J., Apr. 30, 2002, at A1.

52. *Id.*

53. *Id.*

54. *Id.*

55. *See* 148 CONG. REC. S6551 (daily ed. July 10, 2002) (statement of Sen. Edwards).

56. *See* Ellen Joan Pollock, *Limited Partners: Lawyers for Enron Faulted its Deals, Didn't Force Issue/Vinson & Elkins Rejects Idea Firm Should Have Taken Doubts to Client's Board/Face to Face with Fastow*, WALL ST. J., May 22, 2002, at A1.

57. *Id.*

58. *Id.*

59. *See* MODEL CODE OF PROF'L RESPONSIBILITY (1908), *reprinted in* THOMAS D. MORGAN & RONALD D. ROTUNDA, MODEL RULES OF PROFESSIONAL CONDUCT AND OTHER SELECTED

requirement, by itself, would have forced the firm's hand and ultimately, lead to less destruction and mayhem.

D. SARBANES-OXLEY ACT OF 2002 IS ENACTED

Although most of the fraud perpetrated by these corporate actors involved the assistance of accounting magicians rather than corporate counsel, attorneys were at the scene of the crime and could have done something to thwart the extent of such wrongdoing.[60] Accordingly, and although the focus of Sarbanes-Oxley is aimed at the accounting profession, Section 307 specifically targets the "Implementation of Standards of Professional Conduct for Attorneys."[61] As originally drafted, however, the Act failed to include any provisions relating to the professional responsibilities of attorneys.[62] However, after much public outcry including a letter drafted by forty prominent scholars to the Commission,[63] Senator John Edwards drafted a similar letter to the Commission urging it to take action to regulate the conduct of attorneys.[64] After the Commission responded by stating that it would not take any action on the matter absent congressional action, Senator Edwards responded by drafting an amendment to Senate Bill 2673 that eventually served as the predecessor to Section 307 of the Act.[65] Ultimately, Congress

STANDARDS (2002); *see also* Judith Burns, *Attorney Faces a Paradox in the SEC's Conduct Rules*, WALL ST. J., Aug. 19, 2003, at C1 (stating that the Model Rules of Professional Conduct were amended in August 2003 to respond to the Enron catastrophe).

60. *See* 148 CONG. REC. S6551 (daily ed. July 10, 2002) (statement of Sen. Edwards) ("If executives and/or accountants are breaking the law, you can be sure that part of the problem is that the lawyers who are there are involved and are not doing their jobs.").

61. *See* McManamon, *supra* note 46, at 174-75_(stating that in drafting the Act, the legislature "[s]ought to address the entire potpourri of grievances against corporate America"). *See generally* Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8185 (Jan 29, 2003), *available at* http://www.sec.gov/rules/final/33-8185.htm (last visited Oct. 31, 2004); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 307, 116 Stat. 745 (2002) (codified as amended at 15 U.S.C. § 7245 (2002)) (Public Accounting Oversight Board is established under Title I; the serious problem of auditor independence is addressed under Title II; Corporate responsibility is addressed under Title III; Title IV addresses enhanced financial disclosure requirements; Titles V through XI focus on the miscellaneous issues concerning the penalties for violations).

62. 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?*, 56 OKLA. L. REV. 461, 464 (2003).

63. Bruce Rubenstein, *Lawyers Debate Line Between Attorney and Whistleblower*, 12 CORP. LEGAL TIMES 28 (2002).

64. 148 CONG. REC. S5652-53 (daily ed. June 18, 2002) (letter from John Edwards, Senator, 107th Cong., to Harvey Pitt, Chairman, Securities and Exchange Commission (June 18, 2002)).

65. Letter from David Becker, General Counsel, U.S. Securities and Exchange Commission, to Richard W. Painter, Professor of Law, University of Chicago (Mar. 28, 2002), *available at*

sent the Act to President George W. Bush who signed it into law on July 30, 2002.[66] Section 307 required the Commission to promulgate rules within 180 days of the enactment of the Act, establishing "minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers . . . ."[67] Specifically, Section 307, although brief, required the Commission to issue a rule:

> [R]equiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty . . . to the chief legal counsel or the chief executive officer of the company; and if the counsel or officer does not appropriately respond . . . requiring the attorney to report the evidence to the audit committee of the board of directors . . . or to an independent board of directors.[68]

With this directive in mind, the Commission set off to draft Part 205.

III. FINAL RULE, PART 205: THE COMMISSION TAKES ACTION & PROPOSES NOISY WITHDRAWAL

A. CURRENT LANDSCAPE: PART 205 TAKES EFFECT

On January 23, 2003, nearly one year after the Act was sent to the S.E.C., the Commission adopted final rule Part 205 to implement Section 307.[69] The rule only applies to attorneys "appearing and practicing before the Commission."[70] Basically, the pertinent provisions adopted by the

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http://www.abanet.org/buslaw/corporateresponsibility_relatedmat.html (last visited Oct. 28, 2004). *See* 148 CONG. REC. S6551 (daily ed. July 10, 2002); 148 CONG. REC. S6778 (daily ed. July 15, 2002).

66. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 307, 116 Stat. 745, 784 (2002). *See* George W. Bush, Remarks at Signing of Sarbanes-Oxley Act of 2002 (July 30, 2002), *available at* http: www.whitehouse.gov/news/releases/2002/07020020730.html (last visited Oct. 28, 2004).

67. *Id.*

68. *Id.*

69. Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8185 (Jan 29, 2003), *available at* http://www.sec.gov/rules/final/33-8185.htm (last visited Oct. 31, 2004). At this same time, the Commission decided to delay acting on its noisy withdrawal proposal until additional comments were received. *See also* Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. § 205 (2003) (Part 205 is divided into seven categories: 205.1 covers its purpose and scope; 205.2 covers the definitions; 205.3 covers the up-the-ladder reporting; 205.4 covers the responsibilities of supervising attorneys; 205.5 covers the responsibilities of a subordinate attorney; 205.6 covers sanctions and discipline; 205.7 states that there is no private right of action).

70. 17 C.F.R. § 205.2(a) defines "appearing and practicing before the Commission" as:

> (i) Transacting any business with the Commission, including communications in any form; (ii) Representing an issuer in a Commission administrative proceeding or in connection with any Commission investigation, inquiry, information request, or subpoena; (iii) Providing advice in respect of the United States securities laws or the

Commission "require an attorney to report evidence of a material violation, determined according to an objective standard, 'up the ladder' within the issuer to the chief legal counsel or the chief executive officer of the company."[71] If neither of these individuals takes appropriate action, the rule requires the attorney "to report evidence to the audit committee, another committee of independent directors, or the full board of directors."[72] Ultimately, where the attorney, after reporting to the highest rung on the corporate ladder, still fails to receive an appropriate response, the rule permits the attorney, without the client's consent, to disclose confidential information to the Commission to the extent the attorney reasonably believes necessary: (1) "to prevent the issuer from committing a material violation that is likely to cause substantial financial injury to the financial interests or property of the issuer or investors;"[73] (2) to prevent the issuer from "committing perjury," "suborning perjury" or from "committing any act that is likely to perpetrate a fraud upon the Commission;"[74] (3) "to rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interests or property of the issuer or investors . . . ."[75]

Although this rule adds the long needed up-the-ladder reporting requirement to a corporate attorney's repertoire, it leaves the ultimate decision of withdrawal and disclosure to the discretion of the attorney.[76] This decision to leave the attorney with ultimate determination of the best course of action, emphasizes the value of a fact specific inquiry in each case, rather than a *per se* type requirement in every case.[77] Accordingly,

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> Commission's rules or regulations thereunder regarding any document that the attorney has notice will be filed with or submitted to, or incorporated into any document that will be field with or submitted to, the Commission, including the provision of such advice in the context of preparing, or participating in the preparation of, any such document; or (iv) Advising an issuer as to whether information or a statement, opinion, or other writing is required under the United States securities laws or the Commission's rules and regulations thereunder to be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the Commission.

17 C.F.R. § 205.2(a).

71. SEC Adopts Attorney Conduct Rule Under Sarbanes-Oxley Act, Release No. 2003-13, *available at* http://www.sec.gov/news/press/2003-13.html (last visited Oct. 28, 2004).

72. *Id.*, *available at* http://www.sec.gov/news/press/2003-13.html.

73. *Id.*, *available at* http://www.sec.gov/news/press/2003-13.html; *see also* 17 C.F.R. § 205.3(d) (2) (i).

74. 17 C.F.R. § 205.3 (d)(2)(ii).

75. § 205.3 (d)(2)(iii).

76. § 205.3 (d)(2) (stating that the attorney "may reveal" confidential information to the Commission).

77. In the corporate context, withdrawal is often the corporate attorney's only option, but it is important that this be an option and not a mandate.

this rule appropriately balances the competing interests; corporate compliance with securities laws and the well being of long standing attorney-corporate client relationship, which is founded on the confidentiality of communications.[78]

B. S.E.C. PROPOSAL: NOISY WITHDRAWAL

Although the Commission issued final rule Part 205 in January of 2003, it delayed acting on the noisy withdrawal proposal, so that it could conduct further inquiry into its perceived effects. A few days after the implementation of the final rule, the Commission issued Release Number 33-8186, in which it discussed noisy withdrawal, the comments received, the costs and benefits of the proposal and three possible alternatives.[79] As proposed, this provision seeks to amend Part 205.3(d), which currently extends the attorney discretion in determining whether to disclose client confidences.[80] The provision mandates withdrawal from representation by outside counsel, disaffirmance of previous work and notification to the Commission where the board of directors fails to provide the attorney with an appropriate response.[81] The Commission stated that this proposal is intended to "further the purposes of the up-the-ladder requirement and enhance investor confidence in the financial reporting process."[82] Specifically, the proposal distinguishes between "ongoing" violations and prior violations that are not "ongoing."[83] Additionally, the proposal distinguishes between "retained" or outside counsel and "employed" or in house counsel. Where the material violation is "ongoing," an in house counsel is required to notify the Commission in writing that he or she intends to disaffirm some opinion filed with the Commission on behalf of the issuer and then must "promptly disaffirm" such opinion.[84] Retained

78. *See* Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8185, at 3 (Jan 29, 2003), *available at* http://www.sec.gov/rules/final/33-8185.htm (last visited Oct. 31, 2004) (stating that the "final rule strikes an appropriate balance between our initial rule proposal on up-the-ladder reporting and the various views expressed by commenters while still achieving this important goal."); *see also supra* Section IV: Implications.

79. Securities and Exchange Commission, Implementation of Standards of Professional Conduct for Attorneys, Release No. 33-8186 (Jan. 29, 2003), *available at* http://www.sec.gov/rules/proposed/33-8186.htm (last visited Oct. 31, 2004).

80. *Id.* Under the current rule, withdrawal is not mentioned. Accordingly, the governing Model Rule in the attorney's jurisdiction would control.

81. *Id.*

82. *Id.* Increasing investor confidence, but at what cost; the erosion of the attorney-corporate client relationship.

83. *Id.*

84. *Id.*

counsel, like in house counsel, is required to "promptly disaffirm" any opinions submitted to the Commission.[85] However, retained counsel is also required to "withdraw forthwith from representing the issuer."[86] Additionally, within one business day after withdrawing, retained counsel is required to "give written notice to the Commission of the attorney's withdrawal, indicating that the withdrawal was based on professional considerations."[87] With regard to material violations that have already occurred and are not ongoing, the proposal places the decision to notify the Commission and disaffirm the opinion in the hands of the attorney, irrespective of whether in house or retained counsel is involved.[88] Additionally, the proposal provides retained counsel with the option to withdraw, but does not require withdrawal as with ongoing violations.[89]

In comparing Part 205 with the proposed amendment, it is evident that the proposal leans far more toward reforming corporate governance than preserving the sanctity of the attorney-corporate client relationship.[90] The requirement of mandatory disclosure and withdrawal where retained counsel reasonably believes that a material violation is ongoing is not in accord with the long-standing attorney-client privilege or any of its exceptions.[91] Additionally, it is likely to have an adverse effect on the attorney-corporate client relationship when the corporate client realizes that its communications may be disclosed, subjecting it to severe legal ramifications. After recognizing the proposal's major drawbacks, the Commission issued alternative proposals aimed at more appropriately balancing the competing interests at play.

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85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

90. *Compare id.* at 6-8 *with* 17 C.F.R. § 205.3 (d)(2)(iii). In one respect the proposal is similar to current Part 205. Specifically, its treatment of non-ongoing material violations is similar to Part 205.3 (d) (2) (iii), as disclosure of client confidences is not required.

91. MORGAN & ROTUNDA, *supra* note 59. Attorneys have always had the option to disclose client confidences where the lawyer reasonably believes the client is going to commit a criminal act that is likely to result in imminent death or substantial bodily harm. Additionally, most jurisdictions have recently expanded this permissive disclosure exception to instances where the client is committing fraud.

C. S.E.C. PROPOSES ALTERNATIVES TO NOISY WITHDRAWAL

In response to the critical comments received, the Commission proposed and solicited comments on three alternative proposals.[92] The scope of these alternatives focus on the problems associated with requiring attorneys to disclose client confidences to the Commission.[93] All the alternatives require the attorney to withdraw from representing the issuer.[94] As such, each proposal takes effect from the point of withdrawal.

• *Alternative number one* requires the attorney to provide written notice of his withdrawal to the issuer where the attorney is not provided with an appropriate response.[95]

• *Alternative number two* requires the attorney to provide written notice of his withdrawal to the issuer, as with alternative number one, but then requires the issuer to inform the Commission that the attorney withdrew for professional considerations.[96]

• *Alternative number three* requires the attorney to provide written notice of his withdrawal to the issuer, as with alternatives one and two, but then takes the permissive approach as under Part 205 and permits the attorney to disclose to the Commission that he has withdrawn for professional considerations.[97]

Although these alternatives are minor improvements upon the noisy withdrawal proposal, all three, nonetheless, fall short of complementing Part 205 in any beneficial manner. All three proposals still mandate attorney withdrawal, which inevitably results in a client who is subsequently making decisions without legal advice.[98] Leaving the attorney with the discretion to withdraw provides the attorney with the option to assess whether his presence may nonetheless still prove to be beneficial to the future decision making of the corporate client, despite its present lapse in judgment. Additionally, alternative number two requires the issuer to report the attorney's withdrawal, which acts in precisely the same manner as noisy withdrawal, with the technical exception of sparing

92. Securities and Exchange Commission, Implementation of Standards of Professional Conduct for Attorneys, Release No. 33-8186, at 10 (Jan. 29, 2003), *available at* http://www.sec.gov/rules/proposed/33-8186.htm (last visited Oct. 31, 2004).

93. *Id.* at 10-16.

94. *Id.*

95. *Id.* at 10-13.

96. *Id.* at 13-15.

97. *Id.* at 15-16.

98. *Id.* at 10-16.

the attorney from making the disclosure.[99] Alternative number three provides the attorney with the discretion to disclose as under Part 205, but because of its mandatory withdrawal requirement, it too, falls short.[100] For the most part, these alternatives offer very little to the attorney-corporate client relationship and result in transforming the attorney into a "rat."[101] The requirement that the attorney provide written notification to the corporate client serves as an evidentiary function and may help improve corporate governance. With that exception, however, and as will be subsequently demonstrated, Part 205 should remain intact without the noisy withdrawal amendment or any of these alternative proposals.

IV. IMPLICATIONS: ISSUES RELATING TO PART 205

A. IMPACT OF PART 205

Part 205 implements the long debated up-the-ladder reporting requirement, and in "rare"[102] situations where the highest authority of the corporation refuses to respond appropriately, permits the attorney to disclose a past, present and/or a future material violation that has "caused," "may cause" or "is likely to cause substantial injury to the financial interest or property of the issuer or investors." [103] As groundbreaking as all this sounds, a corporate attorney returning from a two year sabbatical in September of 2004 might wonder why the Part 205 rules generated so much controversy.[104] Practically speaking, the corporate general counsel's confusion is understandable. Although the rule mandates additional

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99. *Id.* at 13-15. Practically speaking, the issuer is not likely to see much of a distinction between requiring it to notify the Commission or requiring its trusted attorney to do so.

100. *Id.* at 15-16.

101. The term "rat" is often used to describe those who disclose personal or confidential information to authorities. If implemented, "noisy withdrawal" is likely to add this slur to the list of phrases used to refer to attorneys.

102. *See* Securities and Exchange Commission, Implementation of Standards of Professional Conduct for Attorneys, Release No. 33-8186, at 6 (Jan. 29, 2003), *available at* http://www.sec.gov/rules/proposed/33-8186.htm (last visited Oct. 31, 2004) (acknowledging that the proposal addresses the "rare situation" where an attorney reasonably believes an issuer has not made an appropriate response).

103. 17 C.F.R. § 205.3 (d)(2)(i) – (iii). Permissive disclosure has been debated since the 1980's. *See* Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8185, at 30 (Jan. 29, 2003), *available at* http://www.sec.gov/rules/final/33-8185.htm (last visited Oct. 31, 2004) (stating that Part 205.3 (d) (2) "corresponds to the ABA's Model Rule 1.6 as proposed by the ABA's Kutak Commission in 1981-1982 and by the ABA's Commission of Evaluation of the Rules of Professional Conduct ('Ethics 2000 Commission') in 2000, and as adopted in the vast majority of the states").

104. Karl A. Groskaufmanis, *Climbing "Up the Ladder": Corporate Counsel and the SEC's Reporting Requirement for Lawyers*, 89 CORNELL L. REV. 511, 520 (2004).

reporting requirements upon attorneys representing public companies, the reality is that many states have similar rules in place, and even where the state rules did not *mandate* up-the-ladder reporting, many corporate attorneys nevertheless followed it.[105] Additionally, the pre-2003 revision of the Model Rules of Professional Conduct suggested similar up-the-ladder reporting requirements, though not making them mandatory.[106] More recently, however, most states adopted the revised 2003 Model Rules of Professional Conduct, which adopted a *mandatory* up-the-ladder reporting requirement for all attorneys, not just those representing public companies.[107] Accordingly, this federal mandate is likely to add muster to these requirements, especially in the securities context, but any notion that these rules will dramatically affect the attorney-corporate client relationship, should be questioned.[108]

1. Part 205: Its Impact on Investors & Corporate Governance

The rule was designed "to protect investors and increase their confidence in public companies by ensuring that attorneys who represent issuers report up the corporate ladder evidence of material violations by their officers and employees."[109] Whether the rule will actually protect

105. *See id.* (stating that the new rules mandate precisely the conduct that most in-house counsel already expect from both peers and outside counsel). In its adopting release, the Commission emphasized that most of its requirements were consistent with the standards to which many lawyers are subject to already.

106. *See* MORGAN & ROTUNDA, *supra* note 59 (stating that where a corporate actor intends to act in a manner which is detrimental to the organization in that it may cause "substantial injury," the attorney "shall proceed in the best interests of the corporation." Such further conduct "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 the higher authority in the organization . . ." including the highest authority within the organization). Furthermore, Comment 16 to Model Rule 1.16 stated that none of the model rules "prevents the lawyer from giving notice of the withdrawal, and the lawyer may also withdraw or disaffirm any opinion, document, affirmation, or the like." *Id.* at 1.6, Editors' Note (citing the ABA MODEL CODE OF PROF'L CONDUCT R. 1.6, cmt. 14 (2003)).

107. *See* MORGAN & ROTUNDA, *supra* note 59. *See also* Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8185, at 30, 32-33 (Jan. 29, 2003), *available at* http://www.sec.gov/rules/final/33-8185.htm (last visited Oct. 31, 2004) (stating that the "vast majority" of jurisdictions already permit or require the disclosure of illegal conduct).

108. *See* Groskaufmanis, *supra* note 104, at 521-22 (stating that its effects will be minimal); Ryan Morrison, Note, *Turn Up the Volume: The Need for "Noisy Withdrawal" in a Post Enron Society*, 92 KY. L.J. 279, 303 (2003) (stating that thirty-seven states provide attorneys with the option to disclose information to prevent a client from committing a fraudulent act and four states require the attorney to disclose the fraud).

109. *See* Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8185, at 43 (Jan. 29, 2003), *available at*

investors anymore than pre-existing law is unknown, but what may be said is that investor confidence has increased and is likely to continue to increase.[110] Additionally, the rule may improve the accountability and governance of corporations that are subject to the rule. By requiring up-the-ladder reporting, the rule assists in ensuring that evidence of material violations will be addressed and remedied within the corporate structure, "rather than misdirected or 'swept under the rug.'"[111] Furthermore, the rule should "deter corporate misconduct and fraud" by sending a clear signal to management that any evidence of malfeasance will be reported to the highest levels of the corporation.[112] Ultimately, with complementing state professional responsibility laws, this rule is likely to accomplish its goals without publicly airing the corporation's violations in every instance, which would instantaneously affect the perception of the company.[113]

2. Part 205: Its Impact on the Attorney-Corporate Client Relationship

The rule is likely to positively shape the role of corporate counsel within the corporate structure without infringing on the sanctity of the attorney-corporate client relationship because the rule is narrowly tailored in its scope and directed solely to attorneys representing public companies.[114] The rule reinforces the general proposition that the attorney "owes his or her professional and ethical duties to the issuer as an organization."[115] Although corporate attorneys are aware of this responsibility, the realities of the corporate structure often cause turmoil for attorneys attempting to fulfill their professional obligations. By federalizing this professional requirement, management may become more

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http://www.sec.gov/rules/final/33-8185.htm (last visited Oct. 31, 2004).

110. Investor confidence is difficult to quantify, however, as the stock market has increased in value since the months following the market's collapse. It has been assumed that investors have more confidence in the management of these companies and the supervision by the Commission.

111. *See* Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8185, at 44 (Jan. 29, 2003), *available at* http://www.sec.gov/rules/final/33-8185.htm (last visited Oct. 31, 2004).

112. *See id.*

113. Comments of the ABA, Re: Implementation of Standards of Conduct for Attorneys, at 12-13 (April 2, 2003) *available at* http://www.sec.gov/rules/ proposed/s74502/aba040203.htm (last visited Oct. 31, 2004) (stating that the requirements under Part 205 "complement Model Rule 1.13 (some version of which is currently in effect in virtually all states), protect the public interest and recognize the needs of both investors and issuers, as well as those of attorneys who must comply." "We believe the combination of the up the ladder reporting requirements and permissive reporting out adopted by the Commission (with the changes we have suggested), coupled with the enhanced corporate governance systems being put in place, accomplish the Act's objectives of protecting investors and serving the public interest.").

114. *Id.*

115. 17 C.F.R. § 205.3 (a); *see also* MODEL RULES OF PROF'L CONDUCT 1.13 (2003).

understanding of the role of corporate counsel, as the attorney is now acting pursuant to federal law rather than what may have been perceived as an aspiration under the rules of professional conduct. Additionally, by requiring attorneys to take pro-active measures rather than allowing the attorney to sit idly by after the client discounts his concerns, the rule encourages diligence and responsiveness on the part of corporate counsel. As evidenced, it is clear that this rule benefits the corporate client by ensuring that its interests are the primary consideration of the corporate actors, but how does this rule affect the attorneys involved?

Part 205 positively affects attorneys representing public companies. It provides attorneys with increased "guidance and clarity" regarding their ethical obligations if confronted with evidence of malfeasance by their clients.[116] In addition, the rule does not impair the attorney's long standing duty to advocate zealously, nor does it infringe on the attorney-corporate client privilege, as the up-the-ladder reporting requirement pertains to internal reporting rather than reporting to the Commission, as proposed under noisy withdrawal.[117] Additionally, counsel has increased leverage in advising the corporate client as a result of having discretion over whether to disclose corporate malfeasance to the Commission. Further, the negative connotation associated with mandatory disclosure of counsel acting as an extension of the government is removed. Finally, the attorney's increased role is not likely to subject him to increased malpractice insurance rates as there is no private right of action for non-compliance and the rule provides a safe harbor where the attorney acts in "good faith."[118]

It is evident that Part 205 furthers the legal profession's long-standing tradition as advisor to the client. As such, the rule re-enforces the weight afforded to the sanctity of the attorney-corporate client privilege by placing the ultimate determination of whether to disclose client confidences in the hands of the representing attorney rather than arbitrarily mandating disclosure. Additionally, the rule positively contributes to the atmosphere of complete confidentiality by ensuring that in almost all cases, the client's confidences will remain confidential unless the representing attorney believes disclosure is necessary. In a practical sense, the up-the-ladder reporting requirement equates with a "power check" on the individual players within the organization, ultimately ensuring that their individual

116. Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8185, at 44 (Jan. 29, 2003), *available at* http://www.sec.gov/rules/final/33-8185.htm (last visited Oct. 31, 2004).

117. *Id.* at 44, *available at* http://www.sec.gov/rules/final/33-8185.htm (last visited Oct. 31, 2004).

118. 17 C.F.R. § 205.6 (c).

interests are aligned with those of the team or corporate client.[119] When this rule is considered in light of existing state laws and recent amendments to the Model Rules of Professional Conduct, it merely puts some federal varnish on a state requirement.[120]

V. IMPLICATIONS: ISSUES RELATING TO NOISY WITHDRAWAL

A. S.E.C. AUTHORITY TO IMPLEMENT NOISY WITHDRAWAL

Before analyzing the likely impact of this proposal, it is necessary to address whether the Commission has the authority to enact noisy withdrawal. In *Ernst & Ernst v. Hochfelder*, the Supreme Court cautioned the S.E.C. in its rulemaking authority.[121] The Court stated that the "rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law, but is instead only the power to adopt regulations to carry into effect the will of Congress as expressed by the statute."[122] From the Court's statement, it is evident that an agency's authority is limited to the actual authority expressed in the text of the statute. Accordingly, as applied to the instant matter, it is clear that the S.E.C. lacks authority to act outside the express will of Congress.

Under Section 307 of Sarbanes-Oxley, the Commission has the authority to issue a rule "requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty . . ." up the corporate ladder until an appropriate response is received.[123] From this explicit language, it is abundantly clear that the Commission has the

119. "Power check" is a phrase coined by the author. As used above, "check" refers to the ability to have some independent review of an individual actor's performance. A corollary may be drawn to the "checks and balances" system we have in the United States government.

120. Karl A. Groskaufmanis, *Climbing "Up the Ladder:" Corporate Counsel and the SEC's Reporting Requirement for Lawyers*, 89 CORNELL L. REV. 511, 521-22 (2004). One practitioner suggests that although this rule is unlikely to have any substantial effects, as thirty-seven states have similar requirements, it may still nonetheless significantly increase "the opportunities for the Commission and its enforcement staff to second-guess judgments made by counsel when issuer or their agents violate the federal securities laws." In addition to assessing whether the lawyers involved violated the laws, the Commission's staff will weigh whether the lawyers reported the violators in compliance with Part 205.

121. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976).

122. Comments of the Ass'n. of the Bar of the City of New York, Re: Implementation of Standards of Conduct for Attorneys, 4 (Apr. 7, 2003), *available at* http://www.sec.gov/rules/proposed/s74502/abcny040703.htm (last visited Oct. 31, 2004) (citing *Ernst*, 425 U.S. at 214).

123. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 307, 116 Stat. 745, 784 (2002).

authority to implement Part 205 as it stands.[124] However, it is less clear whether the Commission has the authority to implement the noisy withdrawal proposal, as the statute does not expressly mention mandatory withdrawal or disclosure. A further analysis of the statute reveals ambiguity as to whether the commission may act outside its express authority, as it states that the Commission may adopt additional rules that are "in the public interest and for the protection of investors."[125] As such, a review of the legislative debate relating to this statute is appropriate in order to determine whether Congress supports mandatory withdrawal and disclosure by corporate counsel.

The floor debate of the "Edwards-Enzi amendment," which eventually became Section 307 of the Act, suggests that the noisy withdrawal proposal radically departs from congressional intent and may in fact be contrary to the "express and unequivocal intention" of the main proponents of Section 307.[126] Senator Enzi, a co-sponsor of the amendment, stated that "[t]he amendment that I am supporting would not require the attorneys to report violations to the [Commission], only to corporate legal counsel or the CEO and ultimately to the board of directors . . . ."[127] In further opposition to any external disclosure, Senator Sarbanes stated: "It is my understanding that this amendment, which places responsibility upon the lawyer for the corporation to report up the ladder, only involves going up within the corporate structure. [The attorney] doesn't go outside the corporate structure."[128] In response to Senator Sarbanes' statement, Senator Edwards responded and stated, "the only obligation this amendment creates is the obligation to report to the clients, which begins with the chief legal officer, and, if that is unsuccessful, then to the board of the corporation.[129] There is no obligation to report anything outside the client – the corporation."[130] As if congressional intent is not abundantly clear from these statements, Senator Sarbanes concluded this exchange by stating, "I think that this is an important point. I simply asked the question in order to *stress* the fact that this is how the amendment works."[131] It is evident from the legislative record that the actual language

124. *See id.; see also* 17 C.F.R. § 205.3.

125. *Id.*

126. Comments of Jones Day, Re: Implementation of Standards of Conduct for Attorneys (Apr. 7, 2003), *available at* http://www.sec.gov/ rules/proposed/s74502/jonesday040703.htm (last visited Oct. 31, 2004).

127. *See id.* (citing CONG. REC. S6557 (July 10, 2002)).

128. *Id.*

129. *Id.*

130. *Id.*

131. *See id.* (emphasis added).

found in the text of Sarbanes-Oxley is the result of skillful crafting. The express language does not mention noisy withdrawal, and the legislative record appears to indicate Congress' aversion to such a requirement. Accordingly, the "will" of Congress is evident.[132]

In addition to the legislative record, the Commission commented on its authority to issue rules of this nature, possibly demonstrating its purposeful intention to act without authority. On March 28, 2002, prior to the implementation of Part 205, David Becker, General Counsel at the Commission, stated in response to a letter urging Commission action, that any decision to address attorney misconduct through the S.E.C., rather than through state ethics rules, "should be undertaken in the context of Congressional legislation, as opposed to agency rulemaking."[133] In defense of the Commission's inaction, the General Counsel further posited: "There 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."[134]

Additionally, nine months later, the Commission stated in its December 2, 2002 Release, that "this proposal went beyond its *express* directive from Congress and set a higher standard of compliance than the up-the-ladder reporting."[135] From these statements, it is unequivocally clear that the Commission is intentionally acting in excess of its authority, "as expressed by the [plain language of the] statute," as expressed by members of Congress during the floor debate, and as condemned by the Supreme Court in *Ernst & Ernst v. Hochfelder*.[136]

The Commission's decision to act in contravention of its authority

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132. *Ernst & Ernst*, 425 U.S. at 214 (1976).

133. 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?*, 56 OKLA. L. REV. 461, 469 (2003) (citing Letter from David Becker, General Counsel, U.S. Securities and Exchange Commission, to Richard W. Painter, Professor of Law, University of Chicago (Mar. 28, 2002), *at* http://www.abanet.org/buslaw/corporateresponsibility /responsibility_relatedmat.html) (last visited Oct. 31, 2004) (addressing a letter urging the Commission to amend Rule 102(e)).

134. Letter from David Becker, General Counsel, U.S. Securities and Exchange Commission, to Richard W. Painter, Professor of Law, University of Chicago (Mar. 28, 2002), *at* http://www.abanet.org/buslaw/ corporateresponsibility/responsibility_relatedmat.html (last visited Oct. 31, 2004).

135. Ryan Morrison, Note, *Turn Up the Volume: The Need for "Noisy Withdrawal" in a Post Enron Society*, 92 KY. L.J. 279, 296 (2003-04) (citing Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71,670, 71,689 (proposed Dec. 2, 2002) (to be codified at 17 C.F.R. pt. 205) (emphasis added)).

136. *See Ernst & Ernst*, 425 U.S. at 214 (1976).

reflects its prudent aim of protecting investors. However, the Commission, in its attempt to cleanse corporate America, has proposed a rule, which would extend its reach into the protected sphere of the attorney-corporate client relationship, thereby transforming the attorney into a Division of Enforcement staff member.[137] This proposal is fundamentally unsound and is an inappropriate exercise of the Commission's granted regulatory authority pursuant to the Act because its purpose and effect are not in "regulating the professional conduct of the attorney," but in strengthening its "policing power over the client."[138] Accordingly, in reviewing the express language of the statute, the legislative record, Supreme Court precedent, and the Commission's own statements on the subject, it is evident that noisy withdrawal exceeds the Commission's granted authority and accordingly, should not be implemented.[139] To do otherwise, would be

137. *See generally* Comments of the Ass'n. of the Bar of the City of New York, Re: Implementation of Standards of Conduct for Attorneys, (April 7, 2003) *at* http://www.sec.gov/rules/proposed/s74502/abcny040703.htm (last visited Oct. 31, 2004) (stating that it may be legitimately asked why a government agency charged with the detection of wrongdoing seeks to discharge that responsibility by forcing lawyers representing the potential wrongdoer to disclose client confidences. "If the issue is the lack of practical enforcement ability on the part of the SEC, it seems disingenuous to remedy that deficiency in the guise of lawyer ethics."); Richard Hall, *Why the SEC is Unfit to Regulate Lawyers*, 21 INT'L FIN. L. REV. 16 (2002); McManamon, *supra* note 46, at 163.

138. Comments of Jones Day, Re: Implementation of Standards of Conduct for Attorneys (April 7, 2003) *at* http://www.sec.gov/ rules/proposed/s74502/ jonesday040703.htm. (last visited Oct. 31, 2004). *See generally* Comments of Sullivan & Cromwell, Re: Implementation of Standards of Conduct for Attorneys, (Dec. 18, 2002), *at* http://www.sec.gov/rules/proposed/s74502/sullivanc1.htm (last visited Oct. 31, 2004). Additionally, many opponents of noisy withdrawal assert that it raises issues of federalism. Undeniably, noisy withdrawal raises important philosophical questions concerning federalism. Proponents of federalism essentially assert that regardless of the proposal's effect on the attorney-corporate client relationship, the decision to implement such a radical rule should be left in the hands of each sovereign state, rather than uniformly decided by the federal government. Additionally, one cannot overlook the simple fact that the legal profession has always been a self-regulated industry and that such regulation has always come from local practitioners, not Washington legislators and rule-making bodies. In sum, although these concerns are important, they are issues best left for academics, as practitioners must deal with the practical effects of this rule, if implemented, rather than belabor over its constitutional legitimacy.

139. *See* § 17 C.F.R. § 201.102 (e) (1) (i)-(iii) (2002). The Commission has independent authority to discipline attorneys practicing before it that do "not possess the requisite qualifications to represent others" or are "lacking in character or integrity" or "willfully violated" a federal securities law. *Id.* As such, the Commission may ensure that attorneys are properly advising and counseling their clients by deterring improper actions through the use of Rule 102(e). However, this enforcement mechanism requires the Commission to be vigilant in its efforts, rather than merely dictating its responsibilities to others, such as attorneys as proposed under noisy withdrawal. *See* Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8186 (Jan. 29, 2003). Additionally, the Commission has been granted authority to sanction attorneys for non-compliance with the provisions of Part 205. *See* 17 C.F.R. § 205.6 (2002).

contrary to express Supreme Court precedent.[140]

B. PROPONENTS OF NOISY WITHDRAWAL: CONCEALING THE TRUTH TO FURTHER THEIR CAUSE

Aside from the issue relating to the Commission's authority to implement its proposal, proponents of noisy withdrawal assert that it is desperately needed to deter fraud and corporate wrongdoing.[141] In an attempt to garnish emotional support in favor of the proposal, proponents attempt to structure the controversy as one of Good versus Evil, where supporters of noisy withdrawal are depicted as those favoring the public interest and those who are in opposition to the proposal are depicted as supporters of corporate fraud and wrongdoing.[142] In furtherance of their cause, proponents attempt to conceal the true effects of the proposal by basing their arguments on theoretical or untenable assumptions.[143] In order to fully exemplify these points, a brief examination of these illusory arguments is necessary.

Critics of the proposal assert that the implementation of noisy withdrawal risks destroying the sanctity of the attorney-client privilege, as the attorney is required to disclose client confidences.[144] In response, Professor Geoffrey Hazard, a proponent of the proposal, asserts that noisy "withdrawals do not reveal the content of information the lawyer has gained in the course of the representation"[145] because "[i]n theory, an attorney could withdraw from representing a client, disaffirm an S.E.C.

140. *Ernst & Ernst*, 425 U.S. at 214.

141. John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1316 (2003) (stating that deterrence and empowerment strategies need to be pursued in order to align gatekeepers incentives with those of investors). Coffee further states that the S.E.C. rules, such as noisy withdrawal, offer the best prospect for a relevant, precise response, which clearly alerts attorneys to their gatekeeping function.

142. Morrison, *supra* note 135, at 310 ("Supporters of noisy withdrawal believe that client confidentiality should be subservient to the prevention of fraud."); *see* Michael Schroeder, *Deals & Deal Makers: Some at SEC Rethink Lawyer Rules*, WALL ST. J., Jan. 21, 2003, at C7.

143. *See* 1 GEOFFREY C. HAZARD, JR. & WILLIAM HODES, THE LAW OF LAWYERING § 9.30 (3d ed. Supp. 2003) [hereinafter HAZARD].

144. *See generally* Comments of Jones Day, Re: Implementation of Standards of Conduct for Attorneys, (April 7, 2003), *at* http://www.sec.gov/ rules/proposed/s74502/ jonesday040703.htm; Comments of the Ass'n. of the Bar of the City of New York, Re: Implementation of Standards of Conduct for Attorneys, (April 7, 2003), *at* http://www.sec.gov/rules/proposed/ s74502/abcny040703.htm (last visited Oct. 31, 2004); Comments of Sullivan & Cromwell, Re: Implementation of Standards of Conduct for Attorneys, (Dec. 18, 2002), *at* http://www.sec.gov/rules/proposed/s74502/sullivanc1.htm (last visited Oct. 31, 2004); Comments of the ABA, Re: Implementation of Standards of Conduct for Attorneys, (April 2, 2003), *at* http://www.sec.gov/rules/ proposed/s74502/aba040203.htm (last visited Oct. 31, 2004).

145. *See* HAZARD § 9.30.

filing, and notify a third party of the withdrawal without disclosing any confidential information."[146] This assertion is illogical. Whether or not the attorney expressly discloses the information or implicitly does so is purely an academic question and is irrelevant to the corporate client who now has an investigation launched against it. Pursuant to noisy withdrawal, as proposed, the attorney must withdraw, disaffirm relevant opinions and notify the S.E.C. that such withdrawal is based on "professional considerations."[147] Although the attorney's lips do not explicitly release the client confidences, noisy withdrawal undeniably acts as the disclosure of client confidences because the Commission is notified and then directed to the disaffirmed documents, thereby raising a red flag. As can be gleaned from a simple analysis, the *practical* effect of the proposal is to disclose the content of client information.

Critics of the proposal also assert that by infringing on the sanctity of the attorney-client privilege, noisy withdrawal is likely to discourage clients from seeking counsel, thereby having a chilling effect on attorney-corporate client communications.[148] In response, well-respected Professor John Coffee asserts that the corporate attorney must play the role of "gatekeeper."[149] In support of his argument, Coffee asserts that disclosure of client confidences would not "chill desirable attorney-client communications," which are defined as those attorney-client communications leading up to the attorney's discovery of his client's fraud.[150] As such, Coffee contends that "it is the ex post inquiry [those communications after such fraud has been discovered] by the client of the attorney that is most likely to be chilled."[151] Albeit clever, this assertion like those preceding it rests upon two assumptions. Coffee assumes that "ex post communications" are less desirable than "ex ante communications."[152] Additionally, underlying Coffee's assertion is the premise that once the client disregards the provided legal advice, thereby forcing the attorney to conduct up-the-ladder reporting, the attorney has clearly lost his client's respect and may as well withdraw. On the contrary however, the reality is that ex post communications are just as valuable as ex ante communications because the corporate attorney, in this position,

146. Morrison, *supra* note 135, at 303.
147. Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8186 at 7 (Jan. 29, 2003).
148. McManamon, *supra* note 46, at 185.
149. Coffee, *supra* note 141, at 1307.
150. *Id.*
151. *Id.* at 1308.
152. *Id.* at 1307-08.

has the ability to either shape the client's future decisions and guide the client down the "yellow brick road" of legal compliance or the "road to perdition" where further fraud, cover-up and deception is inevitable.[153] Accordingly, and despite Coffee's statements to the contrary, desirable legal action may be accomplished through ex post communications, a desirable action that is likely to be chilled if noisy withdrawal is implemented. As demonstrated, proponents of noisy withdrawal gloss over the real effects of noisy withdrawal – its effects on the corporate attorney, the corporate client and the long recognized attorney-corporate client privilege – in order to further their cause.

C. NOISY WITHDRAWAL'S IMPACT ON THE ATTORNEY-CORPORATE CLIENT RELATIONSHIP

As briefly demonstrated above, noisy withdrawal, if implemented, poses serious threats to the sanctity of the attorney-corporate client relationship.[154] Specifically, it will erode the long time protection afforded to the attorney-corporate client privilege, impair zealous advocacy, deter clients from seeking counsel and inevitably, inflict serious financial destruction upon the corporate client.[155] As this proposal is at the heart of the debate, a more in depth analysis of its implications is crucial.

Public policy underscores the historical value afforded the attorney-corporate client privilege.[156] Its purpose rests upon the basic premise that

153. *See generally* WIZARD OF OZ (Metro Golden Mayer 1939); ROAD TO PERDITION (Dreamworks Pictures 2002) (movies used for entertainment purposes only).

154. Securities and Exchange Commission, Implementation of Standards of Professional Conduct for Attorneys, Release No. 33-8186, at 6 (Jan. 29, 2003), *available at* http://www.sec.gov/rules/proposed/33-8186.htm (last visited Oct. 31, 2004) (acknowledging that the proposal addresses the "rare situation" where an attorney reasonably believes an issuer has not made an appropriate response). One may ask why the Commission would want to risk destroying the sanctity of the attorney-client relationship for the "rare situation" of complete corporate irresponsibility. Briefly, the Commission's duties are not in accord with the duties of attorneys representing corporate clients. As such, it is inappropriate for the Commission to address professional standards of conduct for attorneys other than those mandated by the Sarbanes-Oxley Act of 2002.

155. *See* Comments of the ABA, Re: Implementation of Standards of Conduct for Attorneys, (Dec. 18, 2002), *at* http://www.sec.gov/rules/proposed/s74502/apcarlton1.htm (last visited Oct. 31, 2004) (stating that the Commission should exercise restraint in the regulation of lawyers, as it has traditionally in the past. The ABA then provides several reasons why the Commission should exercise restraint including issues of: federalism; the preservation of the attorney-client relationship; avoidance of the chilling effect on the zealous representation); *See generally Noisy Withdrawal: A Sneak Preview,* (Dec. 29, 2003), *at* http://www.corplawblog.com/archives/000309.html (last visited Oct. 31, 2004) (providing an example of how noisy withdrawal could affect the financial interests of a corporation).

156. David J. Beck, *The Legal Profession at the Crossroads: Who Will Write the Future*

attorneys may best represent the interests of their clients only if clients are free to reveal confidential information without fear that those confidences will be disclosed at a later time.[157] Implicit in this premise lies the understanding that clients will not disclose confidential information to their attorneys if there is a chance that it may be disclosed to third parties at a later time.[158] Accordingly, and as recognized by the Supreme Court in *Swidler & Berlin v. United States*, "the loss of evidence admittedly caused by the privilege is justified in part by the fact that without the privilege, the client may not have made the communications in the first place."[159]

Nevertheless, despite this long-standing privilege and the discretion most states have afforded to attorneys, the Commission's proposal mandates implicit disclosure of client confidences in all cases where the attorney fails to receive an appropriate response from the board.[160] Not only does this proposal violate the policy behind the attorney-client privilege, but such a requirement removes all discretion from the hands of the attorney. As a result, the attorney is forced to consider his personal interests, specifically, how the Commission may perceive his actions in an after the fact review, rather than the interests of his client.[161] By removing the safety net that confidentiality provides, the proposal may have the practical effect of impeding full and frank discussions between attorneys and their clients.[162] Additionally, not only may the client be less likely to disclose pertinent information because of the fear of prosecution, but the attorney's instincts may cause him to divert his attention away from fully

Governing the Conduct of Lawyers Representing Public Corporations?, 34 ST. MARY'S L.J. 873, 898 (2003).

157. *See* Kenneth J. Drexler, *Honest Attorneys, Crooked Clients and Innocent Third Parties: A Case for More Disclosure*, 6 GEO. J. LEGAL ETHICS 393, 394-95 (1992).

158. Duggin, *supra* note 39, at 859 (citing *Upjohn Co.*, 449 U.S. at 393, n.2) (acknowledging the impact that the attorney-client privilege has on whether or not a corporate client will consult with counsel).

159. Swidler & Berlin v. United States, 524 U.S. 399, 408 (1998).

160. Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8186 at 6-12 (Jan. 29, 2003) (citing the proposed noisy-withdrawal provision).

161. *See* Jan L. Handzlik & Stephen J. Connolly, *Playing a Dual Role*, 26 OCT. L.A. LAW. 30, 34-35 (2003) (stating that attorneys should be treated like umpires and accordingly should not have personal interests at stake). *See also* Groskaufmanis, *supra* note 104.

162. *See* Comments of Jones Day, Re: Implementation of Standards of Conduct for Attorneys (April 7, 2003), *at* http://www.sec.gov/ rules/proposed/s74502/ jonesday040703.htm (last visited Oct. 31, 2004) (stating that the proposal would "impede full and frank discussions between attorneys and their clients"); *see also* Comments of Sullivan & Cromwell, Re: Implementation of Standards of Conduct for Attorneys (Dec. 18, 2002), *at* http://www.sec.gov/rules/ proposed/s74502/sullivanc1.htm (last visited Oct. 31, 2004) (stating that the proposed rules would discourage corporate officials from sharing information with their attorneys).

investigating a matter, as his discovery of a questionable corporate act may inevitably require his withdrawal and disclosure.[163] As demonstrated, not only does this proposal risk destroying the sanctity of a long recognized privilege, but it is likely to have the practical effect of discouraging communication between client and counsel.

Additionally, by requiring disclosure of client confidences, the proposal forces attorneys to wear two hats in representing the corporate client: one of counsel and one of adversary.[164] As such, noisy withdrawal effectively makes "attorneys watchdogs or investigators required to second guess a client's decisions in order to protect their own interests, a role necessarily at odds with both the attorney's traditional role of trusted legal advisor and the attorney's ethical obligation of zealous representation."[165] The practical result is that the client will be less candid with their counsel and are likely to exclude counsel from discussions in which sensitive issues may arise.[166]

Furthermore, because the corporate attorney is less likely to be included in sensitive meetings and discussions, a potential result of noisy withdrawal is a corporate client who is in less compliance with the law post-noisy withdrawal then it was pre-noisy withdrawal.[167] The Supreme Court has recognized the import that the privilege has on encouraging open communications between client and counsel. In *Upjohn Co. v. United States*, the Court stated that without the attorney-corporate client privilege to rely upon, "the depth and quality of any [corporate] investigations to ensure compliance with the law would suffer even were they undertaken."[168] Accordingly, it is evident that there is a clear correlation between the presence of the privilege and the corporate client's willingness to disclose confidences to its counsel. As such, unless the Commission's goal is decreased corporate compliance, noisy withdrawal should not be implemented.

In addition to the dramatic consequences on the attorney-corporate client relationship, the effects emanating from the proposal could

163. McManamon, *supra* note 46, at 185.

164. *See* Comments of the Ass'n. of the Bar of the City of New York, Re: Implementation of Standards of Conduct for Attorneys(April 7, 2003) *at* http://www.sec.gov/rules/proposed/s74502/abcny040703.htm (last visited Oct. 31, 2004) (stating that the rule would result in a fundamental shift in the client's perception of the attorney from advisor to adversary).

165. Comments of Jones Day, Re: Implementation of Standards of Conduct for Attorneys, at 3 (April 7, 2003) *at* http://www.sec.gov/ rules/proposed/s74502/ jonesday040703.htm (last visited Oct. 31, 2004).

166. *Id.*

167. *Id.* at 4.

168. Duggin, *supra* note 39 at 859 (citing *Upjohn Co.*, 449 U.S. at 393, n.2).

negatively affect the financial well being of the corporate entity. First, any potential decrease in legal compliance may result in fraud, whether intentional or unintentional, being perpetrated upon the market and investors. Once the fraud is discovered, the practical result is decreased consumer confidence in the corporate governance of the company, which instantaneously affects stock price. Second, once a noisy withdrawal is effected, whether for good cause or not, it is extremely likely that the corporation's stock price will fall dramatically as stock holders attempt to unload the stock before more damaging news presents itself.[169] As has been demonstrated, the impact of noisy withdrawal may result in financial harm to the corporation, its investors and the economy.[170] In the end, the accomplishment of the underlying goals of the Act, such as improving corporate governance and the accountability of the board of directors, is less likely to be attained because issuers may either refrain from seeking legal advice on sensitive issues or withhold pertinent information when they do pursue legal consultation.[171] Noisy withdrawal is in clear conflict with the policy behind the attorney-client relationship and will likely fail to serve the interests of the Commission. Accordingly, no sound justification exists for its implementation.

VI. PROPOSED AMENDMENT TO PART 205

A. PART 205 IN ITS CURRENT FORM RECOGNIZES THE COMPETING INTERESTS

Part 205, as adopted, appropriately balances the competing goals of protecting investors and the market with preserving the sanctity of the long-standing attorney-corporate client relationship. Accordingly, noisy withdrawal or any of the proposed alternatives should not be implemented. However, if the Commission, nevertheless, still decides to amend Part 205, this article proposes minor amendments, which may aptly address the

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169. *See Noisy Withdrawal: A Sneak Preview* (Dec. 29, 2003), *at* wesiwyg://11/http://www.corplawblog.com/archives/000309.html (last visited Oct. 28, 2004) (stating that a result of a law firm's letter being leaked publicly, revealing the corporation's fraudulent conduct, stock prices fell almost nine percent). This case did not even involve an official actual noisy withdrawal and the results were catastrophic for the company. Accordingly, this article simply demonstrates the financial effects that noisy withdrawal may have on a company.

170. Comments of the Ass'n. of the Bar of the City of New York, Re: Implementation of Standards of Conduct for Attorneys (Apr. 7, 2003), *at* http://www.sec.gov/rules/proposed/s74502/abcny040703.htm (last visited Oct. 31, 2004).

171. Comments of Jones Day, Re: Implementation of Standards of Conduct for Attorneys (April 7, 2003), *at* http://www.sec.gov/rules/proposed/s74502/jonesday040703.htm (last visited Oct. 28, 2004); Handzlik & Connolly, *supra* note 161, at 34-35.

Commission's concerns without negatively affecting the attorney-corporate client relationship.

B. PROPOSED AMENDMENT TO PART 205

1. The Requirement of a Written Report

Under Part 205, the corporate attorney is required to report a material violation of securities' laws or a breach of fiduciary duty up the corporate ladder until an appropriate response is provided. In the event the attorney does not receive an appropriate response, the attorney is permitted to make a disclosure to the Commission where he reasonably believes it is necessary. This article proposes that in addition to these requirements, the attorney shall file a written report with the board, explaining the measures the attorney has taken and why the attorney believes such corporate action is problematic.

Additionally, the attorney shall be required to retain a copy of such report for his file. The requirement of a formal written report acts as an evidentiary function, but is also likely to influence the board's decision.[172]

2. Optional Withdrawal

Under the noisy withdrawal concept, the attorney is required to withdraw. Under the proposal suggested here, the corporate attorney shall have the option to withdraw upon reaching the top of the corporate ladder where an appropriate response is not provided. The decision to leave the discretion in the hands of the attorney is recognized under the current Model Rules of Professional Conduct. Model Rule 1.16 (b) permits the attorney to withdraw where such withdrawal may be accomplished without material adverse effect to the client's interests.[173]

This proposal, like current Part 205, appropriately balances the competing interests. The optional withdrawal provision merely attempts to codify the existing approach under the Model Rules, which is not expressed in current Part 205. The rationale for not mandating withdrawal is essentially that the corporation is likely to do more good than harm when the attorney remains with the company and advises it in future endeavors.

172. This proposed requirement of a written report is also proposed under the alternatives to noisy withdrawal. *See also* Part III, C.

173. *See* MODEL CODE OF PROF'L RESPONSIBILITY (1908), *reprinted in* THOMAS D. MORGAN & RONALD D. ROTUNDA, MODEL RULES OF PROFESSIONAL CONDUCT AND OTHER SELECTED STANDARDS, 1.16 (b)(2) (2003).

Although this article recommends leaving Part 205 alone, should the Commission decide to make changes, this proposal is likely to attract support from both the Commission and those in favor of protecting the sanctity of the attorney-client relationship.

VII. CONCLUSION

The Commission has overstepped its boundaries in proposing noisy withdrawal. The proposal exceeds the Commission's congressional mandate under Sarbanes-Oxley and violates the Supreme Court's understanding of the role of administrative agencies. Additionally, noisy withdrawal is likely to erode the long time protection afforded to the sanctity of the attorney-corporate client relationship and ultimately, serves to discourage the use of counsel in the corporate setting. As a result, corporate America's compliance with securities laws would rapidly deteriorate, possibly causing Enron-like situations to become commonplace. Accordingly, the Commission should leave Part 205 in place and refrain from promulgating any additional rules pertaining to attorney conduct absent congressional authorization. Ultimately, the Commission is left with this decision. Until this issue is resolved, corporate attorneys will continue to be uncertain in their role as counsel. The question that will linger is whether their role is one of confidant and advisor or one of gatekeeper.