

12 CHAIRMAN CHEEK: Professor Murdock, I

13 understand is here.

14 Good morning, sir. Our format is to give
15 you the opportunity to make any comments in addition
16 to your written testimony and rearticulate the
17 written testimony and we would like to ask you some
18 questions.

19 PROFESSOR CHARLES MURDOCK: Since I am late,
20 let me be brief and we can save time that way.

21 I think one of the reasons that I'm here is
22 I expect that you will get a lot of opposition to
23 your proposal, I think you have done an excellent job
24 and put a lot of effort into it and a lot of thought

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1 into it and I thought it would be nice for someone to
2 come here and say that they agreed with you.

3 CHAIRMAN CHEEK: We appreciate that.

4 PROFESSOR CHARLES MURDOCK: I think one of
5 the things that lawyers don't appreciate is the
6 question of tone and I refer to tone in my written
7 remarks. And while people may differ with me,
8 I think that the Supreme Court decision in Central
9 Bank of Denver eliminating and even abetting

10 liability and the '95 Private Securities Litigation
11 Reform Act or at least the way it has been
12 interpreted by some courts, and I reference "Silicon
13 Graphics" really set a tone that you don't need to
14 worry anymore. And I think that one of the things
15 that your report does is effects a change in tone and
16 I think that's very important.

17 When I started practicing almost 40 years
18 ago, the lawyer was really seen as a counselor, and
19 there was a lot of continuity between lawyer and
20 client, and there has been a lot of changes over the
21 years and the practice of law is much more
22 competitive, clients are much more likely to change
23 lawyers, and I think that's had an impact on the
24 legal profession.

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1 Most lawyers and most clients are wonderful
2 people, but there are some clients and there are some
3 lawyers who regard themselves more as a hired gun
4 than as a counselor.

5 So I think tone is something that's very
6 important. I think one of the things, again, when

7 you get into the area, there is a lot of talk about
8 the fact that you cannot legislate morality and I
9 would concur with that but you can create structures
10 that encourage moral action. And I think that the
11 proposals that you are making here and, in fact, do
12 that.

13 In fact, the two things that I thought were
14 most significant was towards the end of your report,
15 and requiring communications between general counsel
16 and the audit committee, I think that's an
17 outstanding recommendation, I think we have to
18 realize that it's very difficult to, in effect, be a
19 whistle blower; it is difficult to move up the
20 organization, it is difficult to go to third parties
21 and that when conduct is permissive and in a
22 competitive environment, you are going to resolve
23 doubts against that kind of action. I think by
24 setting up the structure that you did, creating a

1 communication vehicle between the general counsel and
2 the audit committee and between the outside attorneys
3 and general counsel so they realize they are
4 responsible to him, and not to the person who is

5 giving them the business, that was an outstanding
6 suggestion.

7 Basically that's the drift of where I come
8 from on this.

9 CHAIRMAN CHEEK: Thank you.

10 In your observation about tone and setting a
11 platform for the counseling role in an effective way,
12 did you think of any other areas or matters that the
13 task force did not consider that perhaps should be
14 considered in that connection?

15 PROFESSOR CHARLES MURDOCK: No, I thought
16 you did a pretty good job.

17 CHAIRMAN CHEEK: Do you have --

18 PROFESSOR CHARLES MURDOCK: By the way, the
19 other aspect and I guess this is probably why I like
20 the two suggestions that you made with respect to
21 general counsel and outside counsel, the corporate
22 governance recommendations I think are prudent and
23 they are in line with other suggestions but Enron,
24 for example, had outside directors, they had

1 supposedly very competent outside people and people

2 knowledgeable in accounting matters, sitting on the
3 audit committee so none of these are guarantors but I
4 think what they all do is it is a move towards
5 changing the tone and having people -- disclosure,
6 I think, to a certain extent has become a game, and
7 the goal of disclosure is obfuscation as opposed to
8 clarification.

9 CHAIRMAN CHEEK: Public disclosure about
10 public companies.

11 PROFESSOR CHARLES MURDOCK: Yes, and we need
12 to change the perception of the game and we need to
13 change the tone.

14 CHAIRMAN CHEEK: Do you feel that we made
15 the right cut on the mandatory versus permissive
16 disclosure of third parties confidentiality?

17 PROFESSOR CHARLES MURDOCK: I do because I
18 think if you have permissive you are not going to
19 have disclosure. That there is too much just
20 structurally that argues against taking that step, if
21 you don't have it mandatory, you don't have it at
22 all.

23 MS. HENNESSY: Mr. Allen has raised the
24 concern that by making it mandatory we would be

1 increasing the exposure of lawyers to shareholders.

2 Do you have any views on that?

3 PROFESSOR CHARLES MURDOCK: There is that

4 possibility. On the other hand, you increase the

5 exposure if they don't make disclosure. And the

6 problem he was struggling with are the circumstances

7 under which you are going to make disclosure.

8 I heard part of his remarks and I know he worried

9 about moving from the known to should have known.

10 The argument for the should have known piece is to

11 require lawyers to do some due diligence that you

12 can't use ignorance as an excuse, you cannot close

13 your eyes and just look at a little piece and not

14 look at what is next to it.

15 CHAIRMAN CHEEK: Stanley?

16 MR. KELLER: Let me say I agree with your

17 observations regarding the need to get lawyers back

18 focusing on what their role is. I also appreciated

19 your reference in describing Carter and Johnson

20 identifying the players there as graduates of Harvard

21 Law School. And I assure you that gives you no

22 particular credentials to make these difficult

23 judgments.

24 In your written testimony, you identify two

1 situations, one is Carter and Johnson and your
2 vignette is wonderful in focusing on each step along
3 the way in the process. Then you take a more current
4 example of Elkins' participation in the Enron special
5 purpose entity. I don't want to get into the merits
6 of that.

7 But assuming, as we do, that there are
8 requirements that are triggers for lawyers to take
9 actions, whether it be according externally or going
10 up the chain in the organization, it seems to me your
11 example focused on what may be one of the more
12 difficult issues raised by both the standard for
13 knowledge and the standard for what the conduct being
14 complained of that needs to be observed is.

15 How do you come to grips with defining the
16 point at which the difficult obligation of the lawyer
17 to take additional action takes place. So, for
18 example, if you take your vignette on Carter and
19 Johnson, at what point in that process did the switch
20 go off so that there was an obligation for the
21 lawyers to take further action, recognizing that when
22 you look at the whole process, the SEC, in fact,
23 admits in the conclusion they did not take the
24 necessary steps needed to represent the organization

1 and client adequately but it would be the prospective
2 rule but that rule has not been adequately defined at
3 that point.

4 Then in the Enron-type situation with
5 respect to the special purpose entity where
6 you -- the lawyer, let us say, is incredulous at the
7 ability to use this three percent equity involvement
8 and there's different ways that that can be
9 structured. Let's just say that it was aggressive
10 and the lawyer was sensitive to that and insisted and
11 assured him or herself that, indeed, if the issue was
12 focused for the accountants and the accountants'
13 advice was obtained and the accountants, let's assume
14 they were not Arthur Andersen, they came back and
15 said,
16 "We considered it and in accordance with generally
17 accepted accounting principles, it is fine."

18 How do you define that trigger in those two
19 situations?

20 PROFESSOR CHARLES MURDOCK: First of all,
21 that's clearly the direction we're moving, although
22 U.S. versus Simon took us there a long time ago. The

23 reliance on generally accepted accounting principles
24 is not a defense to fraudulent conduct. That's one

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1 piece.

2 The second piece is that the lawyer very
3 early in the process has to have some backbone and in
4 Carter and Johnson, the lack of backbone by the
5 lawyers is very clear all the way through. They're
6 unduly deferential and they didn't want to hurt the
7 feelings of the CEO. Why? Because the CEO was the
8 one who was responsible for the engagement. What
9 Carter and Johnson does, though, is it does indicate
10 that there is a continuum here, and it highlights the
11 question that you're raising: At what point is it
12 necessary to do something?

13 I don't think that the effect of these rules
14 is that as soon as you see something that you think
15 is amiss, you will run to the SEC. So what you do at
16 different points in that continuum, one right off the
17 bat, you have backbone and tell the CEO that certain
18 things he is suggesting cannot be done. And then you
19 have conversations with the general counsel.

20 Now, unfortunately the general counsel in
21 Carter and Johnson was not a paragon of virtue either
22 and at some point you then have to move to the board
23 of directors but they needed to move to the board of
24 directors far earlier than they did and it is clear

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1 after the fact that had they gone to the board of
2 directors or the audit committee earlier, there would
3 have been a change in the nature of the disclosure.
4 To a certain extent the idea when we are looking at
5 1.6 and we're talking about third-party disclosure,
6 by focusing on that too much, that's a red herring.
7 That if we change the tone not just for lawyers but
8 for management and for the board of directors and if
9 you move up the corporate later, most of the time you
10 are not going to get in a situation in which it is
11 necessary to go outside to go to the SEC.

12 If you look at the Enron situation, it is
13 very complicated, but I think that lawyers working
14 with special purpose entities for whom they are
15 getting highly compensated, some of the literature on
16 this talks about fees in the six figures -- well into
17 the six figures. If you are making that kind of

18 money, you have a responsibility to understand the
19 area of the law in which you're practicing. And I
20 don't think that the -- you have some ambiguity as to
21 whether the Barclay loan was capital or loan. There
22 is ambiguity there. I don't think there is any
23 ambiguity if you go back to 90-15, the ITF 90-15,
24 that risk capital has to be at risk and if half is

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1 sent back, that's where I find fault with the
2 Vinson & Elkins lawyers. At that time you know that
3 you don't have the so-called three percent. On top
4 of that everybody talks about three percent as a
5 rule. And lawyers ought to go back to the basic
6 document that gives rise to that three percent. You
7 will find that that was in the context, if I recall
8 correctly, of a leasing transaction and the SEC
9 guidance that's incorporated in that says you need to
10 take a look at the nature of the transaction, the
11 riskiness of the transaction as to whether three
12 percent is satisfactory.

13 And I think that with respect to the role of
14 the lawyers, is this riskier such that three percent

15 rule ought to be a six percent or ten percent rule.
16 That's where maybe there is judgment but when you
17 take the so-called risk capital and you send half
18 back, I don't think there is any judgment at that
19 point in time. That's a blatant violation.

20 MR. KELLER: I wasn't getting into so much
21 the particular facts of that situation but rather the
22 issue of how you define the lawyer's responsibility.
23 What is within the lawyer's scope of responsibility
24 and knowledge to the extent the lawyer can rely upon

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1 other professionals as we go through thinking about
2 what the triggering points are.

3 PROFESSOR CHARLES MURDOCK: I think you can
4 rely on other professionals but not absolutely. It
5 depends on the circumstances. That's why I raised
6 90-15.

7 CHAIRMAN CHEEK: Other questions?

8 MR. IDE: Maybe it is a comment. What we
9 tried is where are the lawyers. What we tried to do
10 is say we'll give this to the lawyers and that's the
11 idea of the general counsel. Having been in that
12 box, the general counsel, how many times can you go

13 around the CEO to the board? Once.

14 PROFESSOR CHARLES MURDOCK: Unless you win.

15 MR. IDE: Even then you both are gone.

16 We're trying to build in a structure so the board is
17 equipped to have the resources of the general counsel
18 there to appeal to. By the way, CFO ought to have
19 the same thing, internal auditor ought to have the
20 same thing, HR ought to have the same thing. But you
21 talk about the lawyers and counselors and the lawyers
22 and we don't get into that but my question is where
23 are the law professors during MDPs? It goes back to
24 Bob Cusack, a lawyer who I practiced law with, a

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1 lawyer with the transaction. The inherent conflict
2 of who you are representing. I think one of the
3 problems which raises something we didn't get into.
4 When general counsel uses outside counsel, how many
5 different roles can you give outside counsel and they
6 have the understanding, for example, Enron outside
7 professional investigation. That's an issue that is
8 practiced in general counsel. Think about my choice
9 of outside counsel and who is protecting me against

10 the deal and make sure it is the right deal. And
11 those areas where the lawyers have so many incentives
12 to make things happen. And hopefully we have dealt
13 with structurally for the future by having the board
14 have independent counsel and management of the
15 resources.

16 PROFESSOR MURDOCK: The idea of general
17 counsel, I've heard this analogy used they ought to
18 be the conscience. Sometimes it's not.

19 MR. JACOBS: Let me follow up on that
20 point and Bill's observation. You don't, as an
21 observer of this have some of the personal conflicts
22 that all of us have either as serving as outside
23 counsel or general counsel for corporate clients.
24 I was interested that you so thoroughly embraced what

1 is a transparent compromise in our preliminary
2 report. That is having a laudatory objectives but
3 leaving the general counsel still in the practical
4 dilemma that Bill Ide describes, and I wonder if you
5 have given any thought or have any views on whether
6 like the move of auditors to the custody of the
7 independent directors exclusively serving on an audit

8 committee, there is a need for rethinking the
9 prevailing mode right now of general counsel being
10 part of the management team and administratively and
11 probably in a compensation fashion, subordinate to
12 one or more members of management.

13 PROFESSOR CHARLES MURDOCK: There was a
14 Securities Law Committee meeting yesterday at the
15 Chicago Bar Association, and they were talking about
16 setting up the mechanisms to ensure adequate
17 disclosure and have the disclosure process committee.
18 One of the points that was raised then is that the
19 general counsel should be an adviser to that
20 committee as opposed to a member of that committee.
21 I thought that was a very interesting idea. I would
22 subscribe to that as well. I think that somewhat
23 goes to the question you're addressing.

24 MR. MUNDHEIM: Another way of thinking about

1 it which I heard in a different meeting last night
2 was the board ought to select the general counsel
3 because, after all, ultimately that's to whom the
4 general counsel is responsible. Would you favor

5 that?

6 PROFESSOR CHARLES MURDOCK: Well, it's a
7 very interesting idea, again we moved and the audit
8 area that the committee is responsible for the choice
9 of the auditors and if we are serious about the idea
10 of that -- that the general counsel you know is the
11 conscience of the organization and has these
12 responsibilities and they put such a person in
13 conflict with the CEO. There's something to be said
14 for that and I can't say having just heard it that I
15 would overly subscribe to it. I certainly, going
16 back to the comment that was made, the general
17 counsel or outside counsel goes over the head of the
18 CEO once, that's the end it of, it seems to me the
19 board or audit committee ought to have some input
20 into that and it should be a learnt substantial risk
21 that someone takes when they do go over someone's
22 head and, you know, just like the Sarbanes Act that
23 has some whistle blower protection, there ought to be
24 some protection for general counsel or outside

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1 counsel trying to fulfill their responsibilities.

2 CHAIRMAN CHEEK: Thank you, we appreciate

3 very much your comments.