

**RECOMMENDATIONS OF
THE AMERICAN BAR ASSOCIATION
TASK FORCE ON CORPORATE RESPONSIBILITY
March 31, 2003**

RECOMMENDED POLICIES OF CORPORATE GOVERNANCE

(Note: The following governance practices are recommended for adoption as ABA policy. Footnotes in the full report have been deleted here. See pages 31 to 33 of the full report.)

- 1. The board of directors of a public corporation must engage in active, independent and informed oversight of the corporation's business and affairs, including its senior management.**
- 2. In order to improve the effectiveness of such oversight, the board of directors of a public corporation should adopt governance principles (more fully specified in Part VI of this Report) that (a) establish and preserve the independence and objectivity of directors by eliminating disabling conflicts of interest and undue influence or control by the senior management of the corporation and (b) provide the directors with timely and sufficient information and analysis necessary to the discharge of their oversight responsibilities.**
- 3. The directors should recognize and fulfill an obligation to disclose to the board of directors information and analysis known to them that is relevant to the board's decision making and oversight responsibilities. Senior executive officers should recognize and fulfill an obligation to disclose, to a supervising officer, the general counsel, or the board of directors or committees of the board, information and analysis relevant to such persons' decision making and oversight responsibilities.**
- 4. Providing information and analysis necessary for the directors to discharge their oversight responsibilities, particularly as they relate to legal compliance matters, requires the active involvement of general counsel for the public corporation.**
- 5. A lawyer representing a public corporation shall serve the interests of the entity, independent of the personal interests of any particular director, officer, employee or shareholder.**
- 6. The general counsel of a public corporation should have primary responsibility for assuring the implementation of an effective legal compliance system under the oversight of the board of directors.**
- 7. Public corporations should adopt practices in which:**
 - a. The selection, retention, and compensation of the corporation's general counsel are approved by the board of directors.**
 - b. General counsel meets regularly and in executive session with a**

committee of independent directors to communicate concerns regarding legal compliance matters, including potential or ongoing material violations of law by, and breaches of fiduciary duty to, the corporation.

- c. All reporting relationships of internal and outside lawyers for a public corporation establish at the outset a direct line of communication with general counsel through which these lawyers are to inform the general counsel of material potential or ongoing violations of law by, and breaches of fiduciary duty to, the corporation.**

- 8. The Model Business Corporation Act and the general corporation laws of the states, and the courts interpreting and applying the duties of directors, should more clearly delineate the oversight responsibility of directors generally, and the unique role that independent directors play in discharging that responsibility in public company settings.**
- 9. Engagements of counsel by the board of directors, or by a committee of the board, for special investigations or independent advice should be structured to assure independence and direct reporting to the board of directors or the committee.**
- 10. The SEC and state attorney disciplinary authorities should cooperate in sharing information in order to promote effective and appropriate enforcement of rules of conduct applicable to counsel to public corporations.**
- 11. The courts, law schools and lawyer professional organizations such as the ABA should promote awareness of, and adherence to, the professional responsibilities of lawyers in their representation of public corporations.**
- 12. Law firms and law departments should adopt procedures to facilitate and promote compliance with rules of professional conduct governing the representation of public corporations.**

RECOMMENDED CORPORATE GOVERNANCE PRACTICES

(Note: The following governance practices are NOT recommended for adoption as ABA policy, but are recommended to boards of directors of public corporations in order to improve the effectiveness of their oversight of the corporation's business and affairs. Footnotes in the full report have been deleted here. The text of the report provides brief descriptions of comparable law, listing standards and recommendations from other entities, on pages 62-73.)

- 1. A substantial majority of the members of the board of directors should be independent of the corporation's senior executive officers, both in fact and in appearance.**
- 2. The independent directors should meet regularly outside the presence of any senior executive officer.**
- 3. The board of directors should establish a committee (described in these recommendations as the corporate governance committee) composed exclusively of independent directors with responsibility for the identification and nomination (or recommendation of nomination) of independent members of the board of directors, and for extending invitations to prospective independent board members.**
- 4. The corporate governance committee should appoint (or recommend to the full board of directors the appointment of) the persons to serve on each of the other standing committees of the board.**
- 5. The board of directors should establish an audit committee, composed exclusively of independent directors.**
 - a. The audit committee should meet regularly outside the presence of any senior executive officer.**
 - b. The audit committee should be:**
 - i. authorized to engage and remove the corporation's outside auditor (or if legally permissible, to recommend such engagement or removal to the Board), and to determine the terms of the engagement of the outside auditor;**
 - ii. authorized and afforded resources sufficient to engage independent accounting and legal advisers when determined by the committee to be necessary or appropriate; and**
 - iii. responsible for recommending or establishing policies relating to non-audit services provided by the corporation's outside auditor to the corporation and other aspects of the corporation's relationship with the outside**

senior officers and, if necessary, to a committee consisting solely of independent directors.

8. In addition to approvals required by law, a committee composed exclusively of independent directors and appointed for the purpose by or on the recommendation of the independent directors or a committee composed exclusively of such directors, should review and approve any material transaction between the corporation and any director or senior executive officer of the corporation (and any person or entity controlling or controlled by such director or officer, or in which such director or officer has a direct or indirect material financial interest), including (where permitted by law) a loan or guarantee by the corporation. Such review and approval should include (i) an explanation of why the transaction is in the best interests of the corporation without regard to the interest or desire of the individual (or related person or entity); (ii) a documented rationale for engaging in the transaction with a related party rather than with a third party; (iii) a specific determination of the fairness of the transaction; and (iv) a review of the public disclosure that may be appropriate for the transaction.
9. The board of directors should charge a committee composed exclusively of independent directors (such as an audit committee or a legal compliance committee) with responsibility to obtain and evaluate regular reports from the corporate officers responsible for implementing the corporation's internal controls, codes of ethics and compliance policies, including general counsel, the chief financial officer, the chief internal auditor and the chief compliance officer, on legal and compliance affairs of the corporation as directed by such committee, including, at a minimum, information about violations or potential violations of law and breaches of fiduciary duty by an executive officer or director that could have a material adverse effect on the corporation.
10. The board of directors should consider and determine appropriate action on the following matters:
 - g. Processes for setting agendas and distributing information;
 - h. Policy concerning expected time commitments of directors, and the extent to which other directorships or other factors (such as health) may impair a director's ability to satisfy such commitments;
 - i. Policy concerning rotation of the chair and membership of the board of directors and its corporate governance, audit and compensation committees;
 - j. Whether to appoint a "lead" independent director or an independent director to serve as chair of the board of directors or to preside at meetings of non-management directors;

k. Establishment and maintenance of a training and education program for all directors, and particularly independent directors, in regard to (A) their legal and ethical responsibilities as directors, (B) the financial condition, the principal operating risks and the performance factors materially important to the business of the corporation and (C) the operation, significance and effects of compensation incentive programs and related party transactions; and

l. Periodic evaluations by the directors of (A) the effectiveness and adequacy of meetings of the Board of Directors and its committees, (B) the adequacy and timeliness of the information provided by management to the Board of Directors, (C) the diversity of experience of individual directors and (D) the contributions of each director.

RECOMMENDED REVISIONS TO THE MODEL RULES OF PROFESSIONAL CONDUCT

(Marked to show proposed changes to existing Rules and Commentary.
Unchanged commentary deleted, and indicated * * * . Entire text
available on pages 77 to 89 of full report)

RULE 1.6: CONFIDENTIALITY OF INFORMATION

- (a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).
- (b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:
 - (1) to prevent reasonably certain death or substantial bodily harm;
 - (2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;
 - (3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;
 - (4) to secure legal advice about the lawyer's compliance with these Rules;
 - (5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client;
or
 - (6) to comply with other law or a court order.

Commentary

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[7] Paragraph (b)(2) is a limited exception to the rule of confidentiality that permits the lawyer to reveal information to the extent necessary to enable affected persons or appropriate authorities to prevent the client from committing a crime or fraud, as defined in Rule 1.0(d), that is reasonably certain to result in substantial injury to the financial or property interests of another and in furtherance of which the client has used or is using the lawyer's services. Such a serious abuse of the client-lawyer relationship by the client forfeits the protection of this Rule. The client can, of course, prevent such disclosure by refraining from the wrongful conduct. Although paragraph (b)(2) does not require the lawyer to reveal the client's misconduct, the lawyer may not counsel or assist the client in conduct the lawyer knows is criminal or fraudulent. See Rule 1.2(d). See also Rule 1.16 with respect to the lawyer's obligation or right to withdraw from the representation of the client in such circumstances, and Rule 1.13(c) which permits the lawyer, where the client is an organization, to reveal information relating to the representation in limited circumstances.

[8] Paragraph (b)(3) addresses the situation in which the lawyer does not learn of the client's crime or fraud until after it has been consummated. Although the client no longer has the option of preventing disclosure by refraining from the wrongful conduct, there will be situations in which the loss suffered by the affected person can be prevented, rectified or mitigated. In such situations, the lawyer may disclose information relating to the representation to the extent necessary to enable the affected persons to prevent or mitigate reasonably certain losses or to attempt to recoup their losses. Paragraph (b)(3) does not apply when a person who has committed a crime or fraud thereafter employs a lawyer for representation concerning that offense.

* * *

Withdrawal

~~[14] If the lawyer's services will be used by the client in materially furthering a course of criminal or fraudulent conduct, the lawyer must withdraw, as stated in Rule 1.16(a)(1). After withdrawal the lawyer is required to refrain from making disclosure of the client's confidences, except as otherwise permitted by Rule 1.6. Neither this Rule nor Rule 1.8(b) nor Rule 1.16(d) prevents the lawyer from giving notice of the fact of withdrawal, and the lawyer may also withdraw or disaffirm any opinion, document, affirmation, or the like. Where the client is an organization, the lawyer may be in doubt whether contemplated conduct will actually be carried out by the organization. Where necessary to guide conduct in connection with this Rule, the lawyer may make inquiry within the organization as indicated in Rule 1.13(b).~~

RULE 1.13: ORGANIZATION AS CLIENT

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows facts from which a reasonable lawyer, under the circumstances, would conclude that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. ~~In determining how to proceed, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters and any other relevant considerations. Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such measures may include among others:~~

- ~~(1) asking for reconsideration of the matter;~~
 - ~~(2) advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization;~~
- and
- (3) referring

Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, seriousness of the matter, referral to the highest authority that can act on behalf of the organization as determined by applicable law.

(c) Except as provided in Paragraph (d), if,

(1) despite the lawyer's efforts in accordance with Paragraph (b), the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate fashion action, or a refusal to act, that is clearly a violation of law ~~and is likely to result in substantial injury to the organization, and~~

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization.

then the lawyer may: resign in accordance with Rule 1.16, reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's engagement by an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other person associated with the organization against a claim arising out of an alleged violation of law.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to Paragraphs (b) or (c), or who withdraws in circumstances that require or permit the lawyer to take action under either of those Paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal.

~~(d)~~ (f) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

~~(e)~~ (g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

Comment

The Entity as the Client

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[3] When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful. Decisions concerning policy and operations, including ones entailing serious risk, are not as such in the lawyer's province. ~~However, different considerations arise Paragraph (b) makes clear, however, that~~ when the lawyer knows facts that would lead a reasonable lawyer under the circumstances to conclude that the organization may is likely to be substantially injured by action of a an officer or other constituent that violates a legal obligation to the organization or is in violation of law ~~In such a circumstance, it may be reasonably necessary for the lawyer to ask the constituent to reconsider the matter. If that fails, or if the matter is of sufficient seriousness and importance to the organization, it may be reasonably necessary for the lawyer to take steps to have the matter reviewed by a higher authority in the organization. Clear justification should exist for seeking review over the head of the constituent normally responsible for it. The stated policy of the organization may define circumstances and prescribe channels for~~

such review, and a lawyer should encourage the formulation of such a policy. Even in the absence of organization policy, however, the lawyer may have an obligation to refer a matter to higher authority, depending on the seriousness of the matter and whether the constituent in question has apparent motives to act at variance with the organization's interest. Review by the chief executive officer or by the board of directors may be required when the matter is of importance commensurate with their authority. At some point it may be useful or essential to obtain an independent legal opinion, and might be imputed to the organization, the lawyer must proceed as is reasonably necessary in the best interest of the organization. As defined in Rule 1.0(f), knowledge can be inferred from circumstances, and a lawyer cannot ignore the obvious. The lawyer's obligation to proceed as is reasonably necessary in the best interest of the organization is determined by the conclusions that a reasonable lawyer would, under the circumstances, draw from the facts known. The terms "reasonable" and "reasonably" imply a range within which the lawyer's conduct will satisfy the requirements of Rule 1.13. In determining what is reasonable in the best interest of the organization the circumstances at the time of determination are relevant. Such circumstances may include, among others, the lawyer's area of expertise, the time constraints under which the lawyer is acting, and the lawyer's previous experience and familiarity with the client. For example, the facts suggesting a violation may be part of a large volume of information that the lawyer has insufficient time fully to comprehend. Or the facts known to the lawyer may be sufficient to signal the likely existence of a violation to an expert in a particular field of law but not to a lawyer who works in another specialty. Under such circumstances the lawyer would not have an obligation to proceed under Paragraph (b).

[4] In determining how to proceed under Paragraph (b), the lawyer should give due consideration to the seriousness of the violation and its consequences, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters, and any other relevant considerations. Ordinarily, referral to a higher authority would be necessary. In some circumstances, however, it may be appropriate for the lawyer to ask the constituent to reconsider the matter; for example, if the circumstances involve a constituent's innocent misunderstanding of law and subsequent acceptance of the lawyer's advice, the lawyer may reasonably conclude that the best interest of the organization does not require that the matter be referred to higher authority. If a constituent persists in conduct contrary to the lawyer's advice, it will be necessary for the lawyer to take steps to have the matter reviewed by a higher authority in the organization. If the matter is of sufficient seriousness and importance or urgency to the organization, referral to higher authority in the organization may be necessary even if the lawyer has not communicated with the constituent. Any measures taken should, to the extent practicable, minimize the risk of revealing information relating to the representation to persons outside the organization. Even in circumstances where a lawyer is not obligated to proceed by Rule 1.13, a lawyer may bring to the attention of an organizational client, including its

highest authority, matters that the lawyer reasonably believes to be of sufficient importance to warrant doing so in the best interest of the organization.

[4][5] Paragraph (b) also makes clear that when reasonably necessary to enable the organization to address the matter in a timely and appropriate fashion the lawyer must refer the matter to higher authority, including, if warranted by the circumstances, the highest authority that can act on behalf of the organization under applicable law. The organization's highest authority to whom a matter may be referred ordinarily will be the board of directors or similar governing body. However, applicable law may prescribe that under certain conditions the highest authority reposes elsewhere, for example, in the independent directors of a corporation.

Relation to Other Rules

[5][6] The authority and responsibility provided in this Rule are concurrent with the authority and responsibility provided in other Rules. In particular, this Rule does not limit or expand the lawyer's responsibility under Rule 1.6, 1.8, 1.16, 3.3 or 4.1. Paragraph (c) of this Rule supplements Rule 1.6(b) by providing an additional basis upon which the lawyer may reveal information relating to the representation, but does not modify, restrict, or limit the provisions of Rule 1.6(b)(1) – (6). Under Paragraph (c) the lawyer may reveal such information only when the organization's highest authority insists upon or fails to address threatened or ongoing action that is clearly a violation of law, and then only to the extent the lawyer reasonably believes necessary to prevent reasonably certain substantial injury to the organization. It is not necessary that the lawyer's services be used in furtherance of the violation, but it is required that the matter be related to the lawyer's representation of the organization. If the lawyer's services are being used by an organization to further a crime or fraud by the organization, Rules 1.6(b)(2) and 1.6(b)(3) may permit the lawyer to disclose confidential information. In such circumstances Rule 1.2(d) can may also be applicable, in which event, withdrawal from the representation under Rule 1.16(a)(1) may be required.

[7] Paragraph (d) makes clear that the authority of a lawyer to disclose information relating to a representation in circumstances described in Paragraph (c) does not apply with respect to information relating to a lawyer's engagement by an organization to investigate an alleged violation of law or to defend the organization or an officer, employee or other person associated with the organization against a claim arising out of an alleged violation of law. This is necessary in order to enable organizational clients to enjoy the full benefits of legal counsel in conducting an investigation or defending against a claim.

[8] A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to Paragraph (b) or (c), or who withdraws in circumstances that require or permit the

lawyer to take action under either of these Paragraphs, must proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal, and what the lawyer reasonably believes to be the basis for his or her discharge or withdrawal.

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