

1 CHAIRMAN CHEEK: We appreciate your taking
2 the time out of your busy schedule to share your
3 views with us today and even more importantly we
4 appreciate your continuing our life as the task force
5 and look forward to working with you as we go forward
6 in our process.

7 MR. A.P. CARLTON: Thank you. And I
8 appreciate the opportunity to be here. I was just
9 telling the Chair that I have been over at the
10 section officer's conference ginning up business for
11 you. There are a number of substantive law sections
12 of the ABA that have an abiding interest in what you
13 are doing and have what they think are distinct
14 points of view, public utilities, international law,
15 labor and employment, and so I suspect that you are
16 going to be hearing from them as well. But it is
17 great to be here with you.

18 Mr. Chair, Members of the Commission.

19 It is my great pleasure to appear here
20 today.

21 It was also my pleasure to have reappointed
22 all of you to this task force so that you may
23 continue this important work on behalf of the
24 association. I thank you for your time and

1 continuing dedicated effort. Unfortunately, events
2 continue to unfold in the world of American business
3 that highlight the relevance and crucial timeliness
4 of the work you have undertaken.

5 Indeed, the eyes of American business and
6 the American press are upon us. My daily existence
7 now includes at least one call a day from the press,
8 and not just the financial press, regarding corporate
9 governance and lawyers ethics.

10 I know that this task force will respond in
11 a timely and capable fashion.

12 I am here first to continue to promise you
13 the association resources and support necessary to
14 get the job done. And to assure you that as the
15 Association's spokesperson, I will continue to seek
16 your advice and support in our public response to
17 this unfolding drama. And I expect that we will be
18 responding at a number of levels. Yes, to the press
19 but also to provide answers to the regulators, the
20 Congress, their staffs and, of course, the ABA House
21 of Delegates.

22 I have reviewed closely your preliminary
23 report, and I find it a good start, a solid piece of
24 work. I do have some suggestions for you to consider

1 from the perspective of the ABA's elected leadership
2 which I will share with you momentarily.

3 But, first, please allow me two or three
4 observations.

5 First, as you know, the Board of Governors,
6 following the renewal of the task force, authorized
7 two new members with two specific objectives. One,
8 to add a lawyer member whose practice encompasses
9 corporate governance and public affairs, as well as
10 one having a broad-based background in the larger
11 ABA.

12 I was extremely fortunate to have my
13 wonderful predecessor and friend, Roberta Cooper
14 Ramo, accept my request to serve in that capacity.

15 The Board of Governors authorized another
16 position as well, specifically an ethicist, perhaps
17 an experienced State Supreme Court jurist, who could
18 speak with experience to the practicality as well as
19 the theory, of the interface between corporate
20 governance and legal ethics.

21 And I am happy to say I did not have to look
22 too far to find my friend, retired North Carolina
23 Chief Justice Burley Mitchell to fill that role.

24 Incidentally, I am sure you've been given his

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1 credentials and biography but you should know that I
2 first encountered him 27 years ago, me, a newly
3 minted indigent defense counsel. He, an experienced,
4 tough crime-busting DA. My district attorney.

5 Second, you should know one or two things
6 about my professional experience that you may not
7 know but are pertinent to my views of your task and
8 my testimony here today. In the late '70s, I was a
9 registered lobbyist in Raleigh, North Carolina and in
10 Washington, D.C., for the North Carolina banking
11 industry.

12 In the early '80s, I served a four-year
13 stint as corporate general counsel for a publicly
14 held NASDAQ-listed bank holding company and in this
15 capacity had to face squarely Rule 1.13 more than
16 once.

17 Following the intricate negotiations and
18 acquisition of my bank holding company by what is now
19 Bank of America, I reentered private practice and for
20 most of the last 20 years have, on a continuing
21 basis, represented numerous publicly held

22 corporations, mostly in the capacity of corporate
23 counsel, with supervisory responsibility for
24 securities compliance.

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1 So I come to this subject matter, first as
2 an ABA president, but second, with working
3 professional knowledge and experience that is no
4 doubt informed, but at the same time, perhaps,
5 burdens me with my own professional point of view.

6 We live in a world today that is a far
7 different place than the one we inhabited on Labor
8 Day of 2001. I refer you to my President's Page in
9 this month's ABA Journal as to what I think it means
10 to our profession generally. And I think that all
11 bets are off as any "conventional wisdom" of
12 corporate governance and the ethics of disclosure of
13 client's confidences -- the social and moral
14 underpinnings of those constructs are shifting, much
15 like subterranean shifts of tectonic plates over time
16 -- shifts that sometimes result in earthquakes. This
17 should be taken into account in your final report.

18 I would argue that this task force should

19 not be coy or timid about drawing broad public policy
20 conclusions which lead to policy recommendations for
21 the ABA House of Delegates, policy conclusions that
22 go beyond the technical aspects of corporate
23 securities law and the ABA's model rules of
24 professional conduct.

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1 Taking the 30,000 foot view is what
2 leadership is all about and this issue is not going
3 to be solved by only tweaks to specific rules and
4 regulations.

5 But leaders and great lawyers like
6 yourselves also know that the devil is in the
7 details. So I believe this task force should be very
8 specific with respect to proposed new language for
9 ethical prescriptions or proscriptions or to suggest
10 specific revisions to model corporate laws or to
11 suggest creative specific regulatory mechanisms that
12 will serve broader and new age public policies.

13 So I encourage you to lift your sights and
14 speak to what is undeniably the public's need for new
15 American corporate ethic.

16 I believe the ABA House of Delegates will

17 welcome a report with recommendations that speaks in
18 such a manner. I also believe the ABA's various
19 publics: Our members, the press, the regulators and
20 our elected representatives, expect nothing less from
21 the American Bar Association.

22 First I want to reiterate and appropriate as
23 my own, the charge given to you by my predecessor Bob
24 Hirshon. I note that within this scope is room

1 a-plenty for the suggestion of a substantive,
2 sweeping, precursors to restatements of the law of
3 corporate governance and the ethical principles
4 involved, with the ultimate objective of a statement
5 of public policy enhancing the public trust in
6 corporate integrity and responsibility.

7 As to your fine preliminary report and the
8 work going forward, I would respectfully add my
9 commentary.

10 On the matter of corporate governance, it
11 goes without saying that the American public is
12 angry. Their confidence in the capital market system
13 is very low, perhaps its lowest since the scandals

14 that spawned the Securities and Exchange Commission
15 in the 1930s. And that confidence will only return
16 when they see real change in corporate governance and
17 behavior.

18 So the key to overcoming the problem that
19 our nation faces is to see real change, not just the
20 appearance of change. It is my view that the
21 recommendations in your final report is the area of
22 corporate governance should be both broad in scope
23 and aggressive implementation. What do I mean by
24 that?

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1 First to the issue of scope. I believe that
2 in addition to the extraordinary work contained in
3 your report, this task force should also consider the
4 development of a major public policy statement. I
5 believe that a general road map of principles of
6 corporate governance -- that can be applied to all
7 businesses covered by state law -- can and should be
8 addressed.

9 Second, to the issue of implementation. It
10 is my strongly held position that the key to real
11 change, which is the only prescription that will

12 resuscitate the public trust and confidence in the
13 corporate marketplace, lies more in proactive public
14 policy and less in self-regulatory agencies and blue
15 ribbon commission which tend to lack the teeth and
16 uniformity that is so necessary to create real
17 change. I am sure most of you will agree that in the
18 area of corporate governance we need more than
19 standards, we need good solid public policy. This
20 means SEC regulations, this means legislative acts of
21 Congress and state governing bodies and other forms
22 of mandatory compliance.

23 Your preliminary report gives a real good
24 example of an implementation instrument that does

1 have teeth. You cite the Model Business Corporation
2 Act, which is widely used in creating legislation and
3 law. I would encourage this task force get involved
4 in the process. No one has more to say about changes
5 to this act than the group now before me. I would
6 ask that this Commission partner with the Business
7 Law Section on this matter as soon as possible.

8 Your preliminary report recognized that

9 change is in the air with the following passage:
10 "State courts that review the fiduciary duties of
11 care and loyalty of directors and officers can be
12 expected to identify and give effect to evolving
13 expectations regarding oversight responsibility,
14 conflicts of interest and director independence and
15 the task force believes that such common law
16 development will improve the level of corporate
17 responsibility."

18 I couldn't agree more with that.
19 Development of common law is on the way and I believe
20 that passage underscores my point about both scope
21 and implementation. Number one, development of this
22 common law will require us all to consider the big
23 picture. Number one, this development of common law
24 is the recognition that real implementation will

1 occur only through public policy.

2 So I ask you, ladies and gentleman, to
3 consider yourself public policy generalists. I offer
4 my complete support to this task force in marshalling
5 your considerable intellect and prestige to help
6 shape what the common law and the new American

7 corporate ethic will be. That is what the ABA is all
8 about, fair administration of justice, improvement of
9 the laws and jurisprudence. A wide view? Certainly.
10 But that is only a way to view the forest from the
11 trees.

12 I believe a wide view is also necessary on
13 the lawyer's ethic side of the equation as well.

14 You all know, as well as I do, that the
15 opportunity for thought leadership from this task
16 force on the matter of professional ethics extends
17 well beyond specific model codes of professional
18 conduct. I know every member of this task force
19 personally represents the highest ideal of the
20 upstanding, honorable lawyer. So I will encourage
21 this group to think beyond the particular model codes
22 and bring to the final report some of your wisdom,
23 some of your insight, some of thinking about what it
24 means to be a lawyer.

1 I believe we need to educate the public as
2 well as those walking the corridors of our Congress
3 and state legislatures about the role of a lawyer in

4 the operation of a corporation.

5 Development and disclosure of financial data

6 is not the responsibility of a lawyer. Nor is the

7 assurance that such data is accurate. We should

8 articulate that, unlike the accountants, we have

9 rejected dual roles for ourselves. Our vote in the

10 House of Delegates on MDP signified that we find it

11 our professional duty to avoid conflicts of interest.

12 So in talking about lawyer ethics, we must hold

13 ourselves to high standards for what we are

14 responsible for. But also explain what we are not

15 responsible for. As Chairman Pitt did on August

16 12th, we must take every opportunity we can to

17 distinguish our profession from others. Your report

18 presents us with such an opportunity. I suggest that

19 it is an opportunity you should not pass up. Do

20 these concepts go beyond the model rules? Certainly.

21 But I'm of the mind that they come under your

22 purview.

23 This is not to say that we ignore the

24 intricacies of the model code. Your preliminary

1 report did a terrific job of outlining your positions

2 on each one and I support each and every
3 recommendation. I would also encourage this task
4 force to become actively involved in the actual
5 drafting of the language. To get your hands a little
6 dirty. Please work with the standing committee on
7 professional responsibility. Its chair, Marvin Karp,
8 has assured me that they are ready to work in tandem
9 with you. And I hope in February, if things are
10 looking tight in a vote before the House of
11 Delegates, that we can count on your significant
12 political skills to move the ball forward. You can
13 certainly count on my help and support.

14 In closing, I would like to reiterate my
15 unwaivering support for this task force. I would
16 like to commend you for an excellent preliminary
17 report. You have already made all of us in the
18 leadership very proud. And I have a feeling the best
19 is yet to come. We are at a momentous time in our
20 nation's history. Post Enron, post 9-11, our nation
21 is seeking answers to some of the most difficult
22 questions imaginable.

23 The American Bar Association is a key player
24 in finding a solution to the crisis of corporate

1 confidence. And how the ABA reacts, and what the ABA
2 does, is, to a large extent, in your hands. To this
3 end each of you carry a tremendous responsibility on
4 your shoulders. I know you will exercise it well.
5 Please call me any time for any reason. I'm here to
6 support you and your efforts. Thank you very much.

7 CHAIRMAN CHEEK: Thank you, President
8 Carlton.

9 We appreciate your support and challenges to
10 us which we accept and I think, as you may know, we
11 have been in contact with Marvin Karp and going to
12 work hand in hand in our project together to the
13 House with some specific recommendations in a joint
14 fashion.

15 I'll open it for any questions if anybody
16 has any at this time.

17 MR. IDE: My question gets to the public
18 policy. As you saw in our report we said in essence
19 corporate law of Delaware and I won't read all the
20 cases that would cover most of the situations we're
21 dealing with, but trying to find a structure to drive
22 the behavior other than ask a lawyer every time a
23 legal opinion -- this kind of thing. Where are we in
24 the public policy? The other thing is the state law

1 system seems to be lagging so far behind events as
2 they move, you have Sarbanes and the SEC and we
3 challenged the person from Illinois this morning
4 where are the states. His response was we don't want
5 to pile on, everything is being taken care of. What
6 suggestions do you have where we start looking?

7 MR. A.P. CARLTON: As to the process I think
8 with perhaps the conference on uniform state laws,
9 looking at some of the restatements, looking at the
10 Model Act, I think that some recommendations in that
11 area would be well taken.

12 As to the substance of those
13 recommendations, I'll leave that to you but what
14 we're looking for may go beyond the structure of what
15 we're talking about under the current law, be it
16 Delaware or Model Act. As to independent corporate
17 director, outside independent director
18 responsibility, I think that the investing public and
19 everybody involved in the capital markets is looking
20 with renewed interest at truly independent directors
21 as being the focus of the first line of defense, if
22 you will, and asking them to be truly independent.
23 I believe there is a sense that over the past 20 or
24 30 years that the independence of the directory, the

1 American directory has been compromised. I think we
2 need a policy statement and some specifics with
3 respect to public policy mechanisms, be it
4 legislation or regulation which embodies that
5 concept.

6 MS. RAMO: One of the things you mentioned
7 when you talk about the model business corporation
8 act and then a lot of what we're talking about does
9 relate to capital markets and publicly held
10 companies, one of our earlier pieces of testimony
11 this morning sort of related to the problem of how do
12 you deal in one fell swoop with publicly held
13 corporations and being a lawyer, an outside lawyer or
14 inside for publicly held corporations and then you
15 are talking about what many of us deal with that is
16 closely held corporations that follow the Model
17 Business Corporation Act but do not have such a thing
18 as truly independent directors. Tell me where you
19 draw the line if you would at all?

20 MR. A.P. CARLTON: I would think that with
21 respect to publicly held companies is where we start,

22 I think that in drafting legislation those are
23 substitute distinctions of a general nature that are
24 often made and I think that if as long as you have a

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1 generic application to a certain standard, I believe
2 that you can get to that point where you apply
3 independence requirements to those corporations who
4 have chosen to become a publicly held corporation.
5 For those who have not and are still closely held or
6 within the ambit of nonpublicly held, I think you
7 have a different standard and in my own state we have
8 some very specific common law which Justice Mitchell
9 will recall with respect to fiduciary duty of
10 shareholders and closely held corporations.

11 And I expect that that would take care of
12 that area but I think that the American public, the
13 investing public is looking for a response that
14 involves some sort of public policy mechanism, be it
15 legislation or regulation, it speaks directly to that
16 that public perception that the independence of the
17 directory of American corporations has been
18 compromised.

19 CHAIRMAN CHEEK: One of the things that I

20 would love to hear your comment about given your
21 experience as being a general counsel in a publicly
22 held company and a regulated publicly held company,
23 relates to one of our unique governance principles
24 that we have advocated is this direct line of

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1 communication from the general counsel to the
2 independent directors, and in part, our rationale
3 there was based on empowering the general counsel,
4 giving the general counsel an opportunity to be more
5 independent than the natural system of communication
6 might permit given the fact that the senior
7 management hired the general counsel and fires the
8 general counsel.

9 Do you think from your own personal
10 experience that would have enhanced your ability to
11 be an effective participant in corporate
12 responsibility?

13 MR. A.P. CARLTON: Absolutely. When I read
14 that part of the report, I didn't want to get into
15 too many specifics but when I read it, my marginal
16 notation was right on. I believe that would be very

17 -- systems and procedures, that's like a board of
18 directors that has as part of its every agenda an
19 executive session. And ask management to depart,
20 that's a necessity for just maintaining communication
21 among the directors themselves. The theory is the
22 same. As long as you have the system in place, then
23 it's not an unusual thing for the general counsel to
24 ask for that independent communication. And I

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1 believe, I think that's a good -- like the report, a
2 good start.

3 MR. JACOBS: In thinking back again to your
4 experience as a general counsel, in the last month
5 I have seen three different places and it was even
6 mentioned this morning, a somewhat revolutionary
7 proposal here to get a structural change highlighting
8 the fact that lawyers are counsel for the entity and
9 not for management.

10 Would you embrace the recommendation that
11 the board or that a committee of independent
12 directors engage general counsel for the company as
13 they now will for engaging the outside auditors?

14 MR. A.P. CARLTON: There is a parallel for

15 that in public entities. Often you find county
16 attorneys and city attorneys that are independently
17 retained by the elected body rather than the
18 executive manager. My experience with that has been
19 that with respect to the public end of the business,
20 of the public business, that's far more effective but
21 with respect to the day to day getting the work done
22 of the management, it is sometimes counter
23 productive.

24 My experience would be that it's -- you know

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1 nobody ever said it would be easy to be a corporate
2 general counsel. That's one of the things that you
3 have to accept, you are part of management but you
4 have the higher duty and you need to make it clear to
5 your management peers that that's the case, or else
6 otherwise you compromise your ability to work with
7 them because they don't see you as part of the
8 management team. It's a fine line to watch. I would
9 say to you with respect to those proposals, no, I
10 don't think that's necessary, however, I think in the
11 aspirational language of the model rules with respect

12 to, perhaps, some language in the model rules and the
13 appropriate place the question can be answered.

14 Chairman Pitt on August 12th, that was a
15 major part of his speech, he posed the question
16 rhetorically and said, "Who is the client?" And then
17 he answered it and answered it the right way.
18 I think that if there is some way that we can clarify
19 that issue not only for the management you work with
20 and you are a part of but for the directors and for
21 the public, the investing public it makes it easier
22 and tying that to the kind of proposal of independent
23 reporting lines to the audit committee, the
24 independent director committee, which was another

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1 good idea, I think you can accomplish all that.

2 MR. KELLER: I want to add to that and I
3 agree with your approach. What we talked about is
4 having more of the responsibility essentially from
5 the top down as the responsibilities should be on the
6 committees to see they're getting the information and
7 getting the right line of communication. Part of
8 reconciling both is to make it clear that part of
9 governance, a part of the board's function is to make

10 sure that general counsel may be hired to recommend
11 working with management that they have confidence
12 that the general counsel is serving the role that you
13 described. I have given that advice to boards that
14 have asked and do we have our own lawyers. You
15 should make sure the lawyer's company are, in fact,
16 serving your interests and representing you as a way
17 of getting at it.

18 The question that I have is one of the
19 things that I have worried about as we build these
20 super structures to deal with the crisis and
21 confidence that we seen and most of which have been
22 with larger companies and so far the failure to
23 differentiate the problems of the smaller and
24 mid-size companies and the disproportionate burden

1 that some of the super structures that we build and
2 create deals with the problems of the larger company
3 incorrectly and ends up creating such burdens on a
4 relative cost basis and just on the question of
5 "are we depriving smaller companies of access to the
6 public capital markets." There is a policy issue

7 maybe the choice is protect investors as you do that.
8 Just your reaction to some -- the need for some
9 differentiation and recognition of the different
10 circumstances that we find at different relative size
11 of organizations.

12 MR. A.P. CARLTON: Don't go building a
13 different barn because the horse got out, I guess is
14 the thought. I think to me the kinds of proposals
15 we're talking about here are the kinds of things that
16 general counsel -- corporate general counsel have
17 always done informally and to me it is a matter of
18 preventive maintenance. You always, I, at least, as
19 an outside counsel, too, if you don't have the
20 structures and you have a problem you've got to
21 invent them. So to me it is more of a preventive
22 maintenance thought process and that would be my
23 response is that I don't think that the additional
24 cost of having a truly independent audit committee or

1 a committee of independent outside directors and,
2 again, one other thing I may suggest is that
3 somewhere, sometime, somebody has to come up with a
4 good definition of independent director, you referred

5 to the NYSE rules in your report but I suggest you
6 might want to talk about that as well. Because if
7 we're going to key these proposals to who is in the
8 bed and who isn't, we need to know who they are.

9 But in any event in answer to your question,
10 I didn't mean to dance around it, Stan, I think the
11 additional cost will be far outweighed by the benefit
12 to the shareholders.

13 CHAIRMAN CHEEK: Thank you, Mr. President.

14 MR. A.P. CARLTON: Thank you.

15 CHAIRMAN CHEEK: I would comment as sort of
16 a last comment from me that your challenge for us to
17 think in large goals in public policy ways is, in
18 fact, what drives a lot of our specifics that we
19 dealt with in our report. What we were searching for
20 are ways to improve the legal and ethical framework
21 for corporate lawyers to be effective in the system
22 of checks and balances to improve corporate
23 responsibility. That's our overarching goal and
24 we're finding the pathways.

1 MR. A.P. CARLTON: I appreciate that. We,

2 as lawyers, are often given to understatement.
3 That's the way we're trained and we operate. We're
4 operating in an arena here where we need to operate
5 both as lawyers and public policy generalists and
6 I would encourage you to do that because I think Les
7 Jacobs will tell you that the ABA House of Delegates
8 will respond favorably to that.

9 We often get a lot of criticism in the
10 American Bar Association about what the House of
11 Delegates does and doesn't do. This is one of those
12 things where they ought to be doing things and it
13 will look forward to receiving your accumulated
14 wisdom.

15 CHAIRMAN CHEEK: We hope to give them that
16 opportunity. Thank you for your time.

17 MR. A.P. CARLTON: Thank you.