

1 This was someone who's been on both sides, a really
2 public interest orientation. He said look, whether
3 something is a felony in American law today depends on
4 what the prosecutor decides to charge. This guy sits
5 in a criminal court.

6 The reality is that you may think you're
7 isolating a class of conduct by saying okay, felonies
8 are really severe; mandatory disclosure for those, but
9 reality is that you are really, I think, putting a
10 very serious chill on the incentive to communicate
11 with corporate lawyers.

12 MR. CHEEK: Thank you, Professor. We
13 appreciate you being here. Lundy?

14 We welcome you back. We do recall your
15 testimony.

16 THE WITNESS: I won't try to repeat that and
17 I also will not take much time at all with our new
18 points because, frankly, they are simply additional
19 average or thoughts in support of the two principle
20 positions that I last took on September 20th, namely,
21 that we think a mandatory disclosure rule would be a
22 mistake and be counterproductive, and that we believe
23 changing knowledge standard to reasonably should know
24 in model rules 1.2(d, 1.13(b and 4.1(b would be a
25 mistake.

1 MR. CHEEK: Have you changed those views?

2 THE WITNESS: We haven't changed those views.
3 We have some additional arguments why we think those
4 positions should convince the task force, but I don't
5 need to repeat them here. One thing I would like to
6 point to because this is specifically in response to a
7 request from members of the task force, we have tried
8 to devise a possible comment to model rule 1.0(f, the
9 definition of knowingly, known, or knows, which we
10 hope is a balanced discussion of what the knowledge
11 standard ought to be.

12 And the second paragraph of that proposal
13 does pick up the sentence that Professor Morgan
14 pointed to in comment 8 to rule 4.2, that namely --
15 and moves it up to where it would be relevant to the
16 definition of knowledge as used in all the rules, that
17 a person may not avoid knowing a fact or knowing about
18 a situation by engaging in willful blindness by
19 willfully ignoring the obvious.

20 One other point we make in support of our
21 opposition to mandatory withdrawal came as we read
22 through the transcript of Mr. Keller's interrogation
23 earlier and finally the lightbulb went on, and I think
24 we agree with the point he was making, namely, that
25 imposing a mandatory disclosure standard for careful

1 risk averse lawyers will predictably have the effect
2 at least on some of them that it will cause them to
3 withdraw at the first sign of any doubt about the
4 legality or propriety of the client's conduct, and
5 thus -- or the conduct of any corporate officials with
6 whom they are dealing, which will have the rather
7 perverse effect of denying to the corporate client the
8 benefit of experienced, well-known, trusted counsel's
9 advice because they won't be on the scene and they
10 aren't going to take the risk that somebody after the
11 fact can argue, well, you should have -- your duty to
12 report here was mandatory because you should have
13 known that this person's conduct was fraudulent or
14 criminal or they intended to engage in that kind of --
15 and so, Mr. Keller, thank you for that point. We
16 finally tumbled to what you were saying.

17 Again, we make the point that the model
18 rules, although the drafters didn't intend it and
19 didn't want it, and the preparatory language to the
20 model rules still says it's not appropriate to use
21 these rules as a basis for lawyer liability. That is,
22 in fact, the way they are used every day in almost
23 every state. And so the task force must be conscious
24 of that fact when you decide what you want to
25 recommend in the way of what are on the first level

1 only disciplinary rules but have very significant
2 limitations for lawyer liability.

3 MR. CHEEK: Could I ask a question?

4 THE WITNESS: I was actually finished.

5 MR. CHEEK: I'm very interested in your
6 reaction to the interplay with what the commission is
7 suggesting, particularly the reporting out portion of
8 that, and the interplay between that and 1.13 and
9 civil liability in the context of the issues that you
10 deal with.

11 THE WITNESS: Well, preliminarily, we
12 certainly acknowledge that section 307 of
13 Sarbanes-Oxley authorizes the commission to issue
14 minimum standards of professional conduct for lawyers
15 practicing before the commission, and then gives one
16 specific instance which is up the line reporting
17 within a client's organization. But the rule by its
18 terms is broader than that.

19 The commission staff obviously took that
20 broader language and said we will go beyond the
21 minimum suggestion or requirement of the statute and
22 impose additional requirements. That is somewhat
23 ironic in light of the arguments, the legislative
24 history of section 307 of which there is not a lot,
25 but both Senator Edwards and Senator Sarbanes on the

1 floor of the Senate when that section was considered,
2 which didn't take very long, and there were no
3 hearings, I might add, said, well, isn't it the case,
4 Senator Edwards, and Senator Sarbanes says, this would
5 not require any breach of the attorney client
6 privilege because the reporting is all up the line
7 within the client organization? Yes, yes. By the
8 way, Senator Sarbanes said, and so did Senator
9 Edwards, that this rule was not intended to create a
10 private right of action. As I understand it, I
11 haven't seen the proposed rule. I've heard the
12 commission discuss the staff's proposal, and what I
13 could glean from that there is no statement in the
14 SEC's rule that there's no private right of
15 enforcement.

16 It seems to me at a minimum it ought to say
17 that. That's all by way of background.

18 MR. KELLER: The gentleman at the hearing put
19 that on the table and there was a debate over whether
20 to go back and fill that in or just basically key in
21 on this question to be dealt with in the final rule.

22 THE WITNESS: So you conclude as I do that
23 probably in the actual notice of proposed rule making
24 there will be at least a question as to whether the
25 commission ought to specifically address that in the

1 rule, yes. I would say this, if the commission
2 persists in imposing on lawyers who practice before
3 the commission a duty under some circumstances to go
4 outside the client organization, so-called reporting
5 out requirement, it's hard for me to see how that can
6 be squared with the current rules or even anything you
7 are proposing. That's so clearly inconsistent with
8 the concepts of confidentiality and client loyalty.
9 That concept is not based in common law. That's from
10 the law of agency. Every agent has a duty of loyalty
11 to the principle. And that's what lawyers are.
12 They're agents for their clients. So that duty of
13 loyalty is not some outmoded concept. That's very
14 much alive. And I will tell you lawyers are getting
15 sued in this country every day for breach of fiduciary
16 duty, including duty of loyalty. Every time there's a
17 conflict of interest allegation in a civil liability
18 case against a lawyer, it's pled as a breach of
19 fiduciary duty claim.

20 Anyway, I don't know if I were in your place,
21 Mr. Chairman, how I would go about trying to reconcile
22 model rule 1.13 with the kind of porting out rule that
23 I've heard the commissioners and staff discussing at
24 the SEC. It's just a lot will depend on the specific
25 language, so we will need to wait to see that.

1 MR. MUNDHEIM: If you take the case where the
2 lawyer has said that's a clear violation and the
3 independent directors were not able to act
4 disinterested, saying that's fine, what -- after all,
5 it's the corporation that's going to be hurt. That's
6 the client. What's the lawyer to do then?

7 THE WITNESS: Well, under the current model
8 rules the lawyer can do a noisy withdrawal which would
9 put at least other parties to the proposed transaction
10 on notice that the lawyer is not going to be
11 associated with this any further, and if you all go
12 forward with your recommendation to again recommend to
13 the house of delegates that they pass the 1.6(b2 and
14 (B3 that the Ethics 2000 commission recommended, then
15 to me it seems that the lawyer has the authority,
16 although not the mandate, but the authority he or she
17 would need to deal with that situation.

18 MR. MUNDHEIM: Let me switch you to another
19 question. Do you think that the standard triggering
20 1.13 responsibilities should be different than the
21 standards triggering a 1.6 opportunity or mandate?

22 THE WITNESS: I think it should be a
23 knowledge standard in both cases, with the gloss that
24 we have suggested that the lawyer may not avoid having
25 knowledge by ignoring the obvious.

1 MR. KELLER: I just want to be sure I
2 understand what you just said. The implication is
3 that one should not feel an obligation even to be
4 counseling the ultimate client about anything other
5 than that which he actually knows. You should not be
6 going to an authority within your client and saying
7 that I am concerned about this or there appears to be
8 a problem. You just keep this to yourself until you
9 have actual knowledge?

10 THE WITNESS: You're talking about precepts
11 of good lawyering. I'm talking about what would be
12 disciplinable conduct. If you change the disciplinary
13 rule, then you're way beyond what good lawyering would
14 dictate or what real concern for your client would
15 dictate. You're putting the lawyer in a position you
16 can be disciplined if you don't do what we say you
17 should do in this rule. I wouldn't advocate that a
18 lawyer ignore the obvious and consciously refrain from
19 advising a client about conduct that might be
20 dangerous to the corporate client or illegal.

21 I don't understand the value of looking at
22 hypotheticals where the client conduct is by
23 definition clearly wrong, but as we say -- as we said
24 in our first paper, Professor Morgan has said and
25 would say again, those are very, very, rare

1 situations. In real life lawyering of corporate
2 clients in complex transactions it's almost never
3 clear, and so the lawyer is normally asking a lot of
4 questions just to understand what the transaction is
5 all about.

6 MR. MUNDHEIM: Isn't that the problem? The
7 question of where the lawyer concludes that's illegal
8 but I can understand the argument and why it's okay.
9 Isn't that a case where he must be sure that higher
10 authority has reviewed that action before it's taken?
11 Second question. If you go down to the next level
12 where he says I think this is all right but there's
13 also a very good argument that it isn't. Is there an
14 obligation at that point, since you reject the first
15 one you obviously reject the second. Are you sure you
16 reject the first one?

17 THE WITNESS: Well, what I understand
18 Mr. Jacobs' question was outside disclosure.

19 MR. OLSON: Going back to Bob's original
20 question, is there a different rule for what you have
21 to do up the ladder as opposed to when you have to go
22 outside? I just base this on my own practice. A
23 situation where a client is going to do business in an
24 environment where from my prior experience I know that
25 corruption is going on, be it the country or other

1 side of the transaction.

2 I think, and I've always felt that I have an
3 obligation to say to that client, and I'm not upset
4 about being subjected to discipline if I don't meet
5 it, in my experience, people in that situation there's
6 real risk that you're going to be asked to pay bribes
7 and we need to take extra precautions, then I
8 recommend such and such, and I'm not talking about
9 outside --

10 THE WITNESS: I'm sorry. I misunderstood
11 Mr. Jacobs' question. Absolutely, when a lawyer says
12 to the client is really a different -- there may be a
13 lot of the same considerations but --

14 MR. OLSON: The person you talk to, you can't
15 stop and your standard, may be a standard of suspicion
16 or negligence, as opposed to a standard of actual
17 knowledge. Otherwise, you can hide behind you don't
18 have actual knowledge. They're going to ask for a
19 bribe this time so I don't have to push it any
20 further. That's dangerous within the corporation.

21 I'm sorry, Mr. Chairman. I got fired up.

22 MR. JACOBS: I think if in at least one
23 respect you have finessed us again. And what you say
24 in your supplemental comments where you're coming back
25 to issues that were previously raised, you say an

1 assertion was made at the September 20 hearing that
2 under a permissive disclosure rule it is unlikely that
3 lawyers will engage in voluntary disclosure, giving
4 rise to a concern that a permissive disclosure rule
5 will result in no disclosure at all.

6 The question then is how can a permissive
7 disclosure rule improve lawyer conduct? So you
8 correctly phrased the question, but then your answer
9 is more likely, prudent lawyers will use the other
10 means available to them such as early withdrawal to
11 deal with problematic situations. You never actually
12 answer the question that you have identified, that is,
13 how will permissive disclosure improve lawyer conduct?
14 Because you seem to conclude that permissive
15 disclosure that lawyers will just evade.

16 THE WITNESS: Well, the objective, it seems
17 to me, is not more lawyer disclosure. It's better
18 client conduct, and which with mandatory or permissive
19 rule will promote better client conduct. That's a
20 judgment. You've heard a lot of witnesses here say,
21 necessarily lawyers who -- well, lawyers from the
22 academic world and from the world of private practice.
23 They think mandatory disclosure will discourage
24 clients from having the lawyer in the room when they
25 are discussing subjects that may raise questions of

1 doubtful legality.

2 MR. OLSON: That's may be the judgment based
3 on the colloquy earlier that Senator Edwards was
4 making. Basically, he said evidence you had to work
5 within the corporation by not talking. Maybe we
6 should rethink and have the standard for going up
7 within the corporation be a negligence based standard
8 but the standard for going beyond that be a knowledge
9 based standard which basically means rewriting much
10 more substantially than we have contemplated so far in
11 1.13 as well as 1.6.

12 MR. KELLER: Can I just interject? I'm not
13 sure he characterizes it going back to calling it a
14 negligence standard. Take it back to -- we were
15 talking about reporting within the organization, which
16 is up the ladder. At what point do you have to take
17 it further up the chain?

18 Right now 1.13 has a knows there's a material
19 violation. Take it that way. And we've talked
20 around what does "no" mean? You can't ignore the
21 obvious. We have on the table from the SEC a
22 different formulation and it's a combination of nos,
23 but then it's no what? At least as we believe or
24 suspect the formulation, we haven't seen it in actual
25 words, a lawyer has knowledge of fact, information

1 that an attorney would reasonably believe, would lead
2 an attorney to believe that there is a material
3 violation. There's no duty of inquiry.

4 You have to have the knowledge of the facts
5 but then having those facts, then an objective
6 standard, and let's just hypothesize a similarly
7 situated attorney of equal competence and the like,
8 would then lead them to reasonably believe there's a
9 violation. So it's a way from the no, there's a
10 violation standard. Is that a formulation that would
11 bridge the gap and meet corporate governance
12 objectives of getting serious suspicion of material
13 matters up to the right level in the organization.

14 THE WITNESS: I think it's certainly better
15 than reasonably should know. I think, however, it is
16 still to the criticism that the reasonably should know
17 standard is, namely, that facts that would put a
18 lawyer on notice or make a reasonable lawyer believe
19 something will always be clear with the benefit of
20 hindsight than it is at the time you're in the middle
21 of your consultations and that's going to subject
22 lawyers to liability when they didn't have actual
23 knowledge that something wrong was being contemplated
24 by the client.

25 MR. KELLER: What if you then formulated a

1 reckless standard, aware of facts then is reckless in
2 failing to recognize the violations.

3 THE WITNESS: You have to have knowledge of
4 facts but it's facts that would be would be reckless
5 not to conclude that the client was intent on -- well,
6 that's still better than the last.

7 MR. McCALLUM: You like the reasonable belief
8 -- you like that particular standard because from the
9 point of view of the lawyer looking at discipline, the
10 definition of reasonable belief in the rules is that
11 first, the lawyer has to believe it. So all the
12 lawyer has to do is say I didn't believe it and it's
13 not required that his disbelief be reasonable.

14 MR. CHEEK: That's not what the commission
15 proposed.

16 MR. McCALLUM: He was talking about a
17 reasonable belief, and that is mentioned, by the way,
18 in one of the releases but I hadn't seen -- in one of
19 those.

20 THE WITNESS: I thought I heard in the
21 commission's open meeting that it was a reasonable
22 belief.

23 MR. CHEEK: They believe that to be an
24 objective standard.

25 MR. McCALLUM: Meaning you cannot reasonably

1 disbelieve it.

2 MR. CHEEK: On the basis of your actual
3 experience of litigation against the lawyers. In the
4 states that have the permissive 1.6 version have you
5 seen actual increases in liability for lawyers
6 practicing in those states?

7 THE WITNESS: No, Mr. Chairman. We're not
8 aware of any data that reflects that. In fairness, I
9 think we also have to say there's very, very little
10 data out there of any kind about what sort of
11 disclosure occurs in states that have any number of
12 different kinds of rules.

13 MR. JACOBS: Could I ask you one final thing?
14 You've heard obviously today, and we have heard on
15 other occasions and the -- about to be former chairman
16 of the SEC has asserted without providing any data
17 that, in fact, state disciplinary authorities did not
18 pursue corporate lawyer wrongdoings. Is there any
19 basis one way or another on which one could make an
20 objective evaluation of those assertions?

21 THE WITNESS: Well, since ALAS does not cover
22 a number of firms for disciplinary proceedings, we
23 don't have a lot of information about how many of our
24 lawyers are disciplined or aren't. I would have to
25 say from my general reading and from my teaching of

1 legal ethics my impression is the same as you have
2 stated it. Lawyer disciplinary authorities have
3 limited resources. They in most states have their
4 hands full chasing lawyers who are stealing money from
5 their clients so they don't often bring discipline for
6 conflicts of interest or -- and in particular in
7 situations where the lawyer has already been punished
8 in some respect it may make that a lower priority.
9 That is just speculation.

10 MR. MUNDHEIM: I just want you to help me.
11 You said mandatory noisy withdrawal. Why does one say
12 noisy mandatory withdrawal instead of I reject
13 mandatory disclosure?

14 THE WITNESS: I think I said noisy
15 withdrawal. I don't think I said mandatory.

16 MR. MUNDHEIM: I asked you what you would
17 have to do in those circumstances, and you said you
18 would have to withdraw and noisy. That sounds
19 mandatory to me.

20 THE WITNESS: I missed the what would you
21 have to do. My answer is what lawyers actually do,
22 not -- and I didn't mean to be advocating a mandatory
23 noisy withdrawal. Sorry if I misspoke.

24 MR. CHEEK: We'll stand and adjourn for
25 lunch. Appreciate you being with us.