



# SEC Rules Under Sarbanes-Oxley Section 307

February 14, 2003

Paul E. Konney  
Senior Vice President, General  
Counsel and Secretary  
The Estée Lauder Companies Inc.



## Objectives

- Outline SEC's final rules under section 307 of Sarbanes-Oxley Act
- Offer practical comments on rules



## Statute - Sarbanes-Oxley §307

- SEC to adopt “minimum standards” for attorneys appearing before it “in any way”
- Rules to require:
  - reporting of “evidence of a material violation” (“EMV”) to CLO or CEO
  - in absence of appropriate response, reporting to audit committee or board



# Elements of Final Rules

- Covered attorneys
- Reporting trigger: EMV
- Reporting procedure: up the ladder (and down)
- Response to report: inquiry and “remedial measures”
- Sanctions



## Elements Still Subject to Proposals

- Actions if response not “appropriate”:
  - noisy withdrawal and disaffirmation (original rule)
  - withdrawal and/or issuer disclosure (proposed alternative)



## Purposes of Rules

- Protect investors and increase confidence in public companies
- Improve corporate disclosure
- Require lawyers to police corporate compliance



## The Ladder

- Board of Directors
- Audit Committee
- CLO or CEO
- Supervisory attorney
- Subordinate attorney

OR

- Board of Directors
- Audit Committee
- QLCC
- Supervisory attorney
- Subordinate attorney



## Reporting Attorneys

- Outside or inside “attorneys appearing and practicing before the Commission in the representation of an issuer”
- Means attorneys handling SEC matters for companies regulated by SEC
- Excludes lawyers acting in business capacity, and underwriters’ counsel



## Exempt from Coverage

- Foreign attorneys providing advice under U.S. securities laws “incidentally to... the practice of law” outside the U.S.

OR

- Foreign attorneys appearing and practicing before Commission “only in consultation with” U.S. counsel



## Subordinate Attorney

- Attorney appearing and practicing before Commission under supervision of another attorney, e.g., law firm associate or junior inside lawyer
- Only responsibility is to report EMV to supervisor
- May, but need not, engage in further reporting if supervisory attorney fails to comply with reporting procedures



## Supervisory Attorney

- “[A]ttorney supervising or directing another attorney who is appearing and practicing before the Commission”
- Must comply with reporting procedures when subordinate attorney reports EMV
- Must make “reasonable efforts” to ensure that subordinate attorney complies with rules
- CLO is supervisory attorney



## Chief Legal Officer

- On receiving report, CLO must either refer report to QLCC or “cause... inquiry into the evidence... to determine whether the material violation... has occurred...”
- If CLO finds no violation, CLO so advises reporting attorney, providing enough detail for reporting attorney reasonably to believe no violation occurred



## Chief Legal Officer (cont.)

- If CLO finds material violation, CLO must “cause the issuer to adopt” appropriate remedial measures and/or sanctions
- CLO must report remedial measures and sanctions to:
  - CEO
  - audit committee or full board
  - reporting attorney, with sufficient detail to support reasonable belief that proper remedial steps have been taken



## QLCC

- Qualified Legal Compliance Committee may be created to receive attorneys' reports
- Board committee, with 3 independent directors, including one from audit committee
- Must have written procedures for dealing with EMV reports



## QLCC (cont.)

- On receiving EMV report, QLCC must inform CLO and CEO
- If investigation is necessary to determine whether material violation occurred, QLCC must:
  - notify audit committee or full board
  - initiate investigation through CLO or outside counsel
  - retain any necessary experts



## QLCC (cont.)

- If investigation shows material violation, QLCC must:
  - direct issuer to adopt remedial measures and/or impose sanctions
  - inform CLO, CEO and board of results of investigation and actions to be taken
- If issuer fails to follow QLCC's directions, QLCC must notify SEC



## QLCC (cont.)

- Advantages of QLCC:
  - attorney reporting EMV to QLCC would have no further duties
  - CLO referring EMV report to QLCC would be required to take further action only if QLCC asked CLO to conduct investigation
- SEC estimates that 20% of issuers will establish QLCCs



## QLCC (cont.)

- Disadvantages of QLCC:
  - board members are over-burdened already
  - shifting responsibility from CLO to board members violates law of gravity
  - audit committee ultimately will receive information QLCC would receive



## Dissatisfied Reporting Attorney

- If reporting attorney reasonably believes that report back from CLO or CEO is not appropriate or timely, reporting attorney must report EMV to:
  - audit committee, or
  - another independent board committee, or
  - full board
- If reporting attorney is still dissatisfied, he or she:
  - must explain reasons to CLO, CEO or directors
  - may inform SEC



## Original Noisy Withdrawal Proposal

- If reporting lawyer does not receive appropriate response to EMV report, lawyer must withdraw from representation, notify SEC and disaffirm tainted documents filed with SEC



## Alternative Noisy Withdrawal Proposal

- If reporting lawyer does not receive appropriate response to EMV report, and reasonably concludes EMV is substantial and likely to result in substantial injury, lawyer must withdraw from representation
- However, lawyer need not disaffirm documents filed with SEC or notify SEC of withdrawal
- Instead, issuer must disclose withdrawal on SEC Form 8-K within two business days



## In-House Attorneys

- Under original proposal, in-house attorney who does not receive adequate response to EMV must disengage from matter, notify SEC and disaffirm tainted filings
- Under alternate proposal, in-house attorney must disengage from matter and notify issuer
- Under alternate proposal, issuer would then be required to disclose withdrawal on SEC Form 8-K



# SEC Rules Under Sarbanes-Oxley Section 307

February 14, 2003

Paul E. Konney  
Senior Vice President, General  
Counsel and Secretary  
The Estée Lauder Companies Inc.