GODFREY & KAHN S.C.
ATTORNEYS AT LAW

780 NORTH WATER STREET
MILWAUKEE, WI 53202-3590
TEL 414-273-3500
FAX 414-273-5198
www.gklaw.com

GODFREY & KAHN, S.C.
MILWAUKEE
APPLETON
GREEN BAY
WAUKESHA

LAFOLLETTE GODFREY & KAHN
MADISON

M E M O R A N D U M

TO: Our Clients and Friends

FROM: Godfrey & Kahn, S.C.

DATE: January 6, 2003

RE: Standards of Professional Conduct for Attorneys Proposed by the SEC

As mandated by the Sarbanes-Oxley Act of 2002 (the "Sarbanes Act"), the Securities and Exchange Commission recently published a release proposing new rules prescribing minimum standards of professional conduct for attorneys appearing and practicing before the SEC in any way in the representation of public companies. The stated intention of these standards is to ensure that those attorneys do not ignore evidence of material misconduct by the public companies they represent.

This memorandum is a summary of the rules proposed by the SEC in the release. The rules were subject to a comment period that ended December 18, 2002. The SEC is expected to issue final rules on or before January 26, 2003. Given the substantial volume of comments submitted to the SEC on the proposed rules, it is unclear whether the final rules will be substantially similar to the proposed rules.

Background

The SEC currently has the ability to discipline professionals, including attorneys, who practice before it under Rule 102(e) of the SEC's Rules of Practice. The rule permits the SEC to initiate disciplinary proceedings against attorneys who lack competence or integrity, who have engaged in unethical or improper professional conduct or who are determined to have willfully violated or aided and abetted the violation of any provision of the federal securities laws. The SEC may impose a variety of sanctions under Rule 102(e) against any attorney who has been found to have engaged in such conduct, including censure, or a temporary or permanent denial of the privilege of appearing or practicing before the SEC in any way.

The SEC has also taken the position in a number of enforcement actions that attorneys appearing and practicing before the SEC have an obligation to report corporate misconduct to the appropriate officers and directors of the companies they represent, but to date has not adopted standards of professional conduct requiring attorneys to report such instances of corporate misconduct.

Section 307 of the Sarbanes Act requires the SEC to adopt rules that set forth minimum standards of professional conduct for attorneys appearing and practicing before the SEC in any way in the representation of public companies. Section 307 mandates that these rules require an attorney to report evidence of a material violation of the securities laws or breach of fiduciary duty or similar violation by public companies or any of their agents. This report must be made to the company's chief legal officer or chief executive officer, and, to the extent the attorney does not receive an appropriate response from these officers, to the audit committee, a committee of non-employee directors (who are not "interested persons" in the case of registered investment companies) or the board of directors.

Summary of Proposed New Rule

The new rule proposed by the SEC in response to this requirement, to be contained in Part 205 of the Rules of Practice, imposes an "up the ladder" reporting obligation on an attorney appearing and practicing before the SEC in any way in the representation of an issuer who becomes aware of evidence of a material violation of the securities laws or breach of fiduciary duty or similar violation by the issuer or any officer, director, employee or agent of the issuer. Part 205 imposes different reporting standards on attorneys depending on their relationship to the issuer and their relationship to other attorneys representing the issuer. In addition, Part 205 addresses the treatment of confidential information that is the subject of any such report, the impact of this reporting obligation on the attorney-client privilege and the sanctions that the SEC may impose on attorneys who violate Part 205.

Definitions

Part 205 includes a number of defined terms that are necessary to an understanding of the rule. They are as follows:

Appearing and practicing. The SEC has proposed a very expansive definition of the term "appearing and practicing." Appearing and practicing before the SEC under Part 205 includes, but is not limited to,

- transacting any business with the SEC, including any communication (oral or written) with the SEC (for example, assisting an issuer in responding to a comment letter on a registration statement or periodic report or requesting exemptive or no-action relief),

- representing any party to, or the subject of or a witness in, an SEC administrative proceeding (for example, representing an issuer in an enforcement proceeding),

- representing any person in connection with any SEC investigation, inquiry, information request or subpoena (for example, assisting a company in responding to an informal SEC inquiry),

- preparing, or participating in the process of preparing, any statement, opinion or other writing which the attorney has reason to believe will be filed with or incorporated into any registration statement, notification, application, report, communication or other document filed with or submitted to the SEC (for example, advising an issuer to add information to or exclude information from a submission or to characterize particular information in a submission in a certain way or issuing an opinion that is filed as an exhibit to a registration statement),

- advising any party that a statement, opinion or other writing need not or should not be filed with or incorporated into any registration statement, notification, application, report, communication or other document filed with or submitted to the SEC (for example, advising an issuer not to file a contract because it is not material), or

- advising any party that it is not obligated to submit or file a registration statement, notification, application, report, communication or other document with the SEC (for example, advising an issuer that a particular issuance of securities is exempt from the registration requirements of the Securities Act of 1933).

The SEC has stated in the release that the proposed definition is broad enough to include attorneys who do not serve in the legal department of an issuer or who do not act in their capacities as attorneys, but who either transact business with the SEC or assist in the preparation of documents filed with or submitted to the SEC. As a result, individuals who are attorneys that no longer practice law, but who nevertheless participate in the preparation of documents submitted to the SEC (for example, through participation in the Section 302 certification process), may still be considered to appear and practice before the SEC and covered by Part 205.

Appropriate response. The term "appropriate response" means a response to evidence of a "material violation" (defined below) reported to appropriate officers or directors of an issuer that provides a basis for an attorney reasonably to believe either that no material violation is occurring, has occurred or is about to occur, or that the issuer has, as necessary, adopted remedial measures, including appropriate disclosures, and/or imposed sanctions that can be expected to stop any material violation that is occurring, prevent any material violation that has yet to occur, and/or rectify any material violation that has already occurred.

The determination as to whether a response is appropriate would be measured against an objective, rather than a subjective, standard. The SEC has stated that the proposed definition of "appropriate response" is intended to permit attorneys to exercise their judgment as to whether the response of the chief legal officer, chief executive officer, board committee or board of directors is appropriate, so long as the attorneys' determination of what is an appropriate response is objectively reasonable. In other words, would an attorney, acting in a reasonably prudent and competent manner, believe the response was appropriate?

Attorney. The term "attorney" means any person who is admitted, licensed or otherwise qualified to practice law in any jurisdiction, domestic or foreign, or who holds himself or herself out as admitted, licensed or otherwise qualified to practice law.

Breach of fiduciary duty. The term "breach of fiduciary duty" means any breach of fiduciary duty recognized at common law, including, but not limited to, misfeasance, nonfeasance, abdication of duty, abuse of trust and approval of unlawful transactions.

Evidence of a material violation. The term "evidence of a material violation" means information that would lead an attorney reasonably to believe that a material violation has occurred, is occurring or is about to occur.

This proposed definition covers any information that would lead an attorney, acting in a reasonably prudent and competent manner, to believe that a material violation has occurred, is occurring or is about to occur, even if the particular attorney who receives the information does not personally believe that a material violation has occurred, is occurring or is about to occur. However, Part 205 does not describe the process by which the attorney who receives such information must evaluate that information.

In the representation of an issuer. The term "in the representation of an issuer" means acting in any way on behalf, at the behest or for the benefit of an issuer, whether or not employed or retained by the issuer.

Issuer. The term "issuer" means any person the securities of which are registered under Section 12 of the Securities Exchange Act of 1934, or that is required to file reports under Section 15(d) of the Exchange Act, or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 and that it has not withdrawn.

Material. The term "material" means conduct or information about which a reasonable investor would want to be informed before making an investment decision.

Material violation. The term "material violation" means a material violation of the securities laws (state or federal), a material breach of fiduciary duty or a similar material violation.

Reasonable or reasonably. The terms "reasonable" and "reasonably" mean the conduct of a reasonably prudent and competent attorney.

Reasonably believes. The term "reasonably believes" means that an attorney, acting reasonably, would believe the matter in question.

Report. The term "report" means to make known to directly, either in person, by telephone, by e-mail, electronically or in writing.

Issuer as Client

Part 205 states that an attorney appearing and practicing before the SEC in the representation of an issuer represents the issuer as an organization, and is required to act in the best interests of the issuer and its shareholders. Even though an attorney may work and regularly interact with and advise the issuer's officers, directors and employees in the course of representing the issuer, the SEC has emphasized in drafting Part 205 that those individuals are not the attorney's clients.

Reporting Evidence of a Material Violation

Reporting to the Chief Legal Officer and Chief Executive Officer. If an attorney appearing and practicing before the SEC in the representation of an issuer becomes aware of evidence of a material violation by the issuer or any officer, director, employee or agent of the issuer, the attorney is required to report any evidence of the violation to the issuer's chief legal officer, or an individual serving in an equivalent position, or to both the issuer's chief legal officer and chief executive officer, or individuals serving in equivalent positions.

Once the chief legal officer receives a report of a material violation, Part 205 requires the chief legal officer to conduct an inquiry into whether a material violation has occurred, is occurring or is about to occur, unless he or she makes a reasonable determination that such an inquiry is unnecessary. If the chief legal officer determines that there has been no material violation, he or she is required to inform the reporting attorney of this determination. If, however, the chief legal officer determines that there has been a material violation, he or she is required to take any necessary steps to ensure that the issuer adopts appropriate remedial action. Remedial action may include making disclosures or imposing sanctions intended to rectify any violation that has occurred or stop any violation that is occurring or that is about to occur. The chief legal officer is then required to report promptly the remedial measures adopted to the chief executive officer, the audit committee or the full board of directors, and to the reporting attorney. Finally, the chief legal officer is required to document the inquiry and retain the documentation for a reasonable period of time, which the SEC interprets to be no shorter than the statute of limitations applicable to the violation.

If an issuer does not have a chief legal officer or general counsel, the individual serving in an equivalent position would be the chief executive officer. Under those circumstances, the chief executive officer would be responsible for either conducting an inquiry in response to a report or making a determination that no inquiry is necessary.

Part 205 requires a reporting attorney to take steps reasonable under the circumstances to document the report of the material violation and the issuer's response to the report and to retain the documentation for a reasonable period of time.

Reporting to Board Committees or Board of Directors. An attorney who has made a report of a material violation to the chief legal officer or the chief executive officer has an obligation to make an additional report of the violation under two circumstances. First, an attorney has an obligation to make an additional report if he or she reasonably believes that the

chief legal officer or the chief executive officer has not provided an appropriate response to the report. Second, an attorney has an obligation to make an additional report if he or she reasonably believes that the chief legal officer or the chief executive officer has not responded to the report within a reasonable time. The additional report of the violation must be made to the issuer's audit committee, another committee of the issuer's board of directors that consists solely of non-employee directors (who are not "interested persons" in the case of registered investment companies) if the issuer has no audit committee or, in the absence of such a committee, to the full board of directors.

An attorney may also report evidence of a material violation directly to the audit committee, a board committee of non-employee directors or to the full board of directors if the attorney reasonably believes that making such a report to the chief legal officer or the chief executive officer would be futile. An attorney may choose this method of reporting under circumstances in which the chief legal officer or the chief executive officer is involved in the material violation or in which such a report may enable individuals to destroy relevant evidence of the violation.

An attorney who reasonably believes that he or she has received an appropriate and timely response to a report of a material violation from the issuer and who has complied with the record-keeping requirements of Part 205 has no obligation to take further action regarding the evidence of a material violation.

Reporting to the SEC. An attorney who reasonably believes that he or she has not received an appropriate and timely response to a report of a material violation from the issuer must explain the reasons for his or her belief to the individuals to whom he or she made the report. The attorney must also take reasonable steps to document the individual's response or the absence of a response and retain this documentation for a reasonable period of time. In addition to this report, an attorney may have additional obligations or may take additional action.

Mandatory Obligations. If an attorney retained or employed by the issuer:

- has not received an appropriate response to a report of a material violation or has not received an appropriate response to such a report in a reasonable time,

- reasonably believes that a material violation *is ongoing or is about to occur*, and

- reasonably believes that the material violation is likely to result in substantial injury to the financial interest or property of the issuer or of investors,

then, depending on the relationship of the attorney to the issuer, the attorney is required to take several actions.

An attorney retained by the issuer as outside counsel is required to (i) make a "noisy withdrawal," that is, withdraw forthwith from representing the issuer and indicate that the withdrawal is based on professional considerations, (ii) within one business day of withdrawing, give written notice to the SEC of the withdrawal and indicate that the withdrawal was based on professional considerations and (iii) promptly disaffirm to the SEC any opinion, document, affirmation, representation, characterization, or the like in a document filed with or submitted to the SEC, or incorporated into such a document, that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading. The issuer's chief legal officer is also required to inform any attorney retained or employed to replace the withdrawing attorney that the attorney's withdrawal was based on professional considerations.

In the proposing release, the SEC has stated that the prospect of a noisy withdrawal will effectively require an issuer's directors to act and will virtually ensure an immediate inquiry by the SEC if they do not.

An in-house attorney, on the other hand, is required to (i) notify the SEC in writing that he or she intends to disaffirm an opinion, document, affirmation, representation, characterization, or the like in a document filed with or submitted to the SEC, or incorporated into such a document, that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading and (ii) promptly make such disaffirmation in writing to the SEC. The SEC has not proposed to require in-house attorneys to resign under these circumstances.

Permitted Actions. If an attorney retained or employed by the issuer:

- has not received an appropriate response to a report of a material violation or has not received an appropriate response to such a report in a reasonable time,

- reasonably believes that a material violation *has occurred*, and

- reasonably believes that the material violation is likely to have resulted in substantial injury to the financial interest or property of the issuer or of investors, *but that the violation is not ongoing*,

then the attorney may, but is not required, to take the actions discussed above. To the extent an attorney withdraws from the representation, the issuer's chief legal officer is required to inform any attorney retained or employed to replace the withdrawing attorney that the attorney's withdrawal was based on professional considerations.

Impact of Notification to SEC on Attorney-Client Privilege. Part 205 provides that any mandatory or permitted notification to the SEC does not breach the attorney-client privilege.

Alternative Means of Reporting Evidence of a Material Violation

Reporting to a Qualified Legal Compliance Committee. If an attorney appearing and practicing before the SEC in the representation of an issuer becomes aware of evidence of a material violation by the issuer or any officer, director, employee or agent of the issuer, the attorney may, as an alternative to reporting any evidence of the violation to the issuer's chief legal officer and chief executive officer, report such evidence to a "qualified legal compliance committee," if the issuer has duly formed such a committee. The committee is then responsible for responding to the report. Except as discussed below with respect to the issuer's chief legal officer, an attorney who makes a report to a qualified legal compliance committee has satisfied his or her obligation to report evidence of a material violation, is not required to assess the response to the report and is not required to withdraw from the representation or make any report to the SEC.

A "qualified legal compliance committee" is a duly established committee of the issuer's board of directors that consists of at least one member of the issuer's audit committee and two or more non-employee directors (who are not "interested persons" in the case of registered investment companies) that has been authorized to investigate any report of evidence of a material violation by the issuer, its officers, directors, employees or agents. The committee must have the authority and responsibility to:

- inform the issuer's chief legal officer and chief executive officer of any report of evidence of a material violation, unless so informing these individuals would be futile,

- decide whether an investigation is necessary to determine if the reported material violation has occurred, is occurring or is about to occur, and if the committee decides an investigation is necessary, to notify the audit committee or the board of directors, to initiate the investigation, and to retain additional expert personnel as the committee deems necessary,

- direct the issuer to adopt remedial measures and/or impose sanctions to cure or prevent the material violation,

- inform the chief legal officer and the chief executive officer and the board of directors of the results of the investigation and the remedial measures and sanctions imposed, and

- notify the SEC of the material violation and disaffirm in writing any document filed with or submitted to the SEC that any member of the committee reasonably believes is false or materially misleading if the issuer fails in any material respect to take any of the remedial measures that the committee has directed the issuer to take.

Additional Responsibilities of the Chief Legal Officer. As an alternative to conducting an inquiry in response to an attorney's report of evidence of a material violation, an issuer's chief

legal officer may refer the report to a qualified legal compliance committee. If the issuer fails in any material respect to take any of the remedial measures that the committee has directed the issuer to take, the chief legal officer is obligated to notify the SEC of the material violation and disaffirm in writing any document filed with or submitted to the SEC that he or she reasonably believes is false or materially misleading.

Responsibilities of Supervisory and Subordinate Attorneys

Supervisory Attorneys. A supervisory attorney is an attorney who supervises, directs or has supervisory authority over another attorney, and includes an issuer's chief legal officer or the individual serving in an equivalent capacity. Part 205 provides that if a subordinate attorney "appears and practices" before the SEC, then the supervisory attorney also "appears and practices" before the SEC. Supervisory attorneys have several obligations. First, they must make reasonable efforts to ensure that their subordinate attorneys conform to Part 205 and comply with the federal securities laws and regulations. Second, supervisory attorneys are responsible for complying with the reporting obligations described above when a subordinate attorney has reported evidence of a material violation to the supervisory attorney. Finally, if a supervisory attorney receives a report of a material violation from a subordinate attorney and reasonably believes that the information is not evidence of a material violation, then the supervisory attorney must take reasonable steps to document the basis for his or her belief.

Subordinate Attorneys. A subordinate attorney is an attorney who is under the supervision, direction or supervisory authority of another attorney. Part 205 provides that a subordinate attorney is subject to the rule even though he or she is acting at the direction or under the supervision of another person. A subordinate attorney is deemed to have complied with Part 205 if he or she reports evidence of a material violation to his or her supervisory attorney and takes steps reasonable under the circumstances to document the report and the supervisory attorney's response and retains the documentation for a reasonable period of time. To the extent a subordinate attorney reasonably believes that the supervisory attorney has failed to comply with Part 205, he or she is permitted to take the actions permitted or required to be taken by other attorneys under the rule, such as making a report to a board committee or the board of directors or making a report to the SEC.

Treatment of Confidential Information

Defense of Part 205 Proceeding. Part 205 permits an attorney to use otherwise confidential information in connection with any investigation, proceeding or litigation in which the attorney's compliance with Part 205 is at issue. This information includes the report of the evidence of the material violation or the contemporaneous record of the report and the response to the report or the contemporaneous record of the response.

To Prevent or Rectify an Illegal Act. Part 205 also permits an attorney to disclose to the SEC, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary to:

- prevent the issuer from committing an illegal act that the attorney reasonably believes is likely to result in substantial injury to the financial interests or property of the issuer or investors,

- prevent the issuer from committing an illegal act that the attorney reasonably believes is likely to perpetrate a fraud on the SEC, or

- rectify the consequences of the issuer's illegal act in the furtherance of which the attorney's services had been used.

Confidentiality Agreements. Part 205 also contemplates voluntary disclosure of information related to a material violation with the SEC under a confidentiality agreement. If an issuer, through its attorney, shares such information under a confidentiality agreement, Part 205 provides that the sharing of that information will not constitute a waiver of any applicable privilege or protection that the issuer may assert against any other person.

Sanctions

An attorney that violates Part 205 will be subject to the same penalties and remedies that apply to a violation of the Exchange Act. For example, the SEC could commence a civil action seeking injunctive and other equitable relief, as well as civil money penalties. The SEC could also commence a cease and desist proceeding against the attorney. The SEC has stated its belief, however, that a violation of Part 205, without more, would not result in criminal penalties. In addition, the SEC has stated that it does not intend that Part 205 will create any private right of action against an attorney based on his or her compliance or non-compliance with its provisions.

* * * * *

We will continue to monitor the SEC rule proposals and keep you apprised of any new developments. In the meantime, please do not hesitate to contact us if you have any questions regarding the proposed rules.

Godfrey & Kahn Securities Team

Kenneth C. Hunt, kchunt@gklaw.com
Christopher B. Noyes, cbnoyes@gklaw.com
Larry D. Lieberman, llieber@gklaw.com
Carol A. Gehl, cagehl@gklaw.com
Pamela M. Krill, pmkrill@gklaw.com
Dennis F. Connolly, dconnoll@gklaw.com
Ellen R. Drought, edrought@gklaw.com
Michelle M. Nelson, mnelson@gklaw.com
Jake C. Blavat, jblavat@gklaw.com
C.J. Wauters, cwauters@gklaw.com

MW675999_4.DOC