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QUALIFIED LEGAL COMPLIANCE COMMITTEE: POLICIES AND PROCEDURES

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I. INTRODUCTION

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 ("the Act") that provides for various measures to improve the accuracy and reliability of corporate disclosures. On January 29, 2003, the Securities and Exchange Commission (the "Commission") acted pursuant to Section 307 of the Act and issued a release (the "Final Release") entitled, "Final Rule: Implementation of Standards of Professional Conduct for Attorneys" (the "Final Rules") that adopted rules establishing the standards of professional conduct for attorneys appearing and practicing before the Commission on behalf of issuers.[1] The Final Rules require, among other things, that an attorney who is "appearing and practicing"[2] before the Commission in the representation of issuers to report "up-the-ladder" "evidence of a material violation"[3] of U.S. Federal or state securities laws, a material breach

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[1] The adopting release is available at http://www.sec.gov/rules/final/33-8185.htm, and is attached hereto as Exhibit A.

[2] The Final Rules provide that an attorney will not be deemed to be "appearing and practicing" before the Commission unless the attorney is providing legal services to an issuer with whom the attorney has an attorney-client relationship. See, Final Rules, Section 205.2(a). Appearing and practicing before the Commission:

(1) Means:
- (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'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 filed 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 or regulations thereunder to be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the Commission; but

(2) Does not include any attorney who:
- (i) Conducts the activities in paragraphs (a)(1)(i) through (a)(1)(iv) of this section other than in the context of providing legal services to an issuer with whom the attorney has an attorney-client relationship; or
- (ii) Is a non-appearing foreign attorney.

[3] The Final Rules define "evidence of a material violation" to mean "credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur." See, Final Rules, Section 205.2(e).

of fiduciary duty arising under U.S. Federal or state laws, or a similar violation of any U.S. Federal or state laws.

"Up-the-ladder" reporting requires an attorney to report evidence of a material violation to a supervisory attorney[4] or the issuer's chief legal counsel or chief executive officer, as the case may be.[5] When an attorney reports evidence of a material violation directly to the issuer's chief legal or executive officer and the reporting attorney reasonably believes that he or she did not receive an appropriate response from such officers, the reporting attorney must report the violation up to the issuer's audit committee, another committee of independent directors or the full board of directors.[6]

In instances where a subordinate attorney[7] reports evidence of a material violation to a supervisory attorney, however, the supervisory attorney must report such evidence "up-the-ladder" to the issuer's chief legal or executive officer if the supervisory attorney reasonably believes that a material violation has occurred, is ongoing or is about to occur.[8] Furthermore, the supervisory attorney must evaluate the response from the issuer's chief legal or executive officer and, if the supervisory attorney reasonably believes that such officers do not respond appropriately, the supervisory attorney must report the evidence up to the issuer's audit committee, another committee of independent directors or the full board of directors.[9] If the supervisory attorney does not reasonably believe that a material violation has occurred, is ongoing or is about to occur, the supervisory attorney must notify the subordinate attorney of such a determination.[10] At this point, if the subordinate attorney reasonably believes that the supervisory attorney failed to comply with the "up-the-ladder" reporting requirements by not reporting the evidence of a material violation, the subordinate attorney may, but is not required to, report the evidence to the issuer's chief legal or

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[4] The Final Rules define a "supervisory attorney" to include attorneys who are "supervising or directing another attorney who is appearing and practicing before the Commission in the representation of an issuer." Final Rules, Section 205.4(a).

[5] Final Rules, Section 205.3(b)(1) and 205.5(c).

[6] Final Rules, Section 205.3(b)(3).

[7] The Final Rules define a "subordinate attorney" to include attorneys who "appear and practice before the Commission in the representation of an issuer on a matter under the supervision or direction of another attorney (other than under the direct supervision or direction of the issuer's chief legal officer (or the equivalent thereof))." Final Rules, Section 205.5(a).

[8] Final Rules, Section 205.4(c) and 205.3(b).

[9] Id.

[10] Id.

executive officer or to the issuer's audit committee, another committee of independent directors or the full board of directors.[11]

However, if the issuer has established a Qualified Legal Compliance Committee (the "QLCC"), an attorney who is “appearing and practicing” before the Commission in the representation of an issuer may satisfy all of his or her "up the ladder" reporting obligations by disclosing the violation directly to the QLCC.[12]

The QLCC, therefore, allows an attorney to by-pass several steps of reporting “up-the-ladder,” and instead allows the attorney to report evidence of a material violation directly to a single entity within the issuer. While the Commission’s Final Rules do not require an issuer to adopt a QLCC, the Commission “encourages issuers to do so as a means of effective corporate governance.”[13] In fact, the Commission noted that the “QLCC institutionalizes the process of reviewing reported evidence of a material violation,” and suggests that the QLCC “may also produce broader synergistic benefits, such as heightened awareness of the importance of early reporting of possible material violations so that they can be prevented or stopped.”[14]

In order to explain how the QLCC can function as an effective means of corporate governance, this presentation will: (1) set forth the basic structure of a QLCC; (2) analyze the mechanics of reporting to a QLCC; (3) suggest policies and procedures for implementing a QLCC; and (4) discuss the advantages and disadvantages of creating a QLCC.

II. STRUCTURE OF A QLCC

The Final Rules provide that an issuer need not form a QLCC as a new corporate structure if another committee of the issuer meets all the criteria required of a QLCC and agrees to function as such in addition to performing its other duties and responsibilities.[15] The requisite criteria for a QLCC are set forth below.

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[11] Final Rule, Section 205.5(d) and 205.3(b).

[12] Final Rules, Section 205.3(c)(1).

[13] Final Release, Part II, Section-by-Section Discussion of the Final Rules, at 205.2(k).

[14] Final Release, Part II, Section-by-Section Discussion of the Final Rules, at 205.3(c).

[15] Final Release, Part II, Section-by-Section Discussion of the Final Rules, at 205.2(k).

A. Composition

In order to qualify as a QLCC under the Final Rules, a committee must consist of:

1. at least one member of the issuer's audit committee (or, if the issuer has no audit committee, one member from an equivalent committee of independent directors); and

2. two or more members of the issuer's full board of directors who are not employed, directly or indirectly, by the issuer and who are not, in the case of a registered investment company, "interested persons" as defined in Section 2(a)(19) of the Investment Company Act of 1940.[16]

B. Powers and Procedures

In addition to requiring QLCC's to meet certain membership standards, the Final Rules also require a QLCC to adopt and retain certain powers and procedures in order to qualify for QLCC status. Namely, the Commission requires a QLCC to:

1. adopt written procedures for the confidential receipt, retention and consideration of any report of evidence of a material violation under Section 205.3; and

2. be duly established by the issuer's board of directors, with the authority and responsibility to:

    a. determine whether an investigation is necessary regarding any report of evidence of a material violation by the issuer, its officers, directors, employees or agents and, if it determines an investigation is necessary or appropriate, to:

        i. notify the audit committee or the full board of directors; and

        ii. initiate an investigation, which may be conducted either by the chief legal counsel (or the equivalent thereof) or by outside counsel; and

[16] Final Rules, 205.2(k)(1). The "Commission considers it appropriate and consistent with the mandate in the Act to ensure a high degree of independence in QLCC members and members of committees to whom reports are made under Section 205.3(b)(3). Accordingly, the Commission anticipates that these provisions will be amended to conform to final rules defining who is an 'independent' director under Section 301 of the Act, upon adoption of those rules." Final Release, Part II, Section-by-Section Discussion of the Final Rules, at 205.2(k).

iii. retain such additional expert personnel as the committee deems necessary; and

b. at the conclusion of any such investigation to:

i. recommend, by majority vote, that the issuer implement an appropriate response to evidence of a material violation; and

ii. inform the chief legal officer and the chief executive officer (or the equivalents thereof) and the board of directors of the results of any such investigation under this section and the appropriate remedial measures to be adopted; and

3. have the authority and responsibility, acting by majority vote, to take all other appropriate action, including the authority to notify the Commission in the event that the issuer fails in any material respect to implement an appropriate response that the qualified legal compliance committee has recommended the issuer to take.[17]

In order to fully understand how the QLCC's powers and procedures actually work, it is helpful to clarify a few points.

- The QLCC has the authority and the responsibility to recommend that an issuer take appropriate remedial action in response to evidence of a material violation, but the QLCC cannot direct the issuer to take such action. The Commission specifically designed the Final Rules this way because a QLCC's power to compel the full board of directors to take action would conflict with established corporate governance models.[18]

- Decisions and actions of the QLCC must be made by majority vote; unanimity is not required.[19]

- If the issuer fails in any material respect to implement an appropriate response that the QLCC has recommended, the QLCC has authority and responsibility, acting by majority vote, to notify the Commission of such failure.[20]

[17] Final Rules, 205.2(k)(2)-(4).

[18] Final Release, Part II, Section-by-Section Discussion of the Final Rules, at 205.2(k).

[19] Id.

[20] Final Rules, Section 205.2(k)(4).

C. QLCC Member Liability

As explained above, the Final Rules impose great responsibility and stringent requirements on the QLCC. Members who serve on the QLCC will be charged with making the ultimate decision with respect to deciding what qualifies as a material violation, what remedial measures to take and whether to notify the Commission if the issuer fails to adequately respond to the QLCC's recommended course of action. However, in light of the burden placed upon QLCC members, the Commission expressly stated in the Final Release that it "does not intend service on a QLCC to increase the liability of any member of a board of directors under state law, and, indeed, expressly finds that it would be inconsistent with the public interest for a court to so conclude."[21] It is important to note, however, that neither Section 307 of the Act nor the Final Rules contain any provision with respect to the liability of directors who serve on the QLCC.

III. REPORTING MECHANICS

A. Reporting Obligations of Attorneys

As noted earlier, the QLCC offers attorneys an alternative to the traditional "up-the-ladder" reporting whereby the attorney first reports evidence of a material violation to a supervisory attorney or the chief legal or executive officer, as warranted, and then to the board or one of its committees if the attorney does not receive a satisfactory response from the chief legal or executive officer.

Given the complexities of "up-the-ladder" reporting when a supervisory and subordinate attorney are involved, issuers will want to create standardized systems for reporting evidence of a material violation. One way to establish a routine practice would be for an issuer to require a subordinate attorney to report evidence of a material violation to the appropriate supervisory attorney. Once the supervisory attorney receives notice of such a material violation, the supervisory attorney may want to draft a memorandum describing the alleged material violation and the supervisory attorney's determination as to whether the evidence needs to be reported "up-the-ladder." Furthermore, the supervisory attorney may want to ask the subordinate attorney who reported the evidence to sign the memorandum acknowledging his or her agreement with the determination to report, or not report, further "up-the-ladder" the alleged material violation. In so doing, the supervisory attorney preserves a record as to the facts of the case and the subordinate attorney's decision to accept the determination of the supervisory attorney. If the reporting attorney and the supervisory attorney do not agree on the outcome, the supervisory attorney may well want to document in greater detail his or her reasons for the decision.

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[21] Final Release, Part II, Section-by-Section Discussion of the Final Rules, at 205.2(k).

If the issuer has a pre-existing QLCC, however, an attorney who reports evidence of a material violation directly to that QLCC:

1. satisfies his or her reporting obligation to report such violation; and

2. is not required to assess the issuer's response to the reported evidence of the material violation.[22]

Thus, if an attorney reports evidence of a material violation to the QLCC he or she satisfies all reporting obligations and is not required to determine whether or not the issuer takes appropriate remedial measures. The job of assessing the appropriateness of the issuer's response falls upon the QLCC and not the attorney. This shift in responsibility from the attorney to the QLCC frees the attorney from having to act as a "watch-dog" and allows the issuer to deal directly with the reported violation itself.

It is important to understand that in order to take advantage of the QLCC reporting paradigm, the issuer must have a QLCC in place before a reported material violation has occurred.[23] The issuer will not be able to use a QLCC if it establishes such a committee in response to a specific incident.

B. Reporting Obligations of the Chief Legal Officer

The issuer's chief legal officer, or the equivalent thereof, may also take advantage of the benefits of reporting to a QLCC. The chief legal officer may report evidence of a material violation directly to a previously established QLCC in lieu of causing an inquiry to be made as would otherwise be required by the Final Rules.[24] Once the chief legal officer has reported the evidence of a material violation to the QLCC, he or she must notify the reporting attorney that the report has been referred and, thereafter, the QLCC is responsible for responding to the evidence presented to it.[25]

C. Reporting Obligations When Retained by the QLCC to Investigate or Litigate a Reported Violation

The Final Rules also remove an attorney's reporting obligations if he or she has been retained or directed by a QLCC to investigate or litigate reported evidence of a material violation. Specifically, an attorney will not have any obligation to report evidence of a material violation if the attorney was retained or directed by a QLCC to:

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[22] Final Rules, Section 205.3(c)(1).

[23] Final Release, Part II, Section-by-Section Discussion of the Final Rules, at 205.3(c).

[24] Final Rules, Section 205.3(c)(2).

[25] Id.

1. investigate such evidence of a material violation; or

2. assert, consistent with his or her professional obligations, a colorable defense on behalf of the issuer (or the issuer's officer, director, employee or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to such evidence of a material violation.[26]

While the Final Rules also remove an attorney's reporting obligations if he or she was retained or directed by the issuer's chief legal counsel to investigate or litigate evidence of a material violation, the attorney and the chief legal counsel must go through a series of steps.[27] First, the attorney must report the results of the investigation to the issuer's chief legal officer. Then, the attorney and the chief legal officer must both reasonably believe that no material violation has occurred, is ongoing or is about to occur. If both do not agree, the chief legal officer must report the results of the investigation to the issuer's board of directors.

The QLCC, however, offers a much simpler and more efficient method of investigating or litigating evidence of a material violation. If an attorney is retained or directed by the QLCC to investigate or litigate evidence of a material violation, neither the attorney nor the issuer's chief legal counsel will be required to report "up-the-ladder" such evidence of a material violation because the QLCC has the responsibility of determining whether disclosure is necessary.

IV. POLICIES AND PROCEDURES

While the Final Rules set forth the basic requirements for a QLCC, they do not offer guidelines as to how a QLCC should be implemented or administered. First, in order to create a QLCC, an issuer's board of directors must approve the QLCC's charter, a sample copy of which is attached hereto as Exhibit B. Second, because the Final Rules were published so recently, one can only speculate as to how "best practices" will evolve with respect to the administration of a QLCC. It may be instructive, however, to look to other special committees that boards often rely upon in managing the business of an issuer. The special litigation committee[28] and the audit committee are two such examples of board

[26] Final Rules, Section 205.3(b)(7).

[27] Final Rules, Section 205.3(b)(6).

[28] A special litigation committee is "an independent committee appointed by a majority of the directors of a corporation, which is charged with the task of determining the propriety of the corporation's pursuit of a derivative action." James L. Rudolph & Gustavo A. del Puerto, The Special Litigation Committee: Origin, Development and Adoption Under Massachusetts Law, 83 Mass. L. Rev. 47, 47 (1998). Further, a special litigation committee, like the QLCC, is (1) comprised of independent directors, (2) vested with the full authority to act on behalf of the board to perform a thorough investigation; (3) able to access outside counsel and other experts; and (4) able to access adequate information.

committees that provide guidance as to how an issuer may manage the operations of a QLCC.

How Does the QLCC Relate to Corporate Governance Principles?

In its composition and the limited scope of its function, the QLCC resembles other committees of the Board of Directors, including the audit committee or special litigation committee. Unlike a special litigation committee, to be effective a QLCC must be created prior to any issue arising that would be appropriate for QLCC consideration. As in the operation of other committees, the likelihood of proper functioning will be improved by careful advance attention to appropriate committee membership. QLCC members should be independent. They should enjoy freedom from potential conflict of interest and other grounds for having the quality and objectivity of their judgment subject to question.

It is also recommended that the Board adopt a charter reflecting the principles governing the QLCC's composition, responsibilities, authority and operation. Such a charter can be for a stand alone committee that would serve as the QLCC, or for an amendment to the charter of an existing committee that could so serve. A draft charter is attached to illustrate some of these considerations. We would expect that such charters would be subject to refinement and revision over time as experience and best practices evolve. It seems likely that QLCC's will serve an important compliance role, and would frequently be the body responsible for initiating investigations to explore, address, and resolve issues relating to possible material violations.

How Often Should the QLCC Meet?

At the very least, the QLCC should meet at the first instance of a reported violation and thereafter as deemed appropriate to conduct or supervise a thorough and exhaustive investigation. However, the question arises as to whether the QLCC should meet on a regular basis. While the special litigation committee does not provide much guidance on this issue since it is usually formed after a claim is brought, the audit committee does offer some insight into how often the QLCC should meet. The New York Stock Exchange proposed new rules relating to audit committees whereby the audit committee would be required to meet at least quarterly.[29] While the QLCC, unlike the audit committee, would not be charged with reviewing the quarterly financial statements, it would be helpful for the QLCC to meet at least once a quarter to discuss any alleged evidence of a material violation in connection with the issuer's accounting, internal accounting controls or audit functions that occurred during the preparation of the quarterly financial statements. Query: Is there routine information that the QLCC should review periodically (e.g., loss contingencies or the management letter from the outside auditors)?

[29] Section 7(b)(ii)(C) of proposed NYSE rules.

Should the QLCC Hire Outside Counsel?

In deciding whether to hire outside counsel, it is helpful to look at the procedures used by special litigation committees. Many commentators on the issue of a special litigation committee have opined that a "corporation should hire 'special counsel' to advise and assist" a special committee of the board.[30] Typically, that outside counsel would not customarily be the principal outside counsel for the issuer. And, generally, outside counsel would be preferable to inside counsel acting alone, since outside lawyers assist the QLCC to "avoid the appearance of a conflict of interest."[31] Furthermore, since the attorney-client privilege only protects communications of a legal nature and does not apply to business advice given by an attorney, it would be preferable to involve outside counsel since in-house counsel often dispenses advice of both a business and legal nature and such mixed advice may not be privileged.

Should the QLCC Keep Minutes of Meetings?

The decision as to whether to keep minutes of QLCC meetings is a difficult one. The QLCC's main task is to investigate, or supervise the investigation of, evidence of a material violation. The key to these investigations, in addition to determining the facts, is preserving the attorney-client privilege and work product doctrine from the beginning of the investigation. On the one hand, if the QLCC keeps minutes of its meetings, the QLCC runs the risk that those minutes, or portions thereof, may not be protected by the attorney-client privilege or the work product doctrine and may be discoverable in subsequent civil or regulatory proceedings. On the other hand, without minutes it may be difficult for the QLCC members to reconstruct their deliberations years after the events occurred. If the QLCC keeps minutes of its meetings, it is advisable for the QLCC to include only the most basic information and to have counsel review the minutes in order to preserve the attorney-client privilege or work product doctrine.

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[30] Alice A. Seebach, Special Litigation Committees: A Practioner's Guide, 24 L.A. L. Rev. 1, 24 (1990); see also, Paul H. Dawes & Mary E. Kostel, The Treatment of the Demand Requirement and the Use of the Special Litigation Committee in Delaware Law and in the American Law Institute's "Principles of Corporate Governance: Analysis and Recommendations," 444 PLI/LIT 383, at *401 (1992); Carlton Investments v. TLC Beatrice International Holdings, Inc., No. Civ. A. 13950, 1997 WL 305829, at *11 (Del. Ch. May 30, 1997) (noting that the special litigation committee's use of highly reputable outside counsel was "efficient").

[31] Seth Aronson & Sharon L. Tomkins, Recent Developments in Shareholder Derivative Actions, 1269 PLI/CORP 791, at *820 (2001); see also, Strougo ex. rel. The Brazil Fund, Inc. v. Padeges, 27 F. Supp. 2d 442, 451 (S.D.N.Y. 1998) (noting that several courts have relied upon the appointment of independent outside counsel as a factor in making a finding of independence for a special litigation committee).

How Should the QLCC Conduct the Investigation?

The investigation should last for as long as necessary to perform a thorough and complete examination.[32] In order to understand what constitutes a "thorough and complete" investigation, it is helpful to examine investigations conducted by special litigation committees. First, the QLCC may not be deemed to have conducted a reasonable good faith investigation if it fails to interview the most important witnesses regardless of how many interviews it conducts.[33] If the QLCC interviews the important witnesses, it does not seem to matter what type of interview format the QLCC uses whether it be in person, or by telephone or written questionnaire.[34] Furthermore, the QLCC should be careful of who is present during interviews of corporate employees since at least one court has cautioned against having in-house counsel present during such times.[35] Finally, the QLCC should thoroughly review all relevant documents in order to conduct a reasonable investigation.[36]

V. ADVANTAGES AND DISADVANTAGES OF THE QLCC

Each issuer must decide on its own whether to create a QLCC to investigate evidence of material violations. While the list of pros and cons of creating a QLCC is likely to grow as the law becomes more developed, listed below are some initial impressions on the advantages and disadvantages of using a QLCC as the primary investigatory tool for suspected material violations.

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[32] See, Lewis v. Fuqua, 502 A.2d 962, 936 (Del. Ch. 1985) (holding that an investigation was "reasonable" in light of thorough examination).

[33] See, Seebach, supra note 27, at 29; see also, Hasan v. CleveTrust Realty Investors, 729 F.2d 372, 379-80 (6th Cir. 1984) (holding the investigation was not thorough because the committee failed to interview two companies that could have provided crucial information).

[34] Seebach, at 29.; see also, Auerbach v. Bennett, 47 N.Y.2d 619, 635, 393 N.E.2d 994, 1003, 419 N.Y.S.2d 920, 930 (1979) (holding that investigation by the special litigation committee was sufficient where the committee interviewed witnesses in person and sent written questionnaires to non-management directors); In re General Tire & Rubber Co., 726 F.2d 1075, 1085 (6th Cir. 1984) (holding that the investigation was thorough because the special committee distributed questionnaires, performed personal interviews and telephoned contacts).

[35] Seebach, at 29; see also, Kaplan v. Wyatt, 499 A.2d 1184, 1190 (Del. 1985) (stating that while the presence of in-house counsel during employee interviews was not fatal, such a practice is not recommended).

[36] Seebach, at 29; See also, Kaplan, 499 A.2d at 1188 (holding that the investigation was thorough because the committee, among other things, reviewed the relevant documents); Rosengarten v. International Tel. & Tel. Corp., 466 F. Supp. 817, 824 (S.D.N.Y. 1979) (holding that because the committee studied reams and reams of paper and interviewed witnesses, the investigation was thorough).

A. Advantages

Privileges

If the QLCC retains outside counsel at the outset of an investigation into evidence of a material violation, the QLCC increases its ability to use effectively the attorney-client privilege and work product doctrine to protect information gained during the course of the investigation. Without the protection afforded by these doctrines, the issuer may face increased liability due to the disclosure to civil litigants of potentially damaging information.

Sentencing Guidelines

In theory, the Federal Sentencing Guidelines should substantially reward companies which have effective QLCC's. There are significant reductions built into the guidelines when an offense occurs "despite an effective program to prevent and detect violation of law" -- as long as high level personnel did not participate in the fraud.[37] Similarly, there are even greater reductions for organizations that self report and cooperate with the government.[38] We would not be surprised if the guidelines were ultimately amended to include specific reference to QLCC's.

The most important advantage though, of a QLCC in terms of interaction with criminal authorities, is the potential to convince the prosecutor not to charge the company in the first place. First of all, the theory behind the guideline reductions applies equally well in the context of charging decisions -- why penalize a good corporate citizen? How can the government encourage self reporting if there is no way out of a crippling corporate indictment? Second, many prosecutors and scholars already question the utility of criminally charging an inanimate organization. The existence of a substantial and respected QLCC might sway the ultimate decision of a prosecutor or her supervisor. Finally, the government will be dealing with a group of people -- the QLCC members and their outside attorneys -- significantly removed from the company, which may bring down tensions on both sides and comfort the government when making its final decision.

Director and Officer Liability Insurance

In the post-Enron era of skyrocketing insurance rates for directors and officers, establishing a QLCC may present a unique opportunity for an issuer to negotiate for lower premiums. The existence of a properly constituted and functioning QLCC should demonstrate an issuer's commitment to corporate ethics and its resolve to deal quickly and effectively with any material violations. The QLCC will address, and if necessary, correct,

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[37] U.S.S.G. § 8C2.5(f).

[38] U.S.S.G. § 8C2.5(g).

undisclosed material violations that otherwise may subject the issuer to substantial, incremental liability. Furthermore, the Commission has expressly stated in the Final Release that membership on a QLCC is not intended to increase the liability of any of its members. As a result, issuers that have QLCC's in place may be able to negotiate for lower insurance premiums for their directors' and officers' coverage.

B. Disadvantages

Standard of Review for a QLCC's Decision Not to Act

The Final Rules do not provide any standard by which to judge a QLCC's decision not to take action after investigating evidence of a material violation. Thus, a QLCC will have no clear guidance as to when to recommend remedial action and/or when to disclose that a material violation has occurred. In light of this uncertainty, there is potential for liability for members of the QLCC and the issuer if a QLCC fails to take action with respect to evidence of a material violation.

Reporting to the Commission

At present, it is unclear whether the QLCC will be required to report its findings to the Commission.[39] The Final Rules only provide that the QLCC has the "authority and responsibility, acting by majority vote" to notify the Commission if the issuer fails to follow the QLCC's recommended course of action.[40] Thus, it is not clear whether the QLCC must report to the Commission or whether it has discretion to disclose its findings. Given the uncertainty, QLCC members may face a greater risk of liability if they choose not to disclose their findings to the Commission.

Increased Legal and Financial Expertise

While the Commission has stated that it does not expect directors who serve on the QLCC to face increased liability, the fact remains that QLCC members will need to have some legal and financial expertise in order to investigate effectively evidence of material violations. However, directors who serve on audit committees are already concerned with the existing level of "financial literacy" that is required of them to serve on such committees[41] and of the new "financial expert" qualifications under Section 407 of the Act. Notwithstanding the Commission's words to the contrary, directors may be hesitant to serve on the QLCC because they may fear additional exposure to liability for their perceived lack of legal and/or financial expertise. [42] One may argue, however, that QLCC members will

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[39] See, Susan Hackett, The Road to Compliance, Texas Lawyer, March 3, 2003.

[40] Final Rules, 205.2(k)(2)-(4).

[41] Section 303.01(B)(2)(b) of the NYSE Listed Company Manual.

[42] See, Hackett, supra, note 33.

presumably be covered by insurance and the issuer's indemnity and, as a result, need not concern themselves with the potential for incremental liability. While this argument may be true in most circumstances, it is less persuasive if the issuer files for bankruptcy because the indemnity is lost and it is unclear what value the insurance will have if it also applies to the issuer.

VI. CONCLUSION

Each issuer must decide whether to create a QLCC to investigate evidence of a material violation. If the issuer decides to create a QLCC, it must first chose whether to create an entirely new committee or whether to use a pre-existing committee such as an audit committee to serve both roles. The issuer must then ensure that it vests the QLCC with the appropriate authority required by the Commission's Final Rules. Even if the issuer complies with such rules, however, it is not entirely clear how the QLCC will actually function. Due to the lack of guidance regarding the administration of a QLCC, we are left to examine the management of other board committees such as an audit committee or a special litigation committee as examples. While instructive, these board committees do not provide definitive answers. In fact, the Commission or the courts may interpret the proper functioning of a QLCC in a different manner. Furthermore, as of yet, there is no clear standard by which to judge a QLCC's decision not to act after investigating evidence of a material violation. This lack of clarity may lead to increased exposure if the QLCC decides not to take action with respect to a material violation that, in hindsight, should have been acted on. Despite the uncertainty surrounding the QLCC, however, it appears that the QLCC may be used as an effective tool to manage an issuer's legal risk, especially if the QLCC follows traditional standards applicable to board committees such as an audit committee or a special litigation committee. As the Commission has noted, the QLCC provides an institutionalized method of reporting evidence of material violations and in so doing, allows the issuer to respond promptly to violations that, if left untreated, could lead to increased civil, regulatory and potentially, criminal exposure.