

11 CHAIRMAN CHEEK: Professor Morgan.

12 PROFESSOR THOMAS D. MORGAN: I appreciate

13 the chance to be here. I have worked in this area

14 for a number of years and have had the privilege of

15 being a reporter to some of the groups that have

16 produced some ideas in this area and I suppose that

17 it might be a bit arrogant of me to come and try to

18 talk to a group that now is undertaking the same

19 thing but I do appreciate how difficult the task is

20 that you have and I think that the questions you are

21 dealing with are as central to the future of the bar

22 and the country as any. We have talked about MDP and

23 MJP in the ABA but this one, in my judgment, dwarfs

24 all of them in the potential for getting it wrong.

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1 And so it is critical that I think that we at least

2 offer to try to provide whatever help we can in this.

3 What I have tried to do in my written

4 testimony is give you what I call ten questions and

5 it need not be all the questions you consider but to

6 try to break down what seems to be in the news media

7 a kind of cosmic issue into a series of difficult but

8 discrete questions that you need to look at seriously

9 along with others as you formulate the position that  
10 you're going to come up with.

11           And I do it in a context in which I suggest  
12 to you that what you have in most corporate settings  
13 is a group of lawyers who are working, whether within  
14 the organization or as outside counsel, to work on  
15 particular tasks and particular legal questions that  
16 they face, whether they be tax or human resources,  
17 you name it. And at some point in the process that  
18 they're working on, they come up against an issue  
19 that is going to trigger an obligation to switch from  
20 the role of simply solving the problem before them  
21 and to move to a role in which they report or  
22 investigate or whatever the rules are going to  
23 require them to do. While I try to suggest to you is  
24 that the question that you are trying to come up with

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1 is to define that trigger point and to define what it  
2 is and how much you can tell them about what it is  
3 they ought to be doing.

4           I'm going to take the risk if I may and  
5 given the time of not going through all ten questions

6 but rather to suggest simply three points that I  
7 don't think I said very well in my testimony if I  
8 said them at all.

9 And that might be helpful as you make a  
10 record here to have additional points.

11 First, it seems to me that you may want to  
12 consider whether it is appropriate to propose changes  
13 in the model rules of professional conduct at all or  
14 whether we ought to view what we're dealing with here  
15 as essentially a problem of a registered company,  
16 companies issuing public securities. A question that  
17 is essentially appropriately dealt with by the SEC  
18 and nobody else.

19 I recognize that that's heresy within the  
20 ABA and I share the view that the state regulation of  
21 corporation and the state regulation of ethics is  
22 essential but I think there is a balancing here. If  
23 what you conclude at the end of the day is that the  
24 fuss, the understandable fuss -- and I don't mean to

1 diminish it -- the understandable concern that has  
2 been expressed with respect to the major crises  
3 that -- the major issues that we have seen, that that

4 is essentially a problem of publicly registered  
5 securities. And it may be that we ought to or you  
6 ought to acknowledge that this is an area that is  
7 appropriate for specific regulations, narrowly  
8 focused on those lawyers who are filing with the SEC  
9 and not more generally. I don't resolve that for you  
10 but I suggest that that should not be off the table.  
11 Because although it is inconsistent with ABA  
12 tradition, it may just be that you can solve that  
13 problem without creating a world of additional  
14 complexity and issues.

15       Second, I suggest to you that as the  
16 discussion earlier with Professor Murdock suggested,  
17 the interplay between these ethics issues and the  
18 issues that you come up with, the proposal that you  
19 come up with with respect to corporate governance are  
20 critical. That is to say you may well come up with a  
21 set of proposals that establish your corporate  
22 governance committee, I think is what you call it,  
23 and have the lawyer responsible for reporting to that  
24 committee. And then if the lawyer sends a report to

1 that committee and says I don't know whether this is  
2 serious or whether it isn't anything serious. It is  
3 your job now, committee, you investigate it. But you  
4 take the burden off the outside counsel or the inside  
5 counsel to investigate that. You may well come up  
6 with a solution, again, narrowly focused not creating  
7 a broad duty to investigate and explore and get  
8 yourself cross ways with the people that you  
9 regularly deal with.

10 In short I'm not trying to propose that but  
11 to suggest to you it is another way of kind of  
12 getting a handle on this that doesn't propose  
13 broad-ranging new obligations for lawyers.

14 Finally, as you may remember from my  
15 testimony, I do favor the Ethics 2000 proposal with  
16 respect to Rule 1.6. I encourage you not to lose  
17 sight of the old Kutak proposal with respect to Rule  
18 1.13 (c), that was the rule that proposed that the  
19 lawyer be able to go outside the organization and  
20 with the, if necessary, to make a report.

21 I don't think that it is essential that you  
22 change 1.13 (c), I think you can read 1.13 to permit  
23 the disclosure under 1.6. But it has been asserted  
24 by knowledgeable people, Monroe Freedman being the

1 most principal exponent of the position, that if 1.13  
2 does not permit it then 1.6 doesn't save you.

3 Now, as I say, I think that's wrong. But I  
4 would encourage you, if you are going to go down the  
5 route of disclosure, and the 1.6 standard, that you  
6 look at the 1.13 (c) proposal, which is in my  
7 testimony, from the Kutak Commission and recognize it  
8 is a very limited set of proposals and it says you  
9 only disclose if you really believe the board is  
10 acting in its own self-interest by not reporting.  
11 That is the board's in on the conspiracy.

12 And I think that that is a useful kind of  
13 structure and hedging that you may want to have in  
14 mind if you do, as I believe you should, follow the  
15 1.6 proposals of the Ethics 2000.

16 With that I will respond to your questions.

17 CHAIRMAN CHEEK: I'll ask the first and  
18 turn it over to others.

19 Your comments about the task force  
20 considering whether any changes at all are  
21 appropriate and whether the focus of the human cry is  
22 centered on public corporations. In light of the  
23 federal legislation, Sarbanes-Oxley, would it be your  
24 view that the bar association should defer to the SEC

1 in its rule making capacity under that statutory  
2 provision to set those standards that would be  
3 applicable to lawyers practicing before the  
4 Commission, and therefore, practicing on behalf of a  
5 public corporation?

6 PROFESSOR THOMAS MORGAN: In my judgment  
7 what you ought to be doing is being in there in that  
8 process with all of the resources you can bring to  
9 bear. Sarbanes-Oxley is very, very vague. It drifts  
10 really. If people think your proposal has seeds of  
11 mischief within it, Sarbanes-Oxley is rife with  
12 mischief and it is not to say that you ought to  
13 defer, it is to say in my judgment that the real  
14 focus of your efforts might well be to influence that  
15 process insofar as you possibly can to get it into a  
16 format where it makes more sense.

17 CHAIRMAN CHEEK: But not going so far as to  
18 suggest more balanced and carefully crafted changes  
19 to the model rules, that would have applicability to  
20 all the lawyers whether they represent public  
21 corporations?

22 PROFESSOR THOMAS MORGAN: Mr. Chairman,  
23 I'm not here to oppose all changes in the proposal.

24 I recommended the change to 1.6. What I'm

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1 encouraging you to think about is whether the focus  
2 on the model rules is really where the focus ought to  
3 be at the moment or whether it isn't on the -- where  
4 I think the action really is; and namely, the public  
5 corporation and in particular the political realities  
6 of the fight or the attempt to try to get reasonable,  
7 sensible rules out of the SEC.

8 CHAIRMAN CHEEK: On the second point about  
9 the establishment of the lawyer's ability  
10 to direct the governance committee or some committee  
11 of independent directors, do you feel that that alone  
12 without the ethical changes is sufficient to have  
13 enough of an effect on the checks and balances of a  
14 public company?

15 PROFESSOR THOMAS MORGAN: I'm not certain I  
16 understand the import of the question.

17 CHAIRMAN CHEEK: One of the things we tried  
18 to do was sort of link the two. Changes in 1.13 and  
19 1.6 together with the capability of directly  
20 communicating them, together it was a mosaic of  
21 framework that we felt would enhance the lawyer's

22 role in corporate responsibility. What I heard you  
23 say 1.6 is permissive and 1.13 is okay as is because  
24 it can sufficiently create the right balance of

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1 duties. But I support the direct communication and  
2 so I'm asking you whether that's the right mosaic in  
3 your view?

4 PROFESSOR THOMAS MORGAN: As I have  
5 indicated, I think that Rule 1.13 does correctly  
6 answer my first three questions which are what are  
7 the problems you want lawyers to respond to to  
8 establish a diminimus standard at least, that is to  
9 establish a standard of seriousness that you have to  
10 have and deal with the question of who is covered by  
11 the rule.

12 I think there is what I was simply trying to  
13 say in the second was that there is an interplay  
14 there that if you have a clear reporting process  
15 established, as I think you tried to do, that you can  
16 go a long way toward avoiding some of the adverse  
17 reaction to your initial proposals. To keep the  
18 relationship between the lawyer and the person that

19 they're regularly advising reasonably solid and  
20 simply say, "Look we report this to a group whose job  
21 it is to investigate, there is something wrong here,  
22 I'm not here to condemn you but report for this  
23 committee, this group."  
24 MS. RAMO: I want to follow up on that

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1 point, for lawyers in practice, inside counsel or  
2 outside, particularly inside, those are very  
3 complicated conversations to have. Your idea that  
4 there be a corporate I assume governance committee  
5 composed of independent directors however that's  
6 ultimately defined to which the general counsel  
7 I assume you are saying they would go to if there is  
8 a problem.

9 PROFESSOR THOMAS MORGAN: I think part of the  
10 problem here is that I was not trying to define the  
11 general counsel's role, my view of it is that there  
12 are all sorts of lawyers who are involved in  
13 representing most of these companies. Any one of  
14 which could come up with a concern. I reference in  
15 my testimony the Hong Kong tax lawyer and I do not  
16 mean that to be facetious but to describe somebody

17 who is out of the normal loop and what I'm saying is  
18 that you establish a place where that person goes  
19 with the concerns they have and not burden them with  
20 the same burden that you might well impose on the  
21 general counsel or you might impose on somebody else  
22 but I think the discussions you were having earlier  
23 as to whether the general counsel should be part of  
24 management or should report to the board or somebody

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1 else, that's the kind of discussions that I was  
2 encouraging you to have to think through just what  
3 you want but you really imagine these people doing on  
4 a day-to-day basis.

5 MS. RAMO: Let me push you on that, that's  
6 where I was going. Let's assume that any lawyer,  
7 doesn't matter who it is, observes conduct or becomes  
8 aware of conduct, planned or in the past, that the  
9 lawyer believes could be or absolutely is a violation  
10 of the law. Or more difficult maybe not a violation  
11 of the letter of the law but clearly not in the  
12 interest of the organization. Does that lawyer, in  
13 your situation, have an obligation to say -- we have

14 lots of people saying, we keep saying, the lawyer  
15 presents an actor, just don't do this. The actor is  
16 going to go ahead and do it or has done it and the  
17 lawyer becomes aware. When the lawyer becomes aware,  
18 does the lawyer have an obligation to tell the actor,  
19 his direct client in a sense, this is what I have  
20 observed, this is what I think, I'm now going to go  
21 to the corporate governance committee and report  
22 this?

23 PROFESSOR THOMAS MORGAN: You may  
24 have -- your question has a lot of parts in it that

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1 I'm not entirely sure. You said it doesn't violate  
2 the letter of the law.

3 MS. COOPER RAMO: There are two separate  
4 issues.

5 PROFESSOR THOMAS MORGAN: Yes, in my  
6 judgment it ought to have to violate the law to have  
7 an obligation to report. Now whether you can  
8 certainly remonstrate with your client if it doesn't  
9 but the fact that you don't like the direction you  
10 think that the corporate management, the corporate  
11 board has made a bad judgment to go ahead with a

12 merger, for example, it doesn't create an obligation  
13 on you to report that to anybody. That literally is  
14 not your job description. If you think the  
15 corporation is violating the law and the consequences  
16 of that violation will be serious for the  
17 corporation, I agree that under Rule 1.13 you have an  
18 obligation to act as reasonably necessary in the best  
19 interest of the organization.

20       You could well propose to define that as  
21 reporting to some office. You might not, but you  
22 could do that, that's really what I'm talking about.  
23 But I think there are defined circumstances and you  
24 need to narrowly and carefully define the

1 circumstances.

2       But when they happen, and the obligation is  
3 to act within what we call the restatement, the  
4 recognized lines of authority of the organization.  
5 I take it what you are talking about doing in the  
6 first half of your report is recommending what some  
7 of those lines of authority might be. But I would  
8 not then go out and change 1.13 to say you are

9 obliged to report to the corporate governance  
10 committee which may or may not exist in any actual  
11 corporation that somebody is advising.

12 MR. IDE: I thought your testimony was very  
13 practical and thoughtful. The first two points that  
14 you made today I hope you give us something in  
15 writing on it.

16 On the first point and I'll contain this to  
17 the SEC, I don't think it works that way. I think in  
18 real life whatever rules the SEC comes down to are  
19 what the lawyers have to do and spread, spread,  
20 spread, that's my concern. And I think that lawyers,  
21 these issues we need to grapple with as a profession.  
22 So on that issue that's my recollection.

23 The second, the interplay, to me it doesn't  
24 work that way. In other words, within an

1 organization for the legal side and one of the real  
2 things is critical is that you take the staff  
3 function of law and make it where it is hard wired  
4 together and the information comes up with the  
5 general counsel and the general counsel now, as we  
6 said, it goes to the board, so you know what is going

7 on. One of the big problems in a corporation that I  
8 find if you went out in business units cut the lines  
9 off and they have lawyers scattered all over the  
10 business unit.

11 On the other hand if you have lawyers  
12 popping up and say they are going to governance or  
13 the general counsel defers to a governance committee,  
14 I think it defeats what you're trying to accomplish.

15 PROFESSOR THOMAS MORGAN: Bill, you may be  
16 right and I offer the testimony on the second point,  
17 I offer the testimony as a habit. And if you think  
18 that the second point about reporting is impractical,  
19 I defer to you. That is what you are trying to do.  
20 What I'm trying to suggest is there is a relationship  
21 between how you recommend that you organize those  
22 reporting responsibilities and cutting off to some  
23 extent the obligation of an individual lawyer in  
24 downstate Illinois to go to the board of directors of

1 General Motors. You've got to have some kind of  
2 structure and sense to what that lawyer is supposed  
3 to do.

4           With respect to the first, I think you may  
5 be right that what the SEC proposes will be loosely  
6 then kind of read into the law of governing  
7 everybody. I think that would be a mistake.  
8 My own judgment is that if you are talking about  
9 closed corporations, you are talking about labor  
10 unions or the kinds of organizations that are subject  
11 to Rule 1.13, you may or may not want to apply the  
12 same kind of reporting obligations that you report to  
13 public companies who are selling securities on a  
14 worldwide market. You may want to impose much more  
15 rigorous responsibilities on the lawyers for those  
16 organizations in the setting in which they are making  
17 public disclosure. And I'm encouraging you to at  
18 least consider not trying to solve all of the  
19 problems of all corporations because you face a clear  
20 public concern about incidents that have related to  
21 publicly traded corporations.  
22           MR. JACOBS: The thing that I'm having  
23 difficulty in your ten points is where to begin, and  
24 I think there is a premise here that I'm having

1 trouble with. If you look at the structure of 1.13,

2 which as I understand it you basically embrace, with  
3 the progressive reporting to successive levels of the  
4 responsibility until the problem has been properly  
5 addressed and resolved, short of having a triggering  
6 event of serious legal issue that is unresolved, I'm  
7 having difficulty understanding how it is that the  
8 ultimate authority for a client, the board or some  
9 committee of the board, ever gains the knowledge that  
10 management of the company are repeatedly getting  
11 close to the edge of the cliff and only through the  
12 grace of God and the insight of the general counsel  
13 have they been drawn back.

14 That seems to me to be as important for the  
15 governance of the entity as the fact that one time  
16 out of 100 of those occasions the interception was  
17 not timely enough or effective enough to prevent the  
18 liability from arising.

19 I'm wondering why you seize upon having to  
20 find that trigger before you would think it's  
21 appropriate for the lawyer to be going to the  
22 ultimate authority.

23 PROFESSOR THOMAS MORGAN: It seems to me if  
24 you don't have a trigger, what you are going to

1 create is a situation in which lawyers will have to  
2 be engaging in a self-defensive posture all the time.  
3 There are no two ways about it, you will be reporting  
4 every suspicion of anything in order to protect  
5 yourself against the later charge that you didn't  
6 report enough. I think a board of directors could  
7 well have a system if they chose, that said we want  
8 to hear everything from everybody and the lawyer in  
9 that corporation would send them everything they hear  
10 because they want to know everything. But my sense  
11 is that you have to have some kind of trigger if you  
12 are going to get people to take seriously or at least  
13 with the reporting to sort out what is important  
14 information from what is kind of random.

15 We can disagree, perhaps, on where that  
16 trigger point is but you have to have a trigger and  
17 if you don't you are going to have random --

18 MR. JACOBS: As opposed to the kind of  
19 routine consultation that a lawyer would have with an  
20 individual client, not an organizational client,  
21 when the lawyer was involved in many of that client's  
22 activities or relationships, the lawyer would  
23 conclude often to advise the client of developments  
24 and concerns even though there were not triggers but

1 would not necessarily feel obligated to tell the  
2 client about every phone call or every letter that  
3 was received.

4 PROFESSOR THOMAS MORGAN: Exactly, I think  
5 what you need to understand is that nothing that  
6 we're talking about here says that if a lawyer in his  
7 or her judgment believes that they ought to counsel a  
8 client about something that is illegal or not and  
9 it's not strictly a legal issue. There is nothing  
10 that says they can't do it. The question is what  
11 triggers a legal obligation to act and what I'm  
12 suggesting is that there has to be some level of  
13 seriousness in relation to legal issues that  
14 necessary to trigger that legal obligation.

15 MR. MUNDHEIM: This gets us back to Stan's  
16 question.

17 If you are an outside lawyer in the Hong  
18 Kong situation, and the notion that that lawyer is  
19 going to communicate with any member of the board is  
20 fairly unlikely unless they're by happenstance in a  
21 personal relationship. It would be normal for that  
22 outside Hong Kong lawyer to talk to the senior  
23 counsel or general counsel for the Hong Kong  
24 operation and the trigger for doing that might be

1 quite different than the trigger going up to the  
2 board.

3       When that counsel goes to the counsel, the  
4 senior counsel for Hong Kong, can he rely on that?  
5 Or does he have to go further and follow up what that  
6 senior counsel in Hong Kong did?

7       PROFESSOR THOMAS MORGAN: I think that he  
8 ought to be able, he or she ought to be able to  
9 report to the superior and rely on that superior  
10 unless there is some reason to believe that the  
11 superior is dishonest or in on the plot or whatever  
12 we have in mind here, that's a part of my testimony  
13 that we've got to give people the ability to rely on  
14 apparently reliable people.

15       MR. MUNDHEIM: We're not talking about  
16 superior in the sense in that organization, we're  
17 talking an outside lawyer talking to a natural  
18 contact point and your view would be that when you  
19 disclose to that person and have no reason to think  
20 that person will not act responsibly, you are  
21 finished unless something comes to your attention

22 that suggests the problem is ongoing.

23 PROFESSOR THOMAS MORGAN: Yes, I think you

24 have to have some kind of ability to report and

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1 conclude that you have done the job. One of the  
2 problems with Sarbanes-Oxley is this obligation on  
3 everybody to follow up and I think that's a mistake.

4 MR. MUNDHEIM: The question is what that  
5 follow up means.

6 PROFESSOR THOMAS MORGAN: I agree.

7 CHAIRMAN CHEEK: Nothing more than what you  
8 said.

9 PROFESSOR THOMAS MORGAN: The point I'm  
10 making is that it is important to think through what  
11 it means. If it means follow up forever, it is  
12 different than if it means you report to apparently  
13 reliable people and trust them to do the right thing.

14 PROFESSOR L. HAMERMESH: Professor, I know  
15 how limited your time is.

16 Your testimony this morning and the comments  
17 in the report do suggest that perhaps the problems  
18 that this task force has addressed in relation to  
19 1.13 may be just a peculiarity of public corporation

20 life and should be dealt with on that basis perhaps  
21 rather than dealing with it through generalized  
22 applicable aspect of the law and rules.

23 In what respects, if any, do you think 1.13  
24 could be or its counterpart could be improved to deal

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1 with public company situations in ways that would not  
2 be appropriate for organizations more generally?

3 PROFESSOR THOMAS MORGAN: Well, as I have  
4 suggested. I think that Rule 1.13 is pretty good  
5 now. I think you made something of a mistake in the  
6 preliminary report in assuming that those three  
7 elements are magic or even intended to be governing.  
8 I have suggested that 1.13 (c) could be restored as  
9 it had originally been proposed. I have really  
10 struggled, as I have thought about 1.13, this was an  
11 issue that Ethics 2000 considered and concluded  
12 ultimately and I think I'm fairly representing that  
13 just reorganizing, putting them into new paragraphs  
14 or whatever wasn't going to help and people got  
15 familiar with it and the substance of it was sound.  
16 I would not change 1.13. If there is some issue with

17 respect to the amount of diligence that is required  
18 or the trigger point for investigation before issuing  
19 a report on a publicly issued security, there could  
20 well be different standards for something that you  
21 are going to assign an opinion that the facts and the  
22 letter are accurate or facts in the disclosure  
23 statement are accurate but I don't think it is 1.13  
24 that needs amending.

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1 CHAIRMAN CHEEK: Any others?

2 MR. KELLER: Let me get back to Les'  
3 question. I'm not sure it was focused on -- it is  
4 provocative and troublesome if you think for a moment  
5 of Sarbanes-Oxley position. We think about going up  
6 the chain. It's structured in terms of reporting  
7 when you go up the chain let's say it is the CEO or  
8 the general counsel who pose the problem. And they  
9 back off, they say okay we take your advice, go up to  
10 the edge. Or it could be a subordinate and you take  
11 it to the CEO and general counsel and you satisfy  
12 yourself that they have acted yet you never go above  
13 that level. You think of triggering points. I think  
14 the question that Les was asking, if you think of

15 your client as the entire organization -- as the  
16 organization acting through the board or the  
17 responsible committee, is there a point at which the  
18 facts that the questionable activity or even the  
19 pressing the limits where the lawyers have to be  
20 brought in to intervene and keep things in check is  
21 something that the lawyer needs to report?

22 PROFESSOR THOMAS MORGAN: It's an excellent  
23 question and it's an extraordinarily hard one to deal  
24 with by rule. I don't have any question that the

1 lawyer in that situation may go beyond -- that is may  
2 call in the chairman of the board, whoever you think  
3 the independent directors, whatever, there is no  
4 question about whether you may counsel. Rule 1.6 has  
5 no limitation on what you can do in that regard. The  
6 question of what would be a trigger or how you would  
7 even describe a trigger by rule for what you must do  
8 where what your certain is that you have a general  
9 counsel or vice-president or whatever, who is just a  
10 risky character. Someone taking more risks that you  
11 think the board would intend to take. That's a tough

12 one. I admit that's a legitimate issue.

13 I cannot sit here and propose language to  
14 you that would tell you when there is a -- ought to  
15 be a statutory obligation. That's a legal  
16 obligation.

17 MR. JACOBS: You may over read the report.  
18 The report is not so much critical of 1.13, I think,  
19 though, clearly critical of the concept of avoiding  
20 disruption within the organization that the  
21 commentary appears to think is the norm. And that  
22 I sense that what we have been reaching for is saying  
23 where the organization is the client, that any  
24 counsel to the organization should feel completely

1 free and authorized without stubbing any toes and  
2 without having to jump hurdles and without having to  
3 get approval and without having to have a cataclysmic  
4 triggering event to counsel with any part of that  
5 organization's structure as to what the lawyer  
6 believes that part of the organization ought to know  
7 about its legal affairs. Including the fact that you  
8 have people that live dangerously but miraculously  
9 avoid collisions.

10           PROFESSOR THOMAS MORGAN: As you may  
11 remember from my testimony, I indicated that I don't  
12 think there is any harm in taking the language that  
13 troubles you out of Rule 1.13. I personally, I have  
14 never known any situation in which it appears to me  
15 that it constrained anybody in that regard but you  
16 could take it out and why it is in there, that goes  
17 back to the Kutak Commission which is before I was  
18 involved and my guess is it probably had something to  
19 do with easing concerns at the time that the rule was  
20 originally proposed. I don't know that for a fact.

21           CHAIRMAN CHEEK: Any other questions?  
22 Thank you very much.

23           We appreciate it very much your written and  
24 oral testimony.