105 The Low Down on Reporting Up

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Faculty Biographies

Mark D. Cochran

Mark D. Cochran is vice president, general counsel, and corporate secretary of Hyperion Solutions Corporation in Santa Clara, California. He brings nearly two decades of technology industry experience, working in law departments of both large and small technology companies. The range of his experience includes mergers and acquisitions, corporate governance, Sarbanes-Oxley compliance, and intellectual property protection.

Prior to joining Hyperion, Mr. Cochran served as: vice president, general counsel, and corporate secretary at Brocade Communications Systems; vice president, general counsel to AvantGo (acquired by Sybase); director and assistant general counsel for Advanced Micro Devices and senior corporate counsel to Syntex (acquired by Roche). He began practicing law with the Bay Area firm of Ropers, Majeski, Kohn, Bentley, Wagner & Kane.

Mr. Cochran graduated from University of California, Davis with a B.S. He received his J.D. from Santa Clara University Law School and a M.B.A. from Santa Clara University Graduate School of Business.

Beth Golden

Beth Golden is senior managing director and the global head of compliance at Bear, Stearns & Co., Inc. in New York City.

Previously, Ms. Golden served as deputy to New York State Attorney General Eliot Spitzer, co-managing the attorney general's investigation into Wall Street research and IPO allocation practices, and the negotiations leading to the April 2003 Global Settlement between 10 investment banks and state and federal regulators. She also worked on a number of the mutual fund settlements, as well as the investigation that led to Mr. Spitzer's complaint against Marsh & McLennan. Prior to becoming a federal prosecutor, Ms. Golden clerked for the Honorable Thomas Penfield Jackson in the District of Columbia, practiced with the law firm of Davis Polk & Wardwell, and served as an associate independent counsel to Robert B. Fiske, Jr. in the Whitewater Investigation.

She is a graduate of Harvard College and the University of Chicago Law School.

Michael Nelson

Michael Nelson is counsel and vice president of the Federal Reserve Bank of New York. He advises on corporate governance issues in addition to supporting the markets and bank supervision groups of the bank.

Mr. Nelson previously was an in-house lawyer at Merrill Lynch. He was formerly co-chair of the ABA's international financial services committee and is active in ACC's Greater New York Chapter.

Mr. Nelson is a cum laude graduate of Harvard College and New York University School of Law.

Charles Raeburn

Charles Raeburn is senior corporate counsel in the Pfizer Inc. legal division, corporate governance group. Prior to this position at Pfizer, he was general counsel to Howmedica Inc., a manufacturer of orthopedic implants wholly-owned by Pfizer, and also served as business transactions counsel to Pfizer International and the pfizer animal health group.

Prior to joining Pfizer, Mr. Raeburn was in private practice in New York and served in-house at Union Carbide Corporation and Revlon Inc.

He is a member of the New York State Bar Association and the Association of the Bar of the City of New York (financial disclosure committee), and he is a Pfizer representative to the Council of Institutional Investors.

Mr. Raeburn graduated from New College, in Sarasota, Florida and received his law degree from Yale Law School.

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Session 105 – The Low Down on Reporting Up

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ACC's 2005 Annual Meeting: Legal Underdog to Corporate Superhero—Using Compliance for a Competitive Advantage

October 17-19, Marriott Wardman Park Hotel

Section 307 of Sarbanes-Oxley

- Congressional Response to Enron
  - Congress did not believe the legal profession was self-regulating at an appropriate level.
- *Mandates* the SEC to "issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers..."
  - Includes Up The Ladder Reporting.

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SEC Rule 205

- *Purpose*: Set "forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in the representation of an issuer."
  - Key point is that an attorney's client is the always the organization, not the individuals of the organization.

SEC Rule 205 (cont.)

- Important definitions
  - *Attorney* defined as "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."
  - *Appearing and Practicing before the Commission* defined as
    - Transacting any business with the commission, including communications in any form;
    - Representing an issuer in a Commission administrative proceeding or in connection with any Commission investigation, inquiry, information request, or subpoena;
    - 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
    - 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 incorporating into any comment that will be field with or submitted to, the Commission.

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Up The Ladder Procedure

- If an attorney becomes aware of a material violation, attorney shall report evidence of material violation to the issuer's CLO or to both CLO and CEO.
  - *Material Violation* defined as a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar violation of any United States federal or state law.
  - *Evidence of a material violation* defined as 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.

Up the Ladder Procedure (cont.)

- CLO/CEO shall perform inquiry as to the evidence of a material violation.
  - CLO/CEO shall inform reporting attorney of the final result of the inquiry.
- If a reporting attorney does not think CLO/CEO has made an appropriate response within a reasonable time, the attorney shall report "up the ladder."
  - For example, attorney shall report evidence to the audit committee of the issuer's board of directors.
  - If a reporting attorney believes bringing evidence of material violation to CLO/CEO will be futile, may go directly "up the ladder."

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QLCC Alternative

- Attorney may report evidence of a material violation to a Qualified Legal Compliance Committee ("QLCC").
    - *QLCC* consists of at least one member of the audit committee and two or more members independent members of the issuer's board of directors.
    - *QLCC* must adopt procedures for the confidential receipt, retention, and consideration of any report of a material violation.
- Once an attorney brings forth evidence of a material violation to a *QLCC*, his or her reporting obligations are fulfilled.
    - Not required to assess the issuer's response to the reported evidence
- CLO may choose to report evidence of a material violation to a *QLLC* in lieu of performing an inquiry his/herself.

Duties of Supervising Attorneys

- *Supervising Attorney* defined as "an attorney supervising or directing another attorney who is appearing and practicing before the Commission in the representation of an issuer..."
- Supervising Attorney must comply with the *Up The Ladder Procedure* if a subordinate attorney brings forth evidence of a material violation.

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Duties of Subordinate Attorneys

- *Subordinate Attorney* defined as "an attorney who appears and practices before the Commission in the representation of an issuer on a matter under the supervision or direction of another attorney."
- Comply with SEC Rule 205.
  - Duty fulfilled once evidence of a material violation is reported to a Supervisory Attorney.

Sanctions and Discipline

- Civil penalties and remedies.
- Subject to the disciplinary authority of the SEC, regardless of whether attorney is subject to state disciplinary authority as well.
- No private right of action.
  - "Authority to enforce compliance...is vested exclusively in the Commission."

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Securities Regulation and Law Report

37 Sec. Reg. & L. Rep. (BNA) 108

January 17, 2005

THE DEFECTIVE TRIGGER OF THE SEC'S RULE IMPLEMENTING SOXA'S DUTY TO REPORT

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This report, with the consent of the publisher, relies heavily on a portion of our article, "The Legal and Ethical Duties of Lawyers After Sarbanes-Oxley, *49 Villanova L. Rev. 260 (2004).* **[Correct cite is 49 Villanova L. Rev. 725]**

The heart of § 307 of the 2002 Sarbanes-Oxley Act, and of the SEC rules implementing it, is the lawyer's duty to report. The key question is what circumstances trigger that duty. Section 307 obligated the SEC to adopt a rule requiring a lawyer "to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof)." The rule implementing this requirement, § 205.3(b), states:

If an attorney, appearing and practicing before the Commission in the representation of an issuer, becomes aware of evidence of a material violation by the issuer or by any officer, director, employee, or agent of the issuer, the attorney shall report such evidence to the issuer's chief legal officer [CLO] (or the equivalent thereof) or both the issuer's chief legal officer and its chief executive officer (or the equivalents thereof) forthwith. n1

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n1 17 C.F.R. § 205.3(b)(1). An alternative to reporting to the chief legal officer is reporting to a qualified legal compliance committee and reporting directly to the board or relevant board committee. The alternative of reporting to a previously formed "qualified legal compliance committee" is subject to a trigger similar to the general trigger for reporting to the chief legal officer. Id. § 205.3(c). A lawyer may bypass the chief legal officer and go directly to the board when the lawyer "reasonably believes that it would be futile to report evidence of a material violation to the issuer's chief legal officer and chief executive officer." Id. § 205.3(b)(4).>ENDFN>

The SEC rules define "evidence of a material violation" in § 205.2(e) as "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 occurring, or is about to occur." n2

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n2 17 C.F.R. § 205.2(e). Other relevant definitions are "material violation" in § 205.2(i) and "breach of fiduciary duty" in § 205.2(d).>ENDFN>

In assessing how well the SEC rules implement the Congressional mandate, it is important to keep in mind the goals of § 307. In the wake of Enron and other corporate scandals, Congress was concerned that too many corporate lawyers were taking a "see no evil, report no evil" approach to their representations.

The purpose of § 307 was to change this corporate legal culture and practice and encourage more reporting of dubious corporate activities. Thus, Congress abandoned the "subjective" approach of Model Rule 1.13(b), which imposes no obligations on a lawyer unless she "knows" that illegal activity is occurring or will occur. Instead, Congress mandated an objective trigger, while at the same time lowering the triggering standard from one of definitive violation to "evidence" of a violation. The hope was that an objective, probabilistic "evidence" trigger would be less subject to manipulation by lawyers inclined not to notice evidence of wrongdoing or to explain such evidence away. The question, then, is whether the SEC rules further this objective. The answer, unfortunately, is that the effectiveness of the triggering standard is undermined by ambiguous and troublesome language.

There are four major deficiencies in the SEC's triggering standard:

1. The Troublesome Double-Negative Standard

In deciding whether to act -- whether to report what Congress wanted to encourage lawyers to report up the corporate ladder -- the lawyer confronting the definition of "evidence of a material violation" in § 205.2(e) must ask herself whether it would be unreasonable not to conclude that the evidence before her demonstrates a reasonable likelihood of a material violation of law. The double-negative formulation makes the standard difficult to understand, interpret or apply. n3

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n3 See Floyd Norris, No Positives in This Double Negative, N.Y. Times, Jan. 24, 2003, at p. C1, stating that the change from a "straightforward" and "reasonably simple definition" to one that is "confusing" and makes the required reporting up the ladder "a lot harder to enforce.">ENDFN>

Law is intended to guide action in the world. Yet it is barely possible to read the SEC's definition out loud without tripping over the words, let alone trying to remember the definition without reading it or trying to work out its mysterious and hidden "logic."

The SEC's standard fails another critical test of sound rulemaking. It will be a nightmare to enforce. The Commission has asked its staff to assume the burden of proving not just one negative, but two. To enforce this rule, the Commission will have to show that it was unreasonable for a lawyer not to conclude that a violation was reasonably likely. The staff is asked to meet an uncertain and unrealistic burden.

The SEC's defense of this definition in the Adopting Release is that it "recognizes that there is a range of conduct in which an attorney may engage without being unreasonable." n4 The idea is that if any "prudent and competent" lawyer might conclude that the evidence did not support the conclusion that a material violation has occurred, up-the-ladder reporting is not required. But this standard renders the reporting requirement of § 307 nearly an empty shell. Any good lawyer will almost always be able to conclude that it is not 'unreasonable' to conclude that the evidence demonstrates legal conduct. The ethos of lawyers is not to report up the corporate ladder, and to find any possible way to avoid doing so.

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n4 See Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8185, *68 Fed.Reg. 6296* (Feb. 6, 2003) (codified at 17 C.F.R. pt. 205) [discussion of § 205.2(l) and (m)]. The SEC used a similar double negative to define "reasonable" in § 205.2(l) and "reasonably believes" in § 205.2(m), again to emphasize a "range" of reasonable behavior or belief. But a range is inherent in the concept of reasonableness.>ENDFN>

The SEC could easily have adopted a rule that a lawyer must report when confronted with information that a prudent and competent lawyer, acting reasonably under the circumstances, would conclude was credible evidence of a material violation. That is precisely the triggering standard we proposed in our comments to the SEC, and which we still support. n5 This clearer and more straightforward definition, incorporating a standard conception of reasonableness, would provide ample recognition of a "range of conduct" and the need for lawyer discretion. n6

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n5 See Letter of Susan P. Koniak, Roger C. Cramton and George M. Cohen to the SEC (Dec. 17, 2002) (commenting on the SEC's proposed rule implementing § 307 of Sarbanes-Oxley), pp. 13-14.

n6 See, e.g., Restatement (Third) Law Governing Lawyers § 52 cmt. b (interpreting a lawyer's duty of competence as one of "reasonableness in the circumstances," which "does not require a lawyer, in a situation involving the exercise of professional judgment, to employ the same measures or select the same options as would other competent lawyers in the many different situations in which competent lawyers

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reasonably exercise professional judgment in different ways"). Moreover, the use of "would" rather than "could" in our proposed standard ensures the recognition of sufficient lawyer discretion without undermining the rule.>ENDFN>

2. The Ambiguity of 'Reasonably Likely'

Congress, in adopting a duty to report triggered by "evidence" of a material violation, intended to encourage more reporting by corporate lawyers, even when those lawyers could imagine some alternative interpretation of the facts or law that would render the conduct in question innocuous. Yet, the SEC's trigger, contained in its definition of "evidence of a material violation," includes the troubling qualification that the evidence must show that a material violation is "reasonably likely."

The SEC's intent was apparently to add a substantiality requirement to the evidence trigger. The Adopting Release states: "To be 'reasonably likely' a material violation must be more than a mere possibility, but it need not be 'more likely than not.'" SEC staff members, while disclaiming authority to speak for the Commission, have stated publicly that "reasonably likely" means less than "more probably than not" and that conduct in "the 20%-40% range of likelihood" should trigger a report. n7 If the language is interpreted that way, it would be consistent with Congressional intent by requiring lawyers to report evidence of possible violations, but not requiring the report of evidence that is so vague or insubstantial as not to warrant additional investigation by the corporation.

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n7 Simon N. Lorne, An Issue-Annotated Version of the SOx 307 Rules, in ALAS Loss Prevention Programs, p. A-117, 125 (June 12, 2003).>ENDFN>

Unfortunately, the language used by the Commission is susceptible of other readings. As one comment on this language stated:

The ordinary, commonly understood meaning of the word "likely" is probable or having a high probability of occurring. Most attorneys would understand the phrase "reasonably likely" as used in Section 205.2(e) to mean probably or more likely than not. Nothing in Part 205 itself seems inconsistent with the commonly accepted understanding of "reasonably likely." n8

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n8 Comment of Attorneys' Liability Assurance Society, Inc., on the SEC Proposed Rule (Mar. 28, 2003).>ENDFN>

The comment goes on to state that the sentence in the Adopting Release, quoted above, "muddies the meaning of 'reasonably likely' by attempting to assign to that phrase the meaning 'possible,' which is counter-intuitive for most attorneys, confusing and contrary to the commonly accepted meaning." n9

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n9 Id.>ENDFN>

In any enforcement action under Part 205, the SEC will face a "plain meaning" attack on its interpretation of "reasonably likely." The Commission should amend the rule to add a definition stating that " 'reasonably likely' means less than 'more probable than not' but more than a remote possibility."

3. 'Becomes Aware' and the Duty of Inquiry

One of the problems with the subjective "actual knowledge" trigger in Model Rule 1.13(b), n10 which Congress sought to replace in § 307, is that it creates an incentive for lawyers not to "know" that wrongdoing is occurring or may occur. An examination of corporate failures and frauds often shows that information that should have led lawyers to inquire was ignored, handled by taking the word of the agents accused of wrongdoing without more, or given only a perfunctory review. Many of these cases involved a number of suspicious circumstances over time, some eye-opening enough to be characterized as red flags. n11 In situations of this type, law firms have frequently ended up settling malpractice or third-party liability claims for large amounts of money.

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n10 Under ABA Model Rule 1.13(b), before and after its 2003 amendment, a lawyer for a corporation has no duty to act unless he "knows" that a violation is occurring or about to occur. "Knows" is defined in Model Rule 1.0(f) as "actual knowledge," which "may be inferred from circumstances."

n11 See Report of the Trustee, In re OPM (S.D.N.Y. 1983). In the OPM fraud, the largest in American history at the time it occurred, the law firm that documented and closed all of OPM's lease transactions continued to represent OPM after learning that the two managers of OPM were guilty of check-kiting involving a bank they owned, engaged in transactions with a particular vendor that were numerous and unusual, and received a letter from OPM's former chief financial officer, just resigned, stating that many of the transactions with that vendor were fraudulent.>ENDFN>

It is unclear how the SEC rules handle the willful blindness problem. Section 205.3(b) imposes a duty to report on a lawyer who "becomes aware of evidence of a material violation." By lowering the trigger from "violation" to "evidence," § 307 and the SEC rules in effect shift much of the burden of a duty of inquiry to the chief legal officer to whom initial reports are made. n12 But there could still remain some level of evidence that is not strong enough to trigger a duty to report but could trigger some kind of duty to inquire. And the higher the threshold of "evidence" needed to trigger the duty to report, for example, due to a strict reading of "reasonably likely" as discussed in the previous section, the more important the meaning of "becomes aware" becomes.

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n12 The duty of inquiry for the chief legal officer as a result of a "report" of evidence of a material violation is made explicit in § 205.3(b)(2).>ENDFN>

"Becomes aware," which is not defined in the rules, sounds like a subjective standard. It could, however, be interpreted to incorporate at least the "recklessness" standard from the case law. We think it should be so interpreted, or better yet, the phrase should be changed or specifically defined to incorporate the recklessness standard. n13 One reason is that lawyers are likely to view compliance with the SEC rules as a kind of "safe harbor" against liability, although the rules themselves do not directly speak to this issue. We do not think the rules should be interpreted to provide such a safe harbor. If they are, however, the SEC rules should not be interpreted as providing weaker protection for investors than the general rules of liability under the securities laws and related law. On the other hand, if the rules do not provide a safe harbor, then lawyers who mistakenly believe they do risk falling into a trap for the unwary.

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n13 One possibility would be to use a "reason to know" standard. The law of agency distinguishes "reason to know" from "should know." The latter standard contemplates a duty of inquiry; the former generally does not. See Restatement (Second) Agency § 9 cmt. d, e. See also Deborah A. DeMott, When Is a Principal Charged with an Agent's Knowledge?, *13 Duke J. Comp. & Int'l L. 291, 300-02 (2003).*>ENDFN>

Although prudent lawyers will investigate suspicious, credible information, due to the threat of an adverse outcome in litigation, the thrust of § 307 is that reliance on the prudence of most lawyers as well as the threat of liability is not a sufficient deterrent to corporate wrongdoing. n14 The SEC rules should implement that vision and not that of the corporate bar.

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n14 Simon Lorne, a former SEC general counsel, draws a very different conclusion. He argues: "Nothing, of course, prevents corporate counsel from establishing their own, lower, standards for reporting; it may well be that a fairly low standard is the right approach when the power of the SEC enforcement division stands behind a failure to meet that standard." Simon N. Lorne, An Issue-Annotated Version of the SOx 307 Rules, in ALAS Loss Prevention Programs, p. A-117, 126 (June 12, 2003).>ENDFN>

4. Imputed Knowledge

A question related to the duty of inquiry and willful blindness, but not addressed in the rules, is the extent to which knowledge within firms will be "imputed" from one lawyer to another. Lawyers often cite the desire to avoid imputation as a key reason for supporting the "actual knowledge" standard in Model Rule 1.13. Even though the SEC rules do not apply specifically to "law firms," as distinct from lawyers, when the client's lawyer-client relationship is with the firm, as it usually is, some form of imputation is necessary, because there must be some way to determine the "knowledge" and "intent" of the firm, which can act only through its agents.

The concept of imputed knowledge comes from the law of agency and partnership. In general, an agent's

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knowledge is imputed to the agent's principal in two situations: (1) if the knowledge concerns a matter in which the agent's own actions bind the principal; or (2) if the agent has a duty to give the principal information. n15 Similarly, under partnership law, "the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind, and the knowledge of any other partner who reasonably could and should have communicated it to the acting partner, operate as ... knowledge of the partnership." n16

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n15 Restatement (Second) Agency § 272.
n16 Uniform Partnership Act § 12. The Uniform Partnership Act defines "knowledge" as actual knowledge as well as "knowledge of such other facts as in the circumstances shows bad faith." Id. § 3(1). This definition incorporates the "willful blindness" standard or the agency law "reason to know" standard. The Revised Uniform Partnership Act, now adopted by a majority of US jurisdictions, broadens the concept of partnership imputation to any "fact relating to the partnership" of which a partner has "knowledge," Revised Uniform Partnership Act § 102(f), but narrows the definition of knowledge to actual knowledge, id. § 102(a). Limited liability companies, a form used by many law firms, are also subject to imputation rules, but the statutes governing these entities do not take a uniform position on the question.>ENDFN>
In applying these principles, the courts over the years have adopted a doctrine of "composite knowledge," which attributes to an entity the collective knowledge of its individual agents even if no one agent had all the knowledge. n17 The SEC has previously endorsed the composite knowledge idea in exercising its disciplinary authority against law firms under Rule 2(e). n18

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n17 See, e.g. *U.S. v. T.I.M.E.-D.C. Inc., 381 F.Supp. 730, 738 (W.D. Va. 1974):* "knowledge acquired by employees within the scope of their employment is imputed to the corporation. In consequence, a corporation cannot plead innocence by asserting that the information obtained by several employees was not acquired by any one individual employee who then would have comprehended its full import. Rather, the corporation is considered to have acquired the collective knowledge of its employees and is held responsible for their failure to act accordingly." But cf. *Woodmont v. Daniels, 274 F.2d 132, 137 (10th Cir. 1959)* ("While in some cases a corporation may be held constructively responsible for knowledge of its agents, whether acting in unison or not, ... we are unwilling to apply the rule to fix liability where, as here, intent is an essential ingredient of tort liability as for deceit.")
n18 See *In re Keating, Muething & Klekamp, Release No. 34-15982, 1979 WL 186370* (July 2, 1979). In that case, the Commission found that the firm "collectively had knowledge" of questionable transactions, but had imposed "a division of authority among the partners within the firm concerning client matters which significantly impaired communications within the firm... . due in part to the lack of comprehensive internal procedures within the firm to gather and evaluate such information in connection with the preparation of [the client's] filings with the Commission." The Commission faulted the firm for failure to have in place "a system which assured that the knowledge of the members of the firm was communicated to the persons responsible for preparing disclosure documents so that adequate disclosure of material information -- which was within the firm's knowledge -- was made." >ENDFN>
In our view, the SEC rules should be amended to apply to law firms and their application should include the idea of composite knowledge. Absent such an imputation rule, law firms would have an incentive to decentralize legal work to minimize the number of lawyers with access to sufficient client information to bring them within the purview of these rules. As a result, the quality of legal work done in securities matters as well as compliance with the securities laws would decline, perhaps in dramatic ways. Moreover, a composite knowledge rule should not add significantly to legal costs. Firms often have good economic reasons for dividing up legal work (in particular, benefits from specialization), and so they already have a need to coordinate and monitor the work and information of various lawyers. A failure to coordinate is itself likely to result in duplication of legal work that itself would unnecessarily escalate fees, as well as an increased risk of malpractice. Finally, the increased risk on law firms as a result of the composite knowledge rule could be mitigated by adopting a system of reduced penalties for firms with effective compliance programs and procedures reasonably designed to prevent violations of the SEC rules.
The question of imputation may be important even if law firms as entities are not covered by the rules. In theory, multiple lawyers or multiple law firms could be in an agency relationship with each other, in which case, the agency rules of imputation would apply to the lawyer in the position of principal. But even if the rules do not adopt "imputation" of knowledge in the sense of a conclusive presumption based solely on an agency relationship, the actual relationship between lawyers may give rise to an inference or presumption of knowledge depending on the circumstances. n19

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n19 See Restatement (Third) Law Governing Lawyers § 94 cmt. g ("If the facts warrant, a finder of fact may infer that the lawyer gained information possessed by other associated lawyers, such as other lawyers in the same law firm, where such an inference would be warranted due to the particular circumstances of the persons working together. Thus, for example, in particular circumstances it may be reasonable to infer that a lawyer who regularly consulted about a matter with another lawyer in the same firm became aware of the other lawyer's information about a fact.").>ENDFN>
An alternative way to handle the problem that imputed knowledge is meant to solve is through the rule concerning the responsibilities of supervisory attorneys. Under § 205.4(b), a "supervisory attorney shall make reasonable efforts to ensure that a subordinate attorney ... that he or she directs conforms to this part." The rule as drafted does not quite solve the imputation problem, because the "evidence of a material violation" that triggers the duty to report may become apparent only after the supervisory attorney gathers information from multiple subordinates. Thus, a supervisory attorney who sought to discourage or diffuse the transmission of bits of information that in and of themselves did not amount to evidence of a material violation would not run afoul of Section 205.4(b).
Section 205.4(b) could, however, be modified to include a responsibility on supervisory attorneys who supervise multiple subordinates to adopt reasonable measures for collecting and coordinating information from those subordinates to facilitate compliance with the rules. In addition, the SEC should amend the rules to clarify that the chief legal officer of the corporation, who is defined as a supervisory attorney under § 205.4(a), is a supervisor not only of inside counsel, but of all outside counsel, or must appoint one outside counsel to serve as such a supervisory attorney for purposes of the duty of collection and coordination of information from multiple firms.
Conclusion: The Importance of the Initial Trigger.
The triggering standard is the gateway to the entire set of obligations created by the rules. If that standard is so weak that lawyers inclined to do so can easily circumvent it, if it is so ambiguous and convoluted that the SEC cannot effectively enforce it, the rules will not have effectuated the statutory objective. We find it disappointing that so little attention has been paid to the triggering standard compared to other issues, most notably noisy withdrawal.
We find it even more disappointing that many lawyers who did pay attention to the trigger, and the SEC which sympathized with their objections, so strongly resisted a simple, objective standard, stated in affirmative terms and incorporating the willful blindness standard, which would fully implement congressional intent that lawyers report evidence of a material violation, while at the same time preserving an appropriate degree of lawyer discretion. The resistance is all the more troubling when one considers how little is really being demanded of the lawyer by the duty to report. n20 In particular, the lawyer is not required to take any further steps without an additional, more demanding trigger, being satisfied.

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n20 "Report" is defined in § 205.2(n) as simply "mak[ing] known to directly, either in person, by telephone, by e-mail, electronically, or in writing." In its initial proposed set of rules, the SEC had required written reports, but even those could have been very informal.>ENDFN>
The reporting up obligation of Part 205 has served a valuable function: reminding corporate lawyers that, under corporate law and state ethics rules, their fundamental obligation is to the corporate entity, not to the officers who temporarily direct its affairs. Informing the ultimate authority -- the board of directors -- of a prospective or ongoing illegality that will cause substantial harm to the corporation is not a radical new idea but a restatement of the requirements of corporate law and state ethics rules. Unfortunately, the SEC's rules implementing § 307 contain a number of major loopholes that are likely to nullify the effectiveness of the reporting up requirement. The most serious loophole is the initial trigger discussed here.

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Systems Management
$21.5 million

POLICIES AND PROCESSES FOR COMPANY ATTORNEYS REPORTING LEGAL VIOLATIONS INCLUDING COMPLIANCE WITH SEC RULE 205

The United States Securities Exchange Commission has adopted Rule 205, requiring certain COMPANY attorneys to report violations of certain U.S. laws to higher authorities within COMPANY. The policies and processes outlined below are intended to assist COMPANY'S in-house attorneys in complying with this requirement. Similar policies and practices have been adopted with respect to outside counsel for COMPANY (who are also subject to SEC Rule 205).

Reporting Violations Not Required by SEC Rule 205

COMPANY Legal Affairs has long encouraged all of its personnel to report, in good faith, any problems or issues they become aware of, especially those that involve violations of the law or legal duties by COMPANY employees or agents.

The adoption of SEC Rule 205 does not change this philosophy. COMPANY Legal Affairs continues to strongly encourage such reporting by all members of Legal Affairs – even if SEC Rule 205 does not require such reporting. To be specific, COMPANY Legal Affairs urges non-lawyers (as well as lawyers) to report violations, urges reports even if the violations are not "material", and urges reports of violations that do not involve U.S. securities laws or fiduciary duties. [1]

As a reminder, these reports may be made through a variety of means:

- If you desire to report anonymously, you may report through
  - The Ethics Office Helpline @ _______
  - The Ethics Office @ _______ (change type from "confidential" to "anonymous"
  - The General Counsel's anonymous e-mailbox @ ________
  - The Corporate Investigations group @ _______ (24 hour line)
  - Corporate Security @ _________ (click on "Report an Incident", and when filling in the form, click on the box to add a check mark next to "I want to remain anonymous."

- If you do not desire to report anonymously, you may report through
  - The Ethics Office Helpline (using your name) or _____
  - The Corporate Investigations group (using your name) or _______
  - Any Legal Manager, including the General Counsel

[1] In some jurisdictions, lawyers may be under an ethical obligation to report certain types of legal violations to higher authority in the company, or, in some cases, outside the company. Additionally, COMPANY'S Financial Integrity Policy may also require attorneys to report situations involving financial misconduct in situations to which Rule 205 does not apply.

However, if you decide that Rule 205 requires you to make a report, it triggers a number of specific obligations on your part and that of your supervisory attorney and/or the General Counsel and possibly others. Therefore, you should report under Rule 205 only if you have determined that you are (or may be) required to do so. If you are not required to do so, you should make your report in any of the variety of means listed above.

Help In Determining Whether An SEC Rule 205 Report Is Required

The determination as to whether an SEC Rule 205 report is required is ultimately that of the individual attorney. COMPANY Legal Affairs should not and will not dictate such a decision. However, if you are considering reporting under SEC Rule 205, and desire to consult with another attorney, you may contact any of the following internal resources to discuss your obligations &/or the appropriate process:

COMPANY attorneys have an ethical obligation to maintain COMPANY'S confidences as well as the attorney-client privilege. You should NOT discuss specific confidential or privileged information with anyone outside of COMPANY in connection with Rule 205 obligations without ensuring that such a consultation maintains COMPANY'S confidences and the privilege unless applicable law specifically requires or allows you to do so.

It is COMPANY'S policy and that of Legal Affairs that you should not be subject to any retaliation or discipline for making a good faith report, whether under Rule 205 or pursuant to the COMPANY Code of Business Conduct or any other COMPANY policy.

What to Do If An SEC Rule 205 Report Is Required

Mandatory Requirements

- If you decide to make a report under Rule 205 you MUST advise if you are doing so by stating that you are "Reporting under SEC Rule 205" or "Reporting under SEC rules on attorneys" or similar language that clearly states that you are doing so. Because such a report will trigger specific obligations for you and the attorney to whom you report it, clearly identifying the report as a Rule 205 report will ensure that it is handled in accordance with the SEC rule.

- You MAY NOT make a Rule 205 report anonymously, since in many cases, the General Counsel must be able to respond to you concerning your report.

- You SHOULD report to the General Counsel directly and immediately if you believe you are subjected to any harassment, retaliation or other disadvantage because you made a Rule 205 report.

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Preferred Practices:

In addition to the above requirements, COMPANY Legal prefers:

- That all Rule 205 reports be made to your supervisory attorney (if you have one) or, if none, to the General Counsel (and not both the General Counsel and the CEO)
- That all 205 reports be made, unless and until otherwise requested by the General Counsel, orally, in person if possible, but if not via secure land line telephonic connection (NOT via e-mail or cell phone)
- That you specify the purpose of the meeting as a Rule 205 (or similar language) report when making the appointment to deliver your report
- That another person other than your supervisory attorney or the General Counsel be present to take notes[2]
- That your report be made as soon as possible after you become aware of information that triggers your obligation to report
- That your report contain as much detail as possible to allow an expeditious investigation (but not waiting to cross every "T")
- That you NOT undertake an investigation yourself unless and until so directed by the General Counsel
- That you advise the General Counsel if you are dissatisfied with his response or are considering reporting to the Audit Committee or Board (for example, if you believe he has not responded promptly enough) to allow a chance for him to provide you with additional information
- That you promptly advise the General Counsel if any outside counsel notifies you that they are considering or may need to make a Rule 205 report
- That you advise the General Counsel as far as possible in advance if you believe you are permitted to and intend to report any violation covered by Rule 205 to persons outside the Company in order to allow a chance for him to provide you with additional information that might be pertinent to your decision
- If you are a supervisory attorney
    - That you advise the General Counsel if a subordinate attorney makes a Rule 205 report to you even if you determine that there is no credible evidence that it is reasonably likely that material violation has occurred and hence no further reporting is required
    - That you make any report to the General Counsel regarding a report received from a subordinate attorney orally, directly, expeditiously, in as much detail as possible and without conducting any investigation; if you have determined that the evidence raised by the subordinate attorney is not credible or that the violation is not covered by SEC Rule 205 (e.g., is not material) or for any other reason SEC Rule 205 does not in fact require a report under the circumstances, the basis for that determination

[2] If for any reason you have specific concerns about any individual attorney being present at such a meeting, please make that known when scheduling your meeting.

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Type: Energy
Sales: $8.4 billion

CINERGY CORP. STANDARDS OF PROFESSIONAL CONDUCT FOR ATTORNEYS[1]

I. Introduction

The purpose of this Standards of Professional Conduct for Attorneys (the "Policy") is to promote compliance with applicable securities laws by Cinergy Corp. and its subsidiaries (collectively, "Cinergy" or the "Company") and their legal counsel, in order to preserve the reputation and integrity of Cinergy Corp. as well as that of all persons affiliated with it. This Policy is also intended to confirm Cinergy's commitment to effective corporate governance, by assisting employees through the structured and efficient process, described herein, in raising concerns of potential material violations of law by the Company.

II. Applicability

The Policy is applicable to all Attorneys (as defined below) of Cinergy and applies to our in-house and outside counsel alike. In-house counsel should make reasonable efforts to inform outside counsel with whom they work of the Company's Policy and to confirm their compliance. Although this Policy creates an affirmative obligation only on Cinergy's Attorneys, all members of Cinergy's Legal Department are encouraged to report suspected evidence of material violations of law in accordance with the procedures set forth herein.

Questions regarding this Policy should be directed to the Company's Chief Legal Officer ("CLO").

III. Policy

A. Report by an Attorney of Evidence of a Material Violation

If an Attorney of the Company becomes aware of Evidence of a Material Violation (as such terms are defined below), that Attorney must promptly report[2] the Evidence to the Legal Department's Corporate Section Leader (the "Corporate Section Leader") or the CLO. In the event the Material Violation to be reported involves the Corporate Section Leader and the CLO, the Attorney must promptly report the Evidence directly to Cinergy's Chief Executive Officer ("CEO") (or Audit Committee of the Board of Directors in the event the reported Material Violation also involves the CEO).

[1] A report made by an Attorney pursuant to the procedures for anonymous and confidential complaints established by the Audit Committee of Cinergy's Board of Directors will satisfy an Attorney's obligations under this Policy.
[2] For these purposes, "report" means to make known to directly, either in person, by telephone, by e-mail, electronically, or in writing.

B. Report and Documentation by the Corporate Section Leader of Evidence of a Material Violation

Upon receipt of an Attorney's report of Evidence of a Material Violation, the Corporate Section Leader shall document the receipt and substance of the report and report the Evidence to the CLO, CEO or Audit Committee, as appropriate.

C. Documentation and Notification by the CLO (or CEO) of a Report of Evidence of a Material Violation

Upon receipt of an Attorney's or Corporate Section Leader's report of Evidence of a Material Violation (the "Reporting Attorney"), the CLO (or CEO) shall document the receipt and substance of the report and inform the CEO, Chief Financial Officer ("CFO"), and Chief Risk Officer ("CRO") of such report (unless the reported Material Violation involves any of such individuals and then shall inform only those individuals who are not involved in the reported Material Violation) as well as the Audit Committee at its next regularly scheduled meeting, or earlier if deemed appropriate.

D. Conducting an Inquiry and Reporting the Conclusions

The CLO (or CEO) shall conduct an inquiry that he or she reasonably believes is appropriate to determine whether the reported Material Violation has occurred, is occurring, or is about to occur.

If the CLO's (or CEO's) inquiry leads him or her to conclude that no Material Violation has occurred, is occurring, or is about to occur, the CLO (or CEO) shall (i) notify the Reporting Attorney, CEO, CFO, CRO, and Audit Committee of such conclusion and the basis therefor, and (ii) document the conclusion of his or her inquiry and notifications thereof.

In the event the CLO's (or CEO's) inquiry does not lead him or her to conclude that no Material Violation has occurred, is occurring, or is about to occur, the CLO (or CEO) shall (i) advise the Reporting Attorney, CEO, CFO, CRO, and Audit Committee of such conclusion and his or her recommended response, (ii) take reasonable steps to ensure that the Company adopts appropriate remedial measures, and (iii) document the conclusion of his or her inquiry and notifications thereof.

Appropriate remedial measures may include, among other things, steps or sanctions to stop any Material Violation that is ongoing; to prevent any Material Violation that has yet to occur; to remedy or otherwise address any Material Violation that has already occurred and to minimize the likelihood of its recurrence; or to retain or direct an attorney, with the consent of the Board of Directors, to review the reported Evidence of a Material Violation.

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E. Reporting Attorney's Responsibilities to Report Up-the-Ladder

In the event the Reporting Attorney believes he or she has not received an Appropriate Response (as such term is defined below) within a reasonable time of reporting the Evidence of a Material Violation, the Reporting Attorney shall explain his or her reasons for such belief to the Corporate Section Leader and CLO (or CEO if the Evidence of the Material Violation was initially reported to the CEO) and report the Evidence of the Material Violation to the CEO and Audit Committee along with the reasons for his or her belief that an Appropriate Response to the initial report was not provided within a reasonable time.

Upon receipt of a report from a Reporting Attorney of Evidence of a Material Violation, the Audit Committee shall review the report and determine whether to undertake an investigation. If the Audit Committee determines that an investigation is appropriate, it shall either direct the CLO or engage independent outside counsel, in its sole judgment, to undertake such an investigation and shall notify the Reporting Attorney of such decision. The CLO or independent outside counsel, as applicable, shall report promptly to the Audit Committee its conclusions from the investigation and the Audit Committee shall take reasonable steps to ensure that the Company takes appropriate remedial measures as necessary.

IV. Definitions/Explanations

A. Who is an "Attorney"?

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 and appears and practices before the Securities and Exchange Commission (the "SEC") in the representation of the Company is an Attorney for purposes of this Policy.[3]

Attorneys need not serve in the Legal Department of the Company to be covered by the Policy, but they must be providing legal services to the Company within the context of an attorney-client relationship.

B. What is "Appearing and Practicing" Before the SEC?

[3] An attorney who meets the following criteria is not an Attorney for purposes of this Policy: (i) is admitted to practice law in a jurisdiction outside the United States; (ii) does not hold himself or herself out as practicing, and does not give legal advice regarding, United States federal or state securities or other laws; and (iii) (A) conducts activities that would constitute appearing and practicing before the SEC only incidentally to, and in the ordinary course of, the practice of law in a jurisdiction outside the United States; or (B) is appearing and practicing before the SEC only in consultation with counsel, not included within this definition, admitted or licensed to practice in a state or other United States jurisdiction.

Appearing and Practicing before the SEC means: (i) transacting any business with the SEC, including communications in any form; (ii) representing the Company in a SEC administrative proceeding or in connection with any SEC investigation, inquiry, information request, or subpoena; (iii) providing advice in respect of the United States securities laws or the SEC'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 SEC, including the provision of such advice in the context of preparing, or participating in the preparation of, any such document; or (iv) advising as to whether information or a statement, opinion, or other writing is required under the United States securities laws or the SEC'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 SEC. Any attorney who is a supervisor of an Attorney shall also be deemed an Attorney for purposes of this Policy.

C. What Constitutes "In the Representation of the Company"?

The provision of legal services as an attorney for the Company, regardless of whether the attorney is employed or retained by the Company, constitutes in the representation of the Company.

D. What is a "Material Violation"?

A Material Violation means a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law.

E. What Constitutes "Evidence" of a Material Violation?

Evidence of a material violation means 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.

F. What is an "Appropriate Response"?

An Appropriate Response is one that, as a result of which, the Reporting Attorney reasonably believes that: (i) no Material Violation has occurred, is ongoing, or is about to occur; (ii) the Company has, as necessary, adopted appropriate remedial measures, including appropriate steps or sanctions to stop any material violations that are ongoing, to prevent any material violation that has yet to occur, and to remedy or otherwise appropriately address any material violation that has already occurred and to minimize the likelihood of its recurrence; or (iii) the Company, with the consent of the Board of Directors or the Audit Committee, has retained or directed an attorney to review the reported

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Evidence of a Material Violation and either: (A) has substantially implemented any remedial recommendations made by such attorney after a reasonable investigation and evaluation of the reported evidence; or (B) has been advised that such attorney may, consistent with his or her professional obligations, assert a colorable defense on behalf of the Company (or the Company's officer, director, employee, or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to the reported Evidence of a Material Violation.

Type: Pharmaceutical
Sales: $32.3 million

Company Policy regarding Compliance with SEC Attorney Conduct Rules

Date: August 5, 2003

1. Reporting Obligations
2 Investigations
3. Confidentiality and Records
4. Compliance
5. Application to Outside Law Firms

POLICY STATEMENT

The Securities and Exchange Commission (the "SEC") recently adopted rules, which are effective on August 5, 2003, requiring in-house and outside attorneys to report up-the-ladder within the company evidence of wrongdoing by the company or its directors, officers, employees or agents. These rules were adopted under Section 307 of the Sarbanes-Oxley Act.

The **Company** takes these rules very seriously, and the Legal Division has adopted the following policy to help **Company** attorneys understand and comply with the rules. As a matter of policy, and notwithstanding the application of the rules only to attorneys “appearing and practicing” before the SEC, the **Company** has determined that all **Company** attorneys are subject to and must comply with the SEC rules as implemented in this policy. While existing **Company** policies relating to compliance and the open door may seem to cover much of the same subject matter, this policy is being issued separately because of its special application to attorneys employed by the **Company**.

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1. REPORTING OBLIGATIONS

1.1 Reporting to Practice Group Heads

Any attorney employed by the **Company**, whether located in the U.S. or not, must report to his or her practice group head evidence of any actual, potential or suspected violation of state or federal law or breach of fiduciary duty by the **Company** or its officer, director, employee or agent. If the attorney reasonably believes that reporting to his or her practice group head would be futile (*e.g.*, if the practice group head is involved in the perceived wrongdoing), then the attorney should report to the General Counsel and the Deputy Chief Compliance Officer ("DCCO").

Reports should be made as soon as possible after the attorney becomes aware of the evidence. A brief description of the factual basis for the allegations should be given in order to allow for an appropriate investigation. (See Section 5.2 below regarding mandatory record-keeping procedures.)

1.2 Reporting to the General Counsel

Upon receiving evidence of a violation of law or breach of fiduciary duty, or upon becoming aware of such evidence directly, a practice group head or the DCCO must promptly report the evidence to the General Counsel. Attorneys who believe that the practice group head to whom they reported evidence (or the DCCO, if applicable) has not taken appropriate action must contact the General Counsel.

Company SEC ATTORNEY CONDUCT POLICY

2. Investigations

2.1 Investigation by the General Counsel

Investigations into reported evidence will be conducted by and under the supervision of the General Counsel, who has the discretion to direct in-house or outside counsel to investigate such evidence. Attorneys other than the General Counsel are prohibited from conducting their own preliminary investigation into compliance matters, unless authorized by the General Counsel. Attorneys who are directed by the General Counsel to investigate evidence of a violation or to defend the **Company** in related litigation must consult with the General Counsel before making a report under this policy.

If the General Counsel determines that no violation covered by the SEC rules has occurred, is ongoing or is about to occur, then the General Counsel must promptly notify the practice group head or DCCO who reported the evidence to him and advise that attorney of the basis for his determination. If the General Counsel concludes that a violation covered by the SEC rules exists, then he must take all reasonable steps to cause the **Company** to adopt an appropriate response and must promptly advise the reporting practice group head or DCCO of that response. The DCCO will keep a record of responses provided by the General Counsel.

2.2 Assessing the General Counsel's Response

Any practice group head or DCCO who believes that the General Counsel has not provided an "appropriate response" to evidence reported by the practice group head or DCCO should consult with the General Counsel. If, after consulting with the General Counsel, the practice group head or DCCO continues reasonably to believe that the General Counsel has not provided an appropriate response, then he or she should report the evidence to **Company** 's Audit Committee.

<u>Appropriate Response</u>. In general, an appropriate response is one that leads the practice group head or DCCO reasonably to believe: (1) that no material violation exists; (2) that **Company** has adopted appropriate remedial measures; or (3) that the **Company**, has been advised by an attorney who has been asked to investigate the matter (and has done so in good faith) that the **Company** assert a colorable defense in a proceeding relating to the evidence.

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2.3 Assessing the Audit Committee's Response

If, after reporting evidence to the Audit Committee, the practice group head or DCCO continues to believe that the **Company** has not provided an appropriate response, then he or she should explain his or her reasons to the General Counsel, CEO and Audit Committee.

Company SEC ATTORNEY CONDUCT POLICY

3. CONFIDENTIALITY AND RECORDS

3.1 Client Confidences

Subject to their general ethical obligations, **Company** attorneys should not make public their reports under the SEC rules or take other action that breaches company confidences or that might be viewed as a waiver of the attorney-client privilege. Any attorney who has questions about this policy should consult his or her practice group head, the Vice President – Corporate Governance (“VPCG”) or the DCCO.

3.2 Written Records of Reports and Responses

The General Counsel and any attorney who reports evidence of a violation under the SEC rules and this policy must make a written record establishing that the report was made, providing a brief description of the nature of the report, and noting whether a response was received.

A copy of all such records should be forwarded to the DCCO within five business days of making the report or receiving the response. The DCCO will keep a log of all such written records.

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4. COMPLIANCE

4.1 Mandatory Compliance

Compliance with the SEC rules and this policy is mandatory. Failure to comply may be grounds for discipline by the **Company**, up to and including termination.

The **Company** will conduct regular training sessions on this policy for current and newly hired attorneys and will provide all attorneys with a copy of this policy.

4.2 Non-Retaliation

It is the **Company** 's policy that no attorney may be retaliated against for raising what he or she believes to be an honest issue or concern or for reporting an actual, potential or suspected violation under this policy. Any attorney who suffers retaliation for making a report under this policy should immediately report the matter to his or her supervisor or the General Counsel.

4.3 Contacts

If an attorney has questions regarding the SEC rules or this policy, the attorney should contact his or her practice group head; VPCG; or the DCCO.

Company SEC ATTORNEY CONDUCT POLICY

5. APPLICATION TO OUTSIDE LAW FIRMS

The **Company's** outside law firms that have attorneys who appear and practice before the SEC are expected to comply fully with the SEC rules and this policy by making appropriate reports to the **Company** 's General Counsel of evidence of a material violation.

In this regard, every **Company** attorney who retains outside counsel on behalf of the company must provide that counsel with a copy of this policy and include a reference to this policy in engagement letters. The **Company** attorney also should request that the outside law firm designate a single attorney as the "point person" to make any required reports to the **Company's** General Counsel and to receive notification regarding responses from **Company's** General Counsel.

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USEFUL TELEPHONE NUMBERS:

General Counsel
Vice President Corporate Governance
Deputy Corporate Compliance Officer
Practice Group Heads
Corporate Governance Group Attorneys
Compliance Group Attorneys

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