1 MR. CHEEK: We have a very full day here at
2 our public hearing at Stanford. We have an additional
3 witness that will appear at the end of the day so our
4 day is now toward 4:30, and I hope that we can keep,
5 even though we're starting five minutes late that we
6 can roughly keep on our schedule as we go forward.
7 I think all the witnesses that may be here
8 and that I'll welcome during the day should recognize
9 that we all have received the written testimony that
10 you've submitted and I think each of us has done our
11 homework and read that. So hopefully, we can address
12 the issues that you particularly want us to focus on
13 during your half hour of presentation and you can take
14 as assumption that we have read the testimony.
15 So with that I welcome you to our hearing.
16 We appreciate your being here and act as long
17 relationship with the ABA and the our interchange of
18 ideas has proved useful over the years so we welcome
19 you.
20 MR. McGUCKIN: Thank you, Mr. Chairman. You
21 just gave me the advice that I give my executive
22 management when they go in front of the Board of
23 Directors. Assume that the directors have done their
24 homework. And if it's okay, what I thought I would do
25 is talk for about 10 minutes or so and then try to

1 respond to any questions any member of the task force
2 may have, and that will give the other witnesses an
3 opportunity to know what kind of mood you're in as we
4 go through the day.
5 So first, good morning. On behalf of 1400
6 in-house counsel around the world who belong to the
7 American Corporate Counsel Association I appreciate
8 the opportunity to address this morning. As the
9 Chairman said, my name is John McGuckin. I'm the
10 vice chairman of ACCA's Board of Directors. I'm also
11 the general counsel of the Union Bank of California
12 here in San Francisco.
13 Since it was founded 20 years ago ACCA has
14 addressed the important involving ethics issues which
15 face in-house lawyers in particular, and our
16 profession in general. Mostly recently, we
17 participated in the ABA's multijurisdictional practice
18 in Ethics 2000 task force. We appreciate the
19 opportunity to continue the dialogue which has been so
20 beneficial to us in the past. I suspect, like many of
21 your speakers today, I substantially revised my
22 comments in light of last Wednesday's SEC announcement
23 of the proposed rules prescribing minimum standards of
24 professional conduct for those of us who practice
25 before the commission.

1 Consequently, I'm going to rely on our
2 written testimony to provide you with the details of
3 our specific concerns about the task force's proposed
4 changes to model rules 1.13 and 1.6. I'm not going to
5 repeat that except to say that we believe by adopting
6 the negligent standard in rule 1.13 and supporting
7 permissive or mandatory reporting outside the client
8 organization under a weakened standard of
9 confidentiality in rule 1.6 would encourage the
10 marginalization of lawyers from our client's business
11 decision making process and undermine the lawyer's
12 ability to fulfill his role as the client's counselor.
13 In large measure these are also our concerns
14 with the SEC's proposal under Sarbanes-Oxley. Last
15 week's proposed rules changed everything in this
16 debate and yet they change nothing. They change
17 everything because we're now faced with the prospect
18 that a federal regulatory agency will provide a
19 federal definition of professional conduct regardless
20 of what we do. The focus of the debate is really no
21 longer here. It's in Washington.
22 Having said that, we don't think that
23 anything really has changed. Although they seek to
24 reduce fraud and misconduct in corporate America, the
25 SEC's proposed model rule changes will in our view

1 marginalize and weaken the role of the lawyer and make
2 us less effective in influence of counselors within
3 the company. It is entirely possible that the impact
4 of these changes will be to decrease the ability of
5 lawyers to uncover misconduct and noncompliance by
6 encouraging clients to exclude in-house and outside
7 counsel from the corporate decision making process.
8 The underlying assumption of the proposed
9 reform seems to be that lawyers, especially in-house
10 lawyers and now our outside securities attorneys, can
11 be the on the spot policemen, investigators, and
12 preventers of corporate misconduct. Now, we can be
13 but only if we are, in fact, on the spot and not on
14 the margins of corporate life. We believe that both
15 the task force and the SEC's proposal misunderstand
16 the dynamics and realities of corporate practice,
17 especially in-house corporate practice today.
18 Despite the well publicized sins of a few,
19 America's corporate executives and their lawyers have
20 a close working relationship which serves the client
21 and the public's best interest by avoiding corporate
22 misconduct and encouraging legal compliance. This is
23 a factor that has been ignored in the debate. Most
24 corporate executives work with their lawyers to comply
25 with the law and to remedy promptly noncompliance when

1 it is discovered. In the spring of 2001 long before
2 Enron became a household word, ACCA surveyed 1500
3 chief executive, chief financial, and chief operating
4 officers to learn their attitudes about their lawyers,
5 both inside and outside counsel. In the fall of this
6 year we surveyed more than a thousand in-house counsel
7 to learn their reaction to the current crisis in
8 corporate responsibility and government.
9 Our CEO survey supports the conclusion that
10 corporate clients already view their lawyers,
11 especially their in-house lawyers, as important and
12 essential members of the management team. 55 percent
13 of the executives surveyed place the general counsel
14 in the top five executives in the company and 91
15 percent said that the chief legal officer was in the
16 top 10. This put the lawyers in a privileged position
17 to understand and influence the company, its business
18 objectives, its legal and regulatory programs, its
19 personalities, its politics, corporate governance, its
20 culture, and strategic vision.
21 Lawyers are at the table when important
22 decisions are made. Although interestingly, in our
23 lawyers' survey 68 percent of the respondents said
24 that they saw a need for an expanded role in the
25 lawyers, especially in the accounting and financial

1 areas.
2 Once in the room the lawyers first role is,
3 of course, as an educator and advisor on legal issues,
4 but the executives told us that the in-house
5 attorney's second most important role was as an ethics
6 advisor. Fully 60 percent of the respondents ranked
7 the role of ethics advisor for the general counsel as
8 critically important to the company. And 90 percent
9 said that the general counsel's performance of that
10 function was excellent or good at this time or at that
11 time.
12 As a profession we should be proud of these
13 statistics, even if some are concerned that the role
14 ethics advisor takes us beyond the traditional role of
15 a lawyer. We also asked the executive respondents
16 what characteristics they needed or valued most in
17 their in-house lawyer. Trustworthiness was the hands
18 down winner. 92 percent of the respondents said this
19 quality was critically important to them. 89 percent
20 said that maintaining confidentiality was number two.
21 While the questions were not posed in terms of the
22 attorney-client privilege, and I doubt based on my
23 experience that most executives compartmentalize their
24 conversations with their lawyers and to those covered
25 by the privilege and those which are not, these

1 responses support the conclusion that when corporate
2 executives consult their lawyers they view the
3 attorneys as trustworthy counselors who will maintain
4 their confidences.
5 That adds to -- is of course the basis and
6 the result of the attorney-client privilege. In
7 responding to the current crisis if we damage the
8 sense of trust and confidence which underlie effective
9 client communications, we will undermine the lawyers'
10 ability to counsel against and help prevent corporate
11 misconduct. We must also safeguard the principal that
12 it is the client's responsibility and privilege to
13 make financial and business decisions as long as they
14 are informed decisions. In most cases there's no
15 illegality involved. In these situations the
16 corporate lawyer must respect the business judgment of
17 their clients as long as the lawyer is confident that
18 the client has heard and considered any concerns, both
19 legal and ethical that the lawyer has raised.
20 While there may be a thin line between
21 ignoring a lawyer's advice and weighing it during the
22 decision making process and not ultimately taking it,
23 the lawyers should not be required to second-guess
24 reasonable business decisions carefully and
25 intelligently made or required or permitted to report

1 these decisions outside the company. Going up the
2 corporate ladder inside the company is reality of life
3 in most companies today. Going outside the
4 corporation is a very different and a very dangerous
5 proposition.
6 Most of us are old enough to remember the S&L
7 crisis. Then as now Congress responded with
8 legislation which imposed on the banking industry, my
9 industry, many of the same panaceas we find in
10 Sarbanes-Oxley. Independent audit committees,
11 management certification of control systems,
12 restricted transactions among affiliates, more
13 disclosure of major events within the company,
14 whistle-blower protection. Then as now, some voices
15 in government, the courts, the media, and the public
16 questioned the ethical standards which seemed to
17 permit the lawyers to stand by as their clients
18 perpetrateto do schemes which cost the American
19 taxpayers billions of dollars.
20 Some of these voices ventured to assert that
21 the lawyer's duty to the public could impose duties of
22 disclosure when, to use a phrase then current, "The
23 client is a crook." Where, asked the judge who
24 sentenced Charles Keating, were the lawyers? Then as
25 now, the ABA impaneled a task force to address the

1 ethical issues arising out of the active and passive
2 complicity of the S&L lawyers. The task force admired
3 the issue imposed by the S&L crisis and determined
4 that nothing needed to be done, the profession ethics
5 framework within which corporate attorneys worked at
6 that time. Nothing happened. The questioning voices
7 were stilled. The public lost interest, and the legal
8 division continued as before.
9 Then the names were Lincoln Savings & Loan
10 Association and Charles Keating. Now the names are
11 Enron and Andy Prastow. To quote that great American
12 jurist Yogi Berra, it's deja vu all over again. But
13 it's not really.
14 Some would say that the legal profession
15 dodged the ethical bullet a decade ago. Others less
16 cynical would say that we failed to recognize and meet
17 the challenge of conscience in the professional then.
18 With Congress and the SEC now in the picture we cannot
19 dodge the bullet or shrink the challenge again. It is
20 easy to articulate what is wrong with the proposed
21 changes in the model rules and why the SEC's
22 regulations will not work. It is more important to
23 recognize that something must be done to align the
24 legal profession and our ethical standards of conduct
25 with the legitimate expectation and demands of the

1 public, that we as officers of the court will not
2 condone or assist in a illegal conduct or even
3 arguably a legal conduct.
4 ACCA will comment on the SEC's proposal. We
5 will also take a hard look at how to what extent the
6 attorney-client privilege is being used and abused.
7 We hope the bar will join us in examining how to deter
8 possible abuse of the privilege as a cloak for
9 inappropriate behavior while preserving the protection
10 which encourages and permits confidential
11 communications between corporate clients and corporate
12 lawyers. We must examine how the rules regarding the
13 representation of organizational clients can be
14 rewritten to provide more positive and realistic
15 guidance to in-house lawyers and outside corporate
16 practitioners.
17 71 percent of the lawyers we surveyed in the
18 fall said that this was needed, and if it was done it
19 would improve the way things are done in American
20 corporations.
21 But regretfully, we don't think that the task
22 force's current proposals or the SEC's complex process
23 of whistle blowing and going up the corporate ladder
24 will do either. We also believe that in order to
25 counsel our clients toward ethical and legal behavior

1 we need to embrace our roles as ethics advisor and
2 focus much more attention on effective compliance
3 strategies. This includes the integration of new
4 corporate governance print policies as to the way our
5 client do business and we advise them, and a continued
6 emphasis on practical and preventive law to encourage
7 and accomplish compliance, and then remedy compliance
8 failures.
9 These are already an important part of many
10 in-house legal departments. They need to be
11 institutionalized in our professional so that our
12 outside counsel understand that both we and our
13 executives expect more of them when they see
14 questionable corporate conduct and decision making.
15 As lawyers we have to understand that we have an
16 important stake in corporate culture which emphasizes
17 legal and ethical conduct. We must go beyond the
18 traditional rules of professional conduct to recognize
19 that as the adducta conscious of the organization the
20 lawyer's position and role must be expanded,
21 protected, and facilitated. We must provide lawyers
22 with clear ethical guidelines and professional tools
23 to become and remain involved in the decision making
24 processes of our clients.
25 The conscience, judgment, and skill with

1 which individual lawyers advise their clients in our
2 increasingly regulated society cannot be restricted or
3 dictated by ethical rules or regulatory processes
4 which undermine the confidence with which clients
5 consult and involve their lawyers. The proposed rules
6 will, we believe, encourage clients to exclude and
7 marginalize their lawyers from discussions, debates,
8 and decisions in which we now participate. If this
9 happens, we will defeat the very goal we seek to
10 accomplish.
11 Thank you. And I'm happy to try to respond
12 to questions.
13 MR. CHEEK: Thank you very much. Let me ask
14 you in light of the fact that we will have an SEC
15 rule, and a SEC rule may or may not be as far-reaching
16 as the proposal that's been articulated, but that SEC
17 rule is likely to be encouraging, if not mandated,
18 disclosure out of the corporate client. In other
19 words, for a segment that this language that the SEC
20 rule comes out with a reporting out obligation on the
21 segment of lawyers that practice before the
22 commission.
23 So that is a given platform that will be in
24 play in dealing with in-house lawyer relationships
25 with their officers and outside counsel's

1 relationship. In addition, we've got 30 -- well, 41
2 states that either require or permit currently
3 disclosure in circumstances where there is a crime.
4 But even in the current application of those model
5 rules it doesn't appear that there's been a disruption
6 of the attorney-client relationship in a way that
7 adversely affects the capability of counselling to a
8 client within that construct.
9 So my question back to you are we dealing
10 with a changing playing field which needs to be
11 adjusted to reflect that or can we really retrench
12 back into something that says that there's absolutely
13 no need for outside third party disclosure?
14 THE WITNESS: The problem with the current
15 situation is you're trying to prove a negative. We
16 know -- we don't know that anything has been done
17 actually. The current rules are there. And it hasn't
18 in my practice adjusted the way that I'm involved in
19 the debates inside the company when an accounting
20 issue may come up. And I think that's true of many
21 general counsel publicly traded companies.
22 But ultimately at this point those debates
23 are decided in an informed way by the appropriate
24 business person. In many cases the in-house counsel,
25 if he or she doesn't agree with the decision, has the

1 opportunity to go up the food chain within the
2 corporate ladder and I think many of us do. It's
3 another matter when it is that disagreement can go
4 outside of the company and there's some type of
5 mandatory requirement under a standard which is a
6 material impact upon the company's financial or which
7 the investor would like to know.
8 I'm not sure that I would term it retrenching
9 back to where we are because I think that there's a
10 perception that the existing rules, although they do
11 talk in terms of crimes and we have seen in some
12 instances of the corporate scandals there have been
13 actually crimes. The more difficult cases are in
14 which they are on the margin. They are not black and
15 white and I think very few situations that we see are
16 black and white. There's some shades of gray.
17 MR. MUNDHEIM: Let me give you a
18 hypothetical. Suppose as inside counsel you go up the
19 ladder and you tell management and then the
20 independent directors that proposed action would
21 violate the law, and the response of management and
22 the board is that on balance they think it's better to
23 take the risk of violating the law and not foregoing
24 economic benefits of acting. One problem is that the
25 board, even the independent members, are not

1 disinterested because they own stock. It's subject to
2 pledge, and if they had to make the or didn't take the
3 act, that might lower the value of the stock and force
4 them to put more money up to secure the pledge. So
5 you say this is a place you can't really trust the
6 disinterested nature of the action or judgment.
7 What's the responsibility of the lawyer for
8 the corporation to his client, the corporation?
9 THE WITNESS: If you have gone -- the
10 tradition response is that the embodiment of the
11 corporation is the board of directors who represent
12 the shareholders. Up until now the traditional
13 response is there is no obligation with regard to the
14 public, but --
15 MR. MUNDHEIM: I want to talk about
16 obligation to the company where there is no
17 disinterested decision maker.
18 THE WITNESS: I don't want to argue with you,
19 but the premise because you're assuming that all
20 outside directors are somehow tainted.
21 MR. MUNDHEIM: My hypothetical the three
22 outside directors have a substantial amount of stock
23 in the company, and it's all pledged.
24 THE WITNESS: In that case I think the
25 responsibility of the in-house lawyer is to resign and

1 you've gone as far as --
2 MR. MUNDHEIM: How does that help the
3 company, the client?
4 THE WITNESS: The only other course of action
5 is to go blow the whistle outside the company. I
6 don't think our obligation as rules of involvement go
7 that far.
8 MR. OLSON: Should they be permitted to the
9 it even if not obligated?
10 THE WITNESS: Our feeling is no, we should
11 not be permitted to do it.
12 MR. OLSON: Even if my analysis -- suppose
13 the question is leaving out the use of a company loan
14 program designed for one purpose, a proxy statement
15 which the lawyer knows has been used for another
16 purpose, namely, to buy a $10,000,000 house in a ski
17 resort or something like that.
18 We know that it would be material to
19 stockholders to know that the manager is abusing this
20 program. The lawyer does not have any obligation to
21 either go outside the corporation and report this and
22 simply resign. Does it have to be a noisy withdrawal
23 or can it be a sneak out the back door and say
24 nothing?
25 THE WITNESS: It's hard in this situation to

1 know who the noise is to. The noise is already to the
2 board of directors. They've rejected the advice. I
3 don't think that the lawyers should do more than
4 resign and leave the company. I don't think that
5 reporting it to the Securities Exchange Commission or
6 anyone else is appropriate within the context because
7 the situation which the lawyer learns all of this
8 advice is because he's involved in the decisions -- in
9 the disclosure or the decision making process, and at
10 this point I think that it is appropriate not to
11 damage the privilege and to have him or her resign.
12 MR. OLSON: If I understand it correctly,
13 though, 71 percent of your members surveyed, according
14 to ACCA's October 21st press release, said, and I'm
15 quoting verbatim from the press release, "More than
16 seven in 10, 71 percent of in-house counsel believe
17 that clearly defining by law instances of mandatory
18 reporting, regardless of attorney-client privilege,
19 would help ensure the well-being of their companies."
20 THE WITNESS: I think that what they're
21 saying, if it's clear what the circumstances were and
22 the narrow situation in which you're giving it is a
23 very, very rare situation. Most of the cases are much
24 more gray in the matter.
25 MR. MUNDHEIM: Certainly you're right about

1 that. If you try to understand what the concept
2 should be you've got to deal with the narrow case that
3 puts up.
4 THE WITNESS: Illegality, if it were clear.
5 I'm not sure how it becomes clear in that. It's the
6 lawyer's opinion that this is a violation of the
7 statute or this is material.
8 MR. OLSON: If the shareholders knew about it
9 they would be so upset that the CEO or whoever is
10 abusing the corporation's policies and misusing
11 assets, as a lawyer not only knows it's a illegality,
12 it's a violation of the corporate standards, but knows
13 that if it were disclosed publicly which the board
14 doesn't want to do, having pledged their stock to the
15 bank and not wanting to damage the reputation of the
16 senior officer, the lawyer says, okay, I'm just going
17 to tiptoe out the back door and not saying.
18 THE WITNESS: There's nothing in today's
19 volatile stock market that doesn't affect the stock.
20 It's a slippery slope because it's true that any piece
21 of information can influence investors in today's
22 market, not just something that is illegal.
23 MR. OLSON: Suppose the lawyer has
24 participated in preparing a proxy statement which has
25 just been filed with the SEC for a transaction which

1 not only involves disclosure about management
2 compensation and the like, but perhaps a business
3 division with another enterprise. Does the lawyer in
4 your judgment have an obligation to say anything to
5 the SEC, withdraw documents? As you know, the SEC
6 proposal is going in this direction. Can they or she
7 tiptoe out the back door and say, "Hey, folks, you're
8 on your own; too bad, shareholders. I'm gone."
9 THE WITNESS: That's a hard -- I understand
10 where you're going. I have difficulty with that case,
11 too. I think our position based -- at ACCA is that
12 the permissive or the mandatory reporting outside will
13 damage the outside -- the attorney-client privilege
14 because our clients will not talk with us. I can see
15 the situation in which you're racing.
16 MR. CHEEK: We have 41 states out there that
17 have this in their ethical rules right now, and it
18 doesn't seem to me that there's any evidence that that
19 has adversely affected the capability of lawyers
20 practicing in that state to counsel their clients.
21 MR. TENNILLE: Does your organization put out
22 any publication for its members, for its general
23 counsel, that they can hand to the CEO of the company
24 which says this is the role that the general counsel
25 ought to play? This is how the privilege works. We

1 are not Mr. CEO or Mrs. CEO your lawyer. We're the
2 lawyer for the company. This is the implication that
3 has. Is there anything that you do to help educate
4 CEOs about the position that general counsel has and
5 what the privilege is?
6 THE WITNESS: We have a lot of information on
7 our web site that goes out to all of our members and
8 many people who are not our members on the role of the
9 in-house counsel, who the client is, and how the
10 attorney-client privilege should work. One of the
11 things we're continuing to work on as a result of what
12 has happened is to increase that. We've done -- we do
13 a lot of programs both on the local and national level
14 on this type of topic.
15 We try to get practical anecdotal evidence
16 from lawyers in a confidential situation as to what is
17 going on within their companies. But we don't have a
18 model rule, model set of rules for in-house counsel at
19 this point, although it's one of the things we're
20 considering trying to draft.
21 MR. McCALLUM: : Actually, I would just like
22 to say we've run out of time, and I know you would
23 like to keep this moving. I do have something
24 connected to the written testimony but if Mr. McGuckin
25 could leave his e-mail address with Sue, I'd be happy

1 to send something to him following the hearing and
2 copy the rest of the task force on it because I know
3 you have a lot of speakers and we're on a tight
4 timetable.
5 I just had one sort of global question to
6 you. Inherent in your recitation of what you say the
7 survey of company management shows with respect to
8 their expectations and desires on their expectations
9 of their in-house counsel, isn't it inherent in what
10 you have found the predictable answer that management
11 would like to have in-house counsel be their lawyer,
12 rather than that they would like to have in-house
13 counsel be independent from them and be the entity's
14 lawyer? And if that's true, which seems to me to be
15 an understandable human condition that when they say
16 we want someone who's trustworthy, they don't mean
17 someone who's going to blow the whistle on me to the
18 board. They mean someone in whom I can confide at no
19 risk to me personally.
20 If that's the premise, is there in fact, the
21 role to have counsel differentiated between counsel
22 who is advising management and counsel who is advising
23 the board?
24 THE WITNESS: I think that's an interesting
25 suggestion. I think one of the ironies of the

1 situation is that in-house counsel spent 20, 25 years
2 getting themselves to the role that they are
3 considered by management to be trustworthy and part of
4 the decision making process. Now that we're there,
5 you have to be careful of what you wish for because we
6 are there. I think that what we will see as a
7 practical matter if the SEC, especially if the SEC
8 rules are proposed is there will be a bifurcation of
9 that responsibility. And there are ways that you
10 could do it in the sense that the general counsel of
11 today generally reports to the chief executive officer
12 of another member of management. You could have the
13 general counsel report as the chief auditor does to
14 the board, to the audit committee. You can have the
15 general counsel responsible for providing advice to
16 management, but independent outside counsel
17 responsible for providing advice to the board. I think
18 that already are in many companies there's a
19 combination of the two.
20 But I think we will see a development of more
21 of a greater role for outside counsel handling matters
22 that come from the board whether they are corporate
23 governance matters, whether they are investigations
24 growing out of the whistle blowing provisions, both
25 Sarbanes-Oxley's provisions, or just because now the

1 board feels that it wants an independent, an
2 "independent view."
3 MR. McCALLUM: Can I follow up on that as to
4 whether you see that as outside counsel who has no
5 other role and relationship with the organization,
6 including the particular role with professional
7 counsel or do you see that as what I'll refer to as
8 regular outside counsel where it being understood that
9 outside counsel's primary responsibily is to the
10 board?
11 THE WITNESS: I would see it in the former
12 context. Other fidicia which was passed by Congress
13 in the S&L crisis there's specific FDIC regulation
14 that posits that the audit committee, the independent
15 audit committee has a right to access the outlet
16 counsel. I think most of the general counsel of banks
17 have a folder which contained the list of outside
18 lawyers with which we do no business whatsoever. We
19 don't do anything. And especially in the service
20 industry we don't bank them, we don't send any work to
21 them, but they are there in this type of an instance.
22 MR. McCALLUM: : I think --
23 The WITNESS: I have a longer list, right
24 now, I think one of the thing we look back on at
25 coming out of Enron in particular, that is going to

1 your regular outside counsel who happens to do other
2 things for the company, litigation, or perhaps you
3 have to segregate off the securities work so they
4 can't do the securities work.
5 MR. McCALLUM: But to distinguish that I have
6 been hearing the talk for the significant point now,
7 to distinguish for what I'll call the special counsel
8 role for the particular situation as opposed to the
9 ongoing advisory role.
10 THE WITNESS: Well, I can see it increase in
11 people in that ongoing advisory role whether they be
12 for the board or the audit committee or the corporate
13 governance committee or the executive compensation and
14 benefit committee. You could have four different law
15 firms in that type of situation. Or you can just have
16 one that provided all of the advice to all of them.
17 And in addition then have still another set of law
18 firms that you're going to only use for the
19 investigations.
20 MR. McCALLUM: : One sentence on quick looks
21 at your stands on M.D.P and look at the line on
22 account from Enron and perhaps revisit your position.
23 THE WITNESS: Yes.
24 MR. CHEEK: Thank you very much for being
25 with us this morning.