

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.

18 CHAIRMAN CHEEK: Welcome.

19 MR. CREAMER: I'm Robert Creamer and I'm
20 one of the loss prevention counsel for Attorneys'
21 Liability Assurance Society retention group and this
22 is Joe Lundy who was one of the other principal
23 drafters of the preliminary statement that we made in
24 response to your preliminary report.

1 CHAIRMAN CHEEK: We welcome you and a
2 number of us, of course, rely heavily on you and
3 appreciate all your efforts in that regard and, also
4 I might add that I am delighted to see that you're
5 having your teleconference addressing a lot of the
6 issues that we're concerned with and I for one will
7 be a participate in listening to that so thank you
8 for putting that on as well.

9 MR. LUNDY: We should tell the task force
10 that we feel it is particularly appropriate for us to
11 address you here because among other things, Bob
12 Creamer and I teach ethics at Northwestern Law School
13 and this is the room where we first taught.

14 MR. CREAMER: The crowds have gotten larger
15 so they have moved us down the pike.

16 We'll be brief because most of what we have
17 to say at this point is in our preliminary statement
18 and we purposely called it a "preliminary statement"
19 because we think we'll have more to say as this task
20 force moves along in its activities and we better
21 understand all of the issues.

22 At this point, we just would like to make
23 two relatively brief points.

24 First of all, we would like to underscore

1 the point that several others have made here today
2 that when you change the model rules of professional
3 conduct, propose to change the model rules of
4 professional conduct, those changes, if adopted by
5 the states, would apply to every lawyer and every
6 representation from General Motors down to the corner
7 grocery store, and we urge you to consider as best as
8 we all can the consequences of those systemic
9 changes. Professor Morgan has raised them, we have
10 raised some of them and we expect as we go along, we
11 will raise more.

12 And the one that we raised in our
13 preliminary statement that I will just mention and in
14 passing is, of course, the change that we think will
15 be brought to bear on the issue of lawyer liability.
16 And as we say in the statement, it seems to be the
17 law in virtually every jurisdiction that the rules of
18 professional conduct have an effect on the law of
19 lawyer liability, and they can either in a few
20 jurisdictions be taken as rules of lawyer liability
21 but even in states where that is not the case, they

22 can be used by expert testimony to establish rules or
23 standards of care and are on a regular basis, and so
24 we urge you to consider, as we say in our paper,

112

1 the effect that these proposed changes would have on
2 lawyer liability.

3 For example, the suggestion that what a
4 lawyer knows should -- the standard of knowledge
5 should be changed to what a lawyer should know, could
6 lead, we think, to a dramatic expansion of lawyer
7 liability in cases where the lawyer and the public
8 later finds that the lawyer's client was dishonest.

9 And so, again, as we point out in detail in
10 the paper, we urge you to consider those issues,
11 because we think they could have an important impact
12 on lawyer liability for every lawyer, in every
13 representation.

14 So with that we would be happy to any answer
15 questions that you might have.

16 MS. HENNESSY: Mr. Hanson in his testimony
17 indicated that under Illinois corporate law there
18 were provisions that were specific to publicly traded
19 corporations.

20 That concept is obviously not embodied in
21 the current model rules of professional conduct.
22 There is no distinction made and it was one of the
23 issues we wrestled with on the corporate governance
24 side.

113

1 Would you think that that distinction should
2 be embodied in the model rules?

3 CHAIRMAN CHEEK: And to add to that --

4 MS. HENNESSY: The obligation should be
5 different depending on whether it is a public company
6 or private?

7 CHAIRMAN CHEEK: And to add to that how does
8 that interface with 3.07 and the SEC's pathway that
9 they want to take to deal with public company ethical
10 issues and should we, you know, defer to that?

11 MR. LUNDY: I think that's part of the
12 answer to Ms. Hennessy's question that is whatever
13 the ABA decides to do, it now appears there's going
14 to be a separate set of regulatory law applicable to
15 lawyers for public companies. And I suppose a good
16 argument could be made maybe the SEC is in a better

17 position to determine what that ought to be than the
18 ABA.

19 On the other hand, we certainly agree with
20 Professor Morgan's suggestion and we intend to follow
21 his advice which is to make sure that we closely
22 monitor the SEC rule-making process, that concerns of
23 practicing lawyers, lawyers who have to wrestle every
24 day with the issues posed by the federal securities

114

1 laws and the disclosure requirements that they work
2 with their clients on, are heard and are part of what
3 the Commission considers when it promulgates a final
4 rule. ALAS will participate in that process.

5 CHAIRMAN CHEEK: Let me probe that further
6 and ask you your thinking about why you think the SEC
7 may be the more effective announcer particularly when
8 they are the regulator that has a certain distinct
9 interest in how they would regulate professions.

10 Why, if the Commission comes out with their
11 set of minimum standards, isn't that a risk that also
12 engenders lawyer liability in the context of that
13 lawyer's conduct under state applicable legal
14 malpractice issues. Wouldn't you have the same sort

15 of tension and shouldn't we take a leadership role in
16 trying to build a framework that recognizes what
17 Congress is deemed to be a public policy from their
18 perspective as opposed to just permitting the SEC to
19 wander down the path?

20 MR. LUNDY: I think the answer to the
21 question is we really haven't, although we teach
22 legal ethics and follow closely the Ethics 2000
23 Commission proceedings and the House of Delegates
24 consideration of the commission's recommendations.

115

1 We really -- ALAS as an organization -- has never
2 confronted the concept of separate legal ethics rules
3 or lawyer -- rules of professional conduct for
4 lawyers who represent public companies. I just don't
5 know how we would come out on that if we -- if that,
6 because part of your agenda, we would try to address
7 it.

8 MS. COOPER RAMO: I wanted to take issue a
9 little bit with your original comment about our
10 making sure that we don't do something that somehow
11 unexpectedly impacts lawyers and I do think that

12 there is a practical difference which then leads to a
13 different articulation about what the highest ethical
14 standards would be for lawyers who represent publicly
15 held corporations and the 99 percent of that or 98
16 percent of the corporations in America which are not
17 publicly held and for us not to recognize that and
18 I'll give you the best example on the issue of
19 independent directors. Whatever percentage of
20 corporations are not publicly held corporations, it
21 would be the rarer and small percent of those that
22 have any independent directors at all.

23 MR. LUNDY: That's right.

24 MS. COOPER RAMO: And so the tools that we

1 give to lawyers who are representing publicly held
2 companies would be virtually useless to all of the
3 other lawyers in America who wrestle with different
4 sets of problems but I guess I need you to argue back
5 with me a little bit about why it wouldn't be better
6 for us, all the lawyers in America, for us to
7 make -- I don't think it is an SEC issue, it is
8 aspirational and practical in terms of what lawyer
9 behavior ought to be at the highest level. But

10 lawyer behavior at the highest level has, you may
11 have all the same ethical standards, the
12 practicalities will be radically different if you
13 have an organization in which you have independent
14 voices and if you have an organization which there
15 are literally no independent voices.

16 MR. CREAMER: If I can revisit
17 Professor Morgan's testimony, I think the current
18 rule, 1.13, does a good job of sorting those issues
19 out and is equally applicable to a large corporation
20 or a small corporation. I think that is the rule
21 that I think we could look to for lawyer's conduct at
22 the highest level. And it is flexible enough to give
23 lawyers the discretion to fit their conduct to the
24 particular situation at hand so that's why we would

117

1 agree with him that the current rule does a good job.

2 CHAIRMAN CHEEK: One of the questions that
3 you are focusing on in your teleconference relates to
4 our recommendation about the mandatory nature of 1.6.
5 As you know, there are a number of states, unlike the
6 model rule, that both have it in permissive form and

7 in mandatory form, a very small number of mandatory
8 form.

9 Have you had experiences where that has
10 translated into civil legal liability for lawyers?

11 MR. LUNDY: We anticipated you might ask
12 that question and the honest answer is we haven't
13 studied whether ALAS-insured lawyers get sued more in
14 Florida and Virginia and Wisconsin and the other --
15 New Jersey -- than in other states because they have
16 a mandatory disclosure rule rather than a permissive
17 one.

18 I do think that it is probably the case
19 there are many fewer public securities offerings
20 handled by lawyers in those states than in others
21 that we can all think of. But the honest answer is
22 we just haven't studied that issue. We could
23 undertake to do so if it would be helpful to the task
24 force but --

1 MR. CREAMER: There is another practical
2 issue. All of these mandatory disclosure rules are
3 relatively recent in the last three or four years and
4 in the normal course of things, I don't think we

5 could tell you because there, to my knowledge, there
6 haven't been that many cases. It will take a while
7 if there is anything to measure for us to be able to
8 measure.

9 MR. KELLER: The one thing you commented on
10 was we should know and we heard about that earlier
11 maybe posing the same question that we put earlier if
12 you look at one of the things that we should know is
13 designed to accomplish is to make clear that actual
14 knowledge, in fact, requires more and that's not a
15 common place or look at the ceiling test.

16 MR. CREAMER: Yes.

17 MR. KELLER: And it does not permit the
18 lawyer to disregard the body of information that
19 would, if you will, flash the triggers to another
20 lawyer. Phrased that way, maybe it takes it out of
21 the diligence issue which to me is a separate issue.
22 Would you see an articulation of a standard of --
23 call it reckless, that word may be somewhat removed
24 from reckless, that would add some meat on what

1 actual knowledge means as a way of approaching that?

2 MR. CREAMER: In fairness, I cannot.
3 I looked over the material that you cite in the
4 preliminary report and I went back and read the two
5 ABA opinions that you cite, and it seems to me that
6 as we say in our paper, that willful blindness,
7 turning a blind eye, I think was your phrase, and
8 recklessness are probably, certainly turning a blind
9 eye would be. And recklessness is probably already
10 captured in the existing rule because, remember,
11 knowledge includes what can be inferred from the
12 circumstance. So, with the current definition, if
13 it's appropriately applied, I think you would
14 certainly cover the blind eye sort of situation and
15 most probably recklessness. If we go beyond that on
16 the continuum that Professor Murdock talked about,
17 I'm not sure where to stop after that because we are
18 concerned, as we say in the paper, that after the
19 company is in bankruptcy and after the damage has
20 been done and the investors have lost money, it is
21 easy to say what you should have know or where you
22 should have looked.

23 We can all look around the room and say we
24 all should have known the tech stock market was

1 overvalued in 2000. I know Joe should have known
2 that. But I don't think he did. I certainly didn't.
3 So I think that's what we're concerned about this
4 continuum. If you take it beyond the current
5 language of the rules which captures blind eyes and
6 reckless, we wouldn't know where to cut it off.

7 I thought about your question about some
8 intermediate step that I think is similar that some
9 of the other task force members talked about today.
10 We cannot come up with that definition.

11 MR. MUNDHEIM: I was going to explore the
12 same and try to urge you -- it is interesting when
13 you talk about it, you talk about actual knowledge
14 and actual knowledge in those terms does not even
15 pick up the concept of recklessness and I think
16 that's one of the things that concerns us. I think
17 we could use some help in trying to articulate a
18 standard which goes beyond actual knowledge. What
19 you really know because you have said you are
20 prepared to go beyond that in terms of recklessness,
21 closing -- averting your eyes, what I think would be
22 helpful is to get some outside assistance and try to
23 craft some language which carries us beyond actual
24 knowledge to something further.

1 CHAIRMAN CHEEK: And it could be not
2 necessarily in the form of a rule amendment but in
3 the form of a commentary or interpretive gloss on it.

4 MR. LUNDY: We'll look at that but as we say
5 in the paper, we think the blind eye is already
6 covered.

7 MR. MUNDHEIM: Let's put it in words that
8 you would be comfortable with. I think the term
9 "actual knowledge" doesn't give that message. It's
10 interesting those are the words that you use.

11 MR. McCALLUM: That's my point, too. It
12 fits together. The rule says that the knowledge
13 includes knowledge that can be inferred from the
14 circumstance but that's ambiguous. For instance, if
15 the lawyer says I didn't know it but acts as if he
16 did, that conduct that indicates that he did know it
17 that might lead to an inference that he knew it even
18 though he denies that he knew it. If that's all it
19 reaches, that's fine, but what we were trying to get
20 at was a little beyond that which is it is plainly in
21 front of him and as you say, he averts his eyes, he
22 refuses to see it. So he can quite honestly say I
23 don't know, I didn't look at the next page.

24 MR. MUNDHEIM: Let me give you a

1 hypothetical. A lawyer is told by the chief
2 financial officer that certain activities only cost a
3 certain amount, which, in relation to kind of general
4 knowledge that the general counsel has, appears very
5 low. He doesn't know anything about this particular
6 activity. If he probes he might find there is an
7 understatement of expenses. Is he all right, is he
8 not knowledgeable in that sense as long as he doesn't
9 ask the next question or should he be asking the next
10 question? That's the kind of situation that I think
11 has been exercising this Commission.

12 MR. CREAMER: I think that is one of the
13 problems that again Professor Morgan deals with. Who
14 the lawyer can trust in those circumstances and to
15 take your example, if I understand it, if the
16 expenses seem low, my answer would be no. You had no
17 further duty to go beyond that and demand to audit
18 the books.

19 MR. MUNDHEIM: But should he go and say to
20 the CFO "explain that to me, I don't understand
21 that?" Or does he say "I heard the answer, I don't
22 want to know anything more"?

23 CHAIRMAN CHEEK: Assuming there is an issue
24 there that if the answer is, you know, less than

123

1 satisfactory and has a material impact on the client.

2 MR. CREAMER: Well, at this point I would
3 not like to go further. It seems to me that if the
4 answers are within and here we go back to the
5 continuum, are within a reasonable range, the lawyer
6 has a right to rely on those. If there are
7 circumstances that make those suspicious or
8 unreasonable.

9 MR. MUNDHEIM: I tried to give you an
10 example where there is a flag, you can denominate it
11 as red or orange, whatever you want; maybe Professor
12 Morgan, since he is here, can think about it.

13 MR. KELLER: I can put words around it as I
14 tried to do before, let's say it would be obvious to
15 any reasonable lawyer that there is a red flag. Is
16 that a standard?

17 MS. HENNESSY: Can I make a suggestion,
18 I don't think you can answer that. Can I -- it
19 probably would be helpful to us if you could look at

20 ALAS' experience with cases in which knowledge was
21 deemed to include turning a blind eye and give us
22 some idea, by courts or ethical bar counsel or what
23 have you, not necessarily if it is confidential
24 identifying, you know, who the people were but giving

124

1 the facts so we can put an articulation of at least
2 some circumstances in which turning the blind eye has
3 been considered to be, you know, implicit in
4 knowledge even though actual knowledge wasn't shown.

5 MR. CREAMER: We'll give you what we can.
6 You can understand that we have some confidentiality
7 issues of our own. Some of what we're likely to find
8 I think is already publicly reported cases but our
9 understanding of the law as we meet here, is what we
10 cited in our paper.

11 MR. LUNDY: The concern we have about red
12 flags and trying to further delineate them in either
13 black letter rules or commentary is that the place we
14 run into red flags is not in judicial opinions or in
15 disciplinary rules, it's in plaintiff's lawyer's
16 closing arguments to juries, that's where we run into
17 reg flags. They are always finding reg flags. They

18 are arguing to the juries that these red flags were
19 so obvious and so numerous that even though this
20 lawyer denies he knew what the client was doing, in
21 fact he had to know, that's exactly how those aiding
22 and abetting cases are argued to juries.

23 We know in a large portion of those cases
24 the lawyers didn't know, didn't even suspect what the

125

1 client was doing was dishonest.

2 It's very hard I think to articulate a
3 standard that will work in all situations. Even if
4 the rules stay the way they are, those arguments will
5 still be made by plaintiff's lawyers in malpractice
6 and other kind of lawyer liability suits. It happens
7 all the time.

8 CHAIRMAN CHEEK: I want to shift subjects to
9 get you out of the hot seat. I didn't notice any
10 commentary in here that related to some of the
11 subject matter that we have talked about recently
12 with President Carlton and others about this direct
13 line of communication of general counsel, independent
14 director, executive sessions and outside counsel and

15 general counsel so there is an opportunity of
16 communication that may not otherwise exist that could
17 serve to enhance their role in seeing the client
18 observe proper corporate responsibility.

19 Do you have concerns about that?

20 MR. CREAMER: We have an interest, we're not
21 ready to make any comment at this point, that's why
22 we labeled our paper "preliminary." We're looking
23 at that.

24 CHAIRMAN CHEEK: We would welcome your

126

1 thoughts when you get to the point.

2 MR. LUNDY: I think we do hope and we're
3 encouraging lawyers in our member firms to give us
4 their reactions to both this task force's preliminary
5 report and to any proposed SEC rules so we hope we'll
6 have a basis within a few months to be more helpful
7 on some of those issues.

8 MS. COOPER RAMO: To make sure I understand,
9 before your current view, which I recognize is in
10 transition, as all of our current views are, is that
11 1.13 is clear enough to you so that it adequately
12 allows lawyers the tools they need to behave in both

13 publicly held corporations and in closely held
14 corporations.

15 MR. CREAMER: That's what I tried to say.

16 CHAIRMAN CHEEK: And that's given due
17 consideration to the real world how difficult it is
18 for a lawyer to make a discretionary judgment, to go
19 above that lawyer's boss or that lawyer's person who
20 engaged them.

21 MR. CREAMER: Yes. All of these issues are,
22 I think, in the real world, difficult, we're not
23 persuaded at this point that changing the rules are
24 going to make those that much easier but --

127

1 CHAIRMAN CHEEK: Les?

2 MR. JACOBS: I think one of the tensions
3 here is the one that you constitute and that is the
4 difference between on the one hand wanting to confine
5 and define the liability and on the other hand, a
6 desire by the public certainly, by some of us to want
7 to alter behavior. And we're stretched between how
8 do we, by stating principles and stating rules,
9 improve on behavior without providing for really

10 unwarranted liability? And one of the difficulties
11 that I have, I hope as you continue to work on this
12 and we hear further from you, you can talk to us a
13 little bit not just about the fact that this change
14 or that change is going to increase exposure but talk
15 to us about the kinds of things that we can do that
16 will improve on behavior that you think will be
17 appropriate, because obviously we can go to a real
18 extreme and make you completely happy and we would
19 not have accomplished anything that the task force
20 wasn't here to do.

21 Now, with that thought in mind, switching to
22 your 1.6 comments which is a big part of your current
23 paper. You give us the statistics back and tell us
24 what jurisdictions are doing, what the restatement

1 says and what Ethics 2000 said, what we've said goes
2 beyond it and is somewhat inconsistent.

3 But it does seem to me that the rule as it
4 now -- as you apparently seem to embrace the concept
5 of voluntary or authorized but not mandatory
6 disclosure, puts lawyers in a position of negotiating
7 with their clients. Not necessarily the client's

8 behavior but the lawyer's disclosure. The lawyer is
9 not required to disclose and it puts that lawyer in a
10 position where there is an inability to say to the
11 client, "I'm sorry, I feel obligated to do this."
12 It's really I want to do it. I want to make a
13 disclosure. That seems to me, except under those
14 circumstances where the attorney-client relationship
15 has been irretrievably concluded, almost never going
16 to happen and, therefore, voluntary disclosure,
17 discretionary disclosure is in practice always no
18 disclosure.

19 And, therefore, that provision is delusory.

20 The second thing, and I'm not asking you to
21 today, unless you want to, say what you think about
22 that but I would like you to think about it and tell
23 me why we're going to get improved conduct with this
24 kind of voluntary rule.

1 The second thing is that you quote out of
2 our report what you consider to be the inconsistent
3 recommendation and the quote, it's not very long is:
4 "To make disclosure mandatory, rather than

5 permissive, in order to prevent client conduct known
6 to the lawyer involving a crime, including violations
7 of federal securities laws and regulations, in
8 furtherance of which the client has used or is using
9 the lawyer's services, and which is reasonably
10 certain to result in substantial injury to the
11 financial interests or property of another."

12 My question to you since you are concerned
13 about liability, why in the world in that factual
14 scenario a lawyer knows a client's conduct is ongoing
15 or is proposed, the client's conduct is using the
16 lawyer's services, and if the lawyer does not prevent
17 it or disclose it, why is the lawyer not going to
18 have coconspirator liability? And is that what you
19 want?

20 CHAIRMAN CHEEK: And as an adjunct to that,
21 isn't making it mandatory enhancing the lawyer's
22 power to change conduct?

23 MR. LUNDY: Well, there are several reasons
24 that I think mandatory is not a good idea even in

1 those limited circumstances. One is that in the
2 context of a major securities offering, for example,

3 it is never or almost never clear to a lawyer what
4 all the facts are. Any individual lawyer working on
5 a matter may know only a small part of what is going
6 on. As we indicated in the testimony, many would be
7 under tremendous time pressure maybe dealing with
8 dozens of different people within the company and
9 outside of the company.

10 And so it will not be clear, almost never be
11 clear, but after the fact in those few cases where
12 the client was in fact committing a fraud, it will be
13 easy for the lawyers for the investors who lost money
14 or the people who bought the business or anybody else
15 who lost money as a result of the securities offering
16 or transaction to make the argument that the lawyer
17 should have prevented this.

18 The lawyer didn't have discretion under
19 their rules and they were required by their ethics
20 rules to disclose and they didn't do it. So they
21 should be liable for the damages since the company is
22 now insolvent or the people in the company are in
23 Guatemala or someplace where they can't be reached,
24 but the lawyer is there and the lawyer's insurance

1 company is there and if you have a mandatory
2 disclosure rule, you have a much tougher argument for
3 the lawyer as to why they didn't disclose. It will
4 all be judged with the benefit of hindsight, not
5 really what the lawyer knew in the middle of the
6 transaction but with the benefit of what discovery --
7 three or four years worth of discovery has determined
8 the course of the liability litigation.

9 MR. CREAMER: Let me just add under the
10 current rules and I think we all agree that if the
11 lawyer knows during the course of a deal that
12 the client is using the lawyer's services to
13 perpetuate the crime of fraud or perpetrate a crime
14 or fraud, that lawyer cannot go forward and must
15 withdraw. And if they have the option to disclose,
16 they may or may not use that discretion.
17 I don't accept the notion that discretion means
18 never. There may be circumstances where the lawyer
19 would disclose. But one thing is clear, even under
20 the current rules, is if the lawyer has to get out of
21 that transaction and cannot go forward if they know,
22 as Joe suggests, that the conduct is illegal or
23 fraudulent.

24 So I think that rule already is enough to

1 change behavior for those people whose behavior is
2 changeable.

3 MR. JACOBS: Where I come from nearly
4 ceasing service but without disclosure or some other
5 rejection of the act would not eliminate
6 coconspirator liability.

7 MR. LUNDY: Wouldn't it depend to some
8 extent at what stage withdrawal occurred?

9 MR. JACOBS: But your premise is that
10 lawyers aren't going to have much clarity on this
11 until it is too late. You say they never really know
12 quite enough.

13 MR. LUNDY: In some cases they won't. In
14 some they will.

15 MR. JACOBS: If you are, I don't know when
16 they will ever withdraw.

17 MR. LUNDY: I will tell you of the calls we
18 get from lawyers in our member firms about how to
19 handle difficult ethical and lawyer liability issues
20 and a number of them relate to do we now have to
21 withdraw? Or we've decided we have to withdraw, do
22 you agree with that? So lawyers do withdraw, at
23 least ALAS-insured lawyers do.

24 MS. COOPER RAMO: And what would you in your

1 now -- think about the issue of -- upon the decision
2 to withdraw is there any further obligation for the
3 lawyer to tell anyone why he is withdrawing and is
4 there a difference in a publicly held company and a
5 nonpublicly held company?

6 CHAIRMAN CHEEK: Within the corporate entity
7 or out?

8 MR. CREAMER: We will continue to think
9 about that question but we will remind everybody that
10 in the current rules there is the comment to Rule 1.6
11 concerning the noisy withdrawal. I know you are
12 familiar with it, it says if you -- if you do
13 withdraw, you may withdraw any opinions that you have
14 given to that to date or any -- retract any
15 statements that you have made to third parties.
16 Normally, from what we hear at least, that if you do
17 withdraw from one of these deals and you do make a
18 noisy withdrawal, that's a pretty public statement
19 and most people get it, that that's what is
20 happening.

21 MR. MUNDHEIM: But when you are being pushed
22 and consider whether there is a requirement of

23 disclosure and the analysis suggests the requirement
24 of disclosure occurs when you otherwise would also

134

1 make a decision to withdraw. And if that's the way
2 to alert the public to something of serious damage.
3 It seems to me an awful lot of water between having
4 made the decision to withdraw and say but you ought
5 to be able to do that quietly.

6 MR. CREAMER: Under the current rules you
7 can do it quietly or noisily.

8 MR. MUNDHEIM: I think the Commission, the
9 task force is saying since it's that small set of
10 circumstances where you would have already made the
11 determination to withdraw that it -- the question
12 then is raised that in addition to withdrawing, you
13 have to notify. It also gives you a much better
14 lever inside the corporation to see conduct is either
15 rectified or not undertaken.

16 MR. CREAMER: Let me think about it further.
17 One thing that comes to mind is that if those are the
18 rules and we're dealing with sophisticated people,
19 there may be in that regime a lot of things that the
20 lawyers never told them because the target population

21 of clients for your concerns may very well turn out
22 to be people who will tell the lawyers what they
23 think the lawyers need to know to get the job done
24 but not enough to cause the lawyers to have to quit.

135

1 And what I think Joe and I are concerned about in
2 that scenario, which is not an unbelievable one, when
3 the money is gone and the investors are suing, then
4 the plaintiffs can say you should have known
5 something was wrong and you had a duty to disclose as
6 well because we now know the people were crooks. It
7 may or may not wash later on that the clients
8 withheld information from you. That's a real
9 concern. I think that you can have clever clients
10 turn the tables on lawyers in these scenarios.

11 MR. KELLER: Can I ask a question, which in
12 all candor, may help you respond to Bob, I'll put it
13 in the form of a question so I don't have to comment.
14 Do you see a difference in the circumstances and
15 willingness therefore frequency in which lawyers are
16 prepared to withdraw because of their concern as to
17 what is going on compared to the circumstance in

18 which the lawyer concludes that they need to blow the
19 whistle externally and if you mandate a noisy
20 withdrawal do you see that affecting -- if you will,
21 if there is a difference, the frequency which lawyers
22 will withdraw and extricate themselves from what they
23 view as a problematic decision.

24 If you don't understand my question, I'll

136

1 make a statement.

2 MS. RAMO: They want to make a noisy
3 withdrawal.

4 CHAIRMAN CHEEK: Thank you.

5 MR. KELLER: What I was trying to say is
6 I think in factoring in the balancing points here, we
7 have to realize that it is easier for lawyers who
8 withdraw to withdraw quietly when they see
9 problematic circumstances or circumstances that
10 trouble them as opposed to having to reach compared
11 to the judgment that there is, in fact, wrongdoing
12 which justifies a mandatory disclosure and that if
13 you make the withdrawal itself, mandate that to be
14 noisy, then you have eliminated it, practicability
15 that now exists for lawyers to extricate themselves

16 from situations where they may have doubt as to its
17 rightness or wrongness but they, on an aspirational
18 basis, do not want to put themselves in the position
19 of proceeding with what may be a problematic
20 situation.

21 MR. LUNDY: I would say this if you go to a
22 mandatory rule as Sarbanes-Oxley 3.07 does in a
23 certain respect it does raise --

24 MR. KELLER: Only internally.

1 MR. LUNDY: Correct. It raises a question
2 what about the lawyer's right to withdraw from a
3 representation. Maybe when the lawyer has less than
4 actual knowledge. Maybe only a suspicion. Maybe
5 only a reasonable belief that something is wrong.
6 Where does the reporting up the line under
7 Sarbanes-Oxley or to regulatory authorities, if it is
8 a mandatory disclosure rule in order to prevent,
9 where does that come in relation to the lawyer's
10 traditional right to withdraw from the representation
11 and just become undesirable because of suspicions
12 about the client's conduct, integrity, whatever

13 that's --

14 MR. CREAMER: Are you suggesting we make all
15 of these withdrawals noisy?

16 MR. KELLER: No. No.

17 MR. McCALLUM: He was showing you a way
18 out, Bob. Say you agree with Stan.

19 MR. KELLER: I was trying to identify a
20 reason why we might not want to, the consequence of
21 doing so is a better way of putting it.

22 MR. MUNDHEIM: I still understand that
23 there are circumstances when you ought to be able to
24 withdraw and say nothing. So unpleasant to work with

138

1 this bunch.

2 CHAIRMAN CHEEK: Any other questions? Thank
3 you both for participating. And that ends our
4 testimony for the day. If there are any comments
5 anybody in the audience has or any questions that you
6 may have we will open the floor to that. Any closing
7 thoughts?

8 PROFESSOR THOMAS MORGAN: I think you're
9 focusing on the question of knowledge is clearly of
10 concern to the task force and an important question.

11 I was going to volunteer to send you a letter within
12 the next couple of weeks.

13 I think one of the things as I have listened
14 to this last series of questions, the more you soften
15 or broaden the concept of what is known, the less
16 likely it is you ought to have a mandatory reporting
17 standard for what you "know." Because if you assume
18 that what you know for purposes of mandatory
19 reporting is something that you really know and have
20 no doubt about, it's a different question than if it
21 is something that you're turning a blind eye toward
22 or whatever. I think you have to struggle with this
23 and I suspect that where you will wind up is where
24 Mr. Creamer and Mr. Lundy were and where I am in my

139

1 testimony and that is ultimately there has to be some
2 kind of situation in which it would be unreasonable
3 to do anything but disclose. But that is a different
4 question than saying that you are going to define the
5 conditions of mandatory disclosure and make it on a
6 case-by-case basis.

7 I would offer some suggestions and others

8 may want to do the same thing.

9 CHAIRMAN CHEEK: Yes.

10 MR. KELLER: If the professor is
11 volunteering to do something, could I ask if he do
12 something as a follow up to one of his suggestions
13 that we leave with the SEC defining rules of conduct
14 in representing public companies. I'm not endorsing
15 that but rather is there a liability consequence that
16 flows from that so that is a lawyer liable to the
17 client if they were to violate the rules of practice
18 that would disqualify them from practicing before the
19 SEC or is that liability limited only to violating
20 the state law rules under which they are licensed and
21 would the consequence be and if you shifted it to the
22 SEC maybe you can address -- maybe you're not
23 addressing but trying somewhat greater flexibility
24 solving the civil liability question.

140

1 PROFESSOR THOMAS MORGAN: I'll be happy to
2 provide that, I'll be sorry I ever raised that.

3 CHAIRMAN CHEEK: We also welcome from each
4 of you and anyone else, any thoughts you may have in
5 light of the SEC rule proposals that come out which

6 may be as soon mid October or so and it would be very

7 relevant for us to have that.

8 Thank you all very much.

9

10 (Whereupon, at 2:23 p.m., the

11 hearing ceased.)

12