

February 3, 2004

The Honorable Michael G. Oxley  
Chairman  
Committee on Financial Services  
U.S. House of Representatives  
Washington, D.C. 20515

The Honorable Richard Baker  
Chairman  
Subcommittee on Capital Markets, Insurance and  
Government Sponsored Enterprises  
Committee on Financial Services  
U.S. House of Representatives  
Washington, D.C. 20515

Attention: Ms. Sapna Delacourt (sapna.delacourt@mail.house.gov)

Re: Subcommittee Hearing on "The Role of Attorneys in Corporate Governance"  
Scheduled for February 4, 2004

Dear Messrs. Chairmen:

Because I am unable to appear at the Hearing, I submit these comments relating to the role of lawyers in corporate governance and request they be made part of the record. I speak for myself alone. Because of my extensive involvement with the American Bar Association (ABA), however, I will refer to some ABA measures intended to provide a greater role for lawyers in corporate governance, as well as to my personal experiences regarding Section 307 of the Sarbanes-Oxley Act of 2002 (the Act) and related SEC rules. My biography is Attachment 1 to this letter.

The ABA's response to the notorious lapses in corporate governance responsibility included the appointment in March 2002 of a Task Force on Corporate Responsibility charged to develop how the current system of corporate governance might be improved. The Task Force was chaired by James S. Cheek, Esquire, of the Nashville, Tennessee Bar, an experienced securities lawyer.

On July 16, 2002, the ABA Task Force submitted a Preliminary Report proposing measures to improve corporate governance, with particular emphasis on ways to increase the effectiveness of lawyers who represent public companies. The Task Force's final Report, issued on March 31, 2003, is available at <http://www.abanet.org/buslaw/corporateresponsibility/home.html>.

The recommendations of the ABA Task Force were contained in three resolutions adopted by the ABA House of Delegates in August 2003, also available at the above address. These included (1) practices to enhance the role of lawyers in corporate governance; (2) amendments to ABA Model Rule of Professional Conduct 1.13 to emphasize that corporate lawyers represent the organization rather than management as individuals; and (3) amendments to ABA Model Rule 1.6 specifically providing that lawyers may reveal client information to prevent or rectify serious financial losses in certain circumstances.

Included in the corporate governance improved practices (Item 1) among other recommendations are the following:

- The board of directors should establish a pattern of holding regular, executive session meetings among the company's general counsel and its independent directors.

- Outside counsel should establish at the outset of the engagement a direct line of communication between outside counsel and the company's general counsel, as well as an understanding that outside counsel are obliged to apprise the general counsel of material violations or potential violations.

The ABA's Amendments to Model Rules 1.13 and 1.6 (Items 2 and 3) also are intended to strengthen the ability of legal counsel to assure the company's compliance with the law. ABA Model Rule 1.13 (Organization as Client) emphasizes that the lawyer for an organization represents the organization rather than managers individually. The Rule requires corporate lawyers to report misconduct "up the corporate ladder" to the company's senior management or, if necessary, to its board or independent directors, unless the lawyer reasonably believes that it is not in the best interest of the company to do so. This rule change closely parallels the standard adopted by the SEC in its Part 205 Rules under Section 307 of the Act. See § 205.3(b).

Similarly, the ABA's Model Rule 1.6 would now permit attorneys to divulge client information to the extent reasonably necessary to prevent or rectify reasonably certain substantial financial injury to third parties arising from the client's crimes or fraud in which the lawyer's services are used. These provisions are consistent with the existing lawyer disciplinary rules of about forty-two states and are substantially similar to provisions of the SEC's Part 205 Rules. See §§ 205.4, 205.5.

The ABA in November 2002 appointed a Task Force on Section 307 of the Sarbanes-Oxley Act of 2002 that I chair. The Task Force helped to prepare recommendations sent by the ABA to the SEC concerning its proposed Part 205 Rules. The ABA expressed general support for the

SEC's final "up the ladder" rule in its April 2, 2003 Comment Letter, but noted serious concerns regarding the Commission's two "noisy withdrawal" proposals. ABA comment letters are available at <http://www.sec.gov/rules/proposal/S74502/aba040203.htm> (filed 4/2/03) and <http://www.sec.gov/rules/proposed/S74502/apcarlton.htm> (filed 12/18/02).

Despite some criticism and continuing concern over their breadth and interpretive uncertainty expressed by the ABA and others, the up-the-ladder rules have found general acceptance among lawyers and their company clients. This is because the rules do not depart significantly from most state ethics standards and are recognized as having established some clear benefits in enhancing the lawyer's role in helping to improve corporate governance.

Thus, the SEC has addressed reporting out by permitting lawyers to report evidence of serious client crimes to the SEC, notwithstanding any inconsistent state rules. As noted above, the SEC's permissive reporting rule resembles exceptions in the ABA Model Rules and lawyer conduct rules that apply in all but 8 states. The rules the Commission continues to consider would, however, increase the obligations of lawyers well beyond reporting up the ladder and permissive reporting outside the company by forcing lawyers to resign from representing companies with the resignations reported to the SEC.

The "noisy withdrawal" rule under consideration would require a lawyer, if (1) having reported evidence of a material violation up the ladder the lawyer fails to receive an "appropriate response" within a reasonable time, and (2) the lawyer reasonably believes that a material violation is ongoing or about to occur that is likely to result in substantial injury to the financial interest of the company or investors, to withdraw forthwith from representing the issuer based on

“professional considerations,” so notify the company and, within one business day, also notify the Commission and promptly disaffirm to the Commission any materially false or misleading document or representation. See Part 205 Rules, proposed § 205(d)(1).

The alternative rule that the Commission also is considering would require the lawyer to withdraw in circumstances similar to those just described. But the company (rather than the reporting lawyer) would then have to report publicly the lawyer’s withdrawal from representing the company for “professional considerations.” See Part 205 Rules, proposed § 205.3(e).

This alternative would not, however, eliminate the fundamental policy concerns regarding harm to the client-lawyer relationship and interference with effective corporate governance that many of us believe would result from mandatory noisy withdrawal. Mandating lawyer withdrawal at all would deny lawyers the flexibility they need to counsel clients effectively on compliance with complex securities laws. It might, for example, encourage lawyers to withdraw prematurely rather than continue to counsel legal compliance regarding difficult issues – when companies most need the lawyer’s advice. If the lawyer withdraws prematurely, the damage to the company and its stockholders could have serious adverse consequences. Even worse, because of the serious consequences that would flow from identifying a possible material violation, a mandatory withdrawal requirement might prompt some lawyers to avoid asking the hard questions that enable them to effectively counsel legal compliance.

Requiring that the lawyer withdraw followed by immediate mandatory reporting by the lawyer or the company could, in addition, severely damage companies and their investors through public disclosure of a withdrawal that might have been unwarranted. The company’s board might

feel forced to disclose damaging information despite justifiably believing that no material violation has occurred solely to avoid the lawyer's withdrawal, the resulting company reporting and its consequences – likely a full scale SEC investigation and private class action suit. While an SEC mandatory noisy withdrawal and reporting requirement might make a difference in the rare situation in which it would be invoked, the mere existence of such a requirement would be likely to make clients reluctant to confide in their lawyers. For these and other reasons, it seems clear to many that either of the SEC's pending proposals would be more likely to harm than protect companies and their investors. In this respect, the pending mandatory withdrawal standards for lawyer conduct do not appear to be “in the public interest and for the protection of investors,” as Section 307 requires.

Of course, when a lawyer knows her services are being or will be used to assist the client in a crime or fraud, she must terminate assistance and if necessary withdraw from representing the client. When it becomes clear, for example, that a client is using its lawyer's services to help accomplish material violations of securities law, the lawyer who continues to assist the client would not only violate disciplinary rules but also engage in illegal and possibly criminal conduct already subject to severe sanctions.

The SEC's Part 205 Rules that provide for permissive reporting out, allow lawyers sufficient flexibility to dissuade clients from criminal or fraudulent activities where the lawyer is likely to be implicated and, if that fails, to protect innocent third parties against substantial financial injury as well as avoid personal liability themselves. Moreover, as the SEC has indicated in *Carter & Johnson* [1981 WL 36552 (SEC 1981)], the best way to assure compliance is to

encourage lawyers to continue counseling clients to comply with law, rather than to provide incentives for withdrawing prematurely because of concern for their own liability. It recognized that, short of assisting fraud, a lawyer's continuing to counsel compliance with the law serves both the public interest and the interests of the company and its investors.

In these circumstances it seems to me unwise to adopt either of the mandatory withdrawal and reporting out rules still under consideration, or to legislate further on lawyers' professional conduct before the SEC. Ample sanctions already exist. Moreover, voluntary compliance so necessary to the effective operation of the securities law is well under way. For example, Lawyers for TV Azteca, Mexico's second largest broadcaster, reportedly applied the SEC's Part 205 Rules to persuade Azteca's independent directors to investigate the adequacy of disclosure of its executive officer's dealings in Azteca's debt instruments. Steven H. Scheinman of Akin Gump's New York office is reported to have written the directors that the Firm had withdrawn from representing Azteca because, in their opinion, certain transactions that the chief executive officer and the general counsel decided not to disclose were required to be disclosed pursuant to U.S. Securities law. Citing Section 307 of the Act, Mr. Scheinman also reserved the right to inform the SEC of the Firm's withdrawal from the representation. (*New York Times*, 12/24/03, page C1, col. 6)

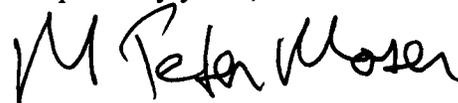
It is clear to those of us involved in the work of the ABA Section of Business Law that securities lawyers all over the country have adopted § 307 guidelines within their law firms. Many firms have conducted § 307 compliance programs that are mandatory for all lawyers, not just securities law specialists. More significantly, greater vigilance by independent directors and

in-house corporate counsel is evident in public companies, and requiring more timely and precise financial disclosures will surely have an enormous impact in assuring that public companies comply with securities law.

We hope that these and many other measures already in place will be given a chance to work, as we believe they will.

Thank you for the opportunity to present my views.

Respectfully yours,

A handwritten signature in black ink that reads "M Peter Moser". The signature is written in a cursive, slightly slanted style.

M. Peter Moser

MPM:mwc  
Attachments

# Piper Rudnick

**M. Peter Moser**, is of counsel to Piper Rudnick LLP and serves on its Ethics Committee. Mr. Moser is Chair of the American Bar Association (ABA) Task Force on Section 307 of the Sarbanes-Oxley Act of 2002. His practice emphasizes corporations, tax and estate planning, and counseling attorneys in legal ethics, malpractice and disciplinary matters, and has also included trial and appellate advocacy. Mr. Moser has written extensively in the areas of judicial conduct and lawyer professional responsibility and has taught these subjects at the University of Baltimore and University of Maryland Law Schools. He has served on various governmental commissions, including the Maryland State Ethics Commission as Chair, the Maryland Attorney Grievance Commission as Chair, and the Maryland Constitutional Convention as Local Government Committee Chair. He currently serves as a consultant to the Maryland Court of Appeals Rules Committee regarding the revised MD Code of Judicial Conduct and amendments to the MD Rules of Professional Conduct for Lawyers, and as a member of the Court of Appeals MD Rules of Professional Conduct Revision Committee. Mr. Moser was an Adviser to the ALI American Law Institute Law Governing Lawyers Restatement project. He was a member of the American Bar Association House of Delegates for 24 years, served on the ABA Ethics Committee and as its Chair, was ABA Treasurer and a member of the ABA Board of Governors. He currently is President of the American Bar Foundation. He also has been President of the Maryland State and Baltimore City Bar Associations. Mr. Moser received his B.A. from The Citadel and his LLB. from Harvard Law School.

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Attachment 1