Crisis in Confidence: Corporate Governance and Professional Ethics Post-Enron

TEXT OF SPEECH BY ROBERT H. MUNDHEIM*

I'm delighted to be here. I can't imagine why you would want to hear from somebody who hasn't been able to hold a job for very long. And worse than that, I don't have any stories, and I don't have either the eloquence or the breadth of knowledge of the profession to describe it as graphically as Robert Gordon has done.

I can tell you, however, that in my role as a corporate counselor, I have never felt that my task was to be primarily a zealous advocate. And I think that it's one of the interesting changes in the way the profession has developed. When I started, the great corporate counselors were senior partners in the outside law firms. That role has now moved away from the outside law firms, largely because law practice for many of those firms has become largely a transactional practice, and the role of counselor has devolved to the general counsel. And if you look at the quality of people in that job today and compare it with the quality of people in that job thirty years ago, you will see that's a real shift.

So what I'd like to do is discuss briefly the role of the corporate lawyer (whether inside or outside counsel). I think I would start where a number of other people have, that the client of the corporate lawyer is the *corporation*: that's simple, it's fundamental. The client is *not* the person with whom the corporate lawyer interacts on a daily basis. And I think for the issues that are relevant here, a significant task of the corporate lawyer is to see to it that relevant information and analysis is put in front of the appropriate decision-makers in the corporation. To build on Jeff Gordon's analysis of the Enron off-balance sheet ventures, that counsel has the responsibility to be sure that the board that approves such ventures understands the special monitoring responsibilities created by their use. That's

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an essential part of a lawyer discharging his responsibility to his client corporation. In some cases, the responsibility may also include advice that if certain disclosures are not made, the company is going to violate the law with the following consequences both to the company and to you, the individuals. In others it may be that in failing to disclose, there are substantial risks of violating the law, of having an expensive and embarrassing investigation, even though you may be found ultimately not to have violated the law.

Having laid out the risks of not making the disclosures, then I think it is probably appropriate in most cases to let the corporation's corporate decision-makers decide. Accordingly, the counsel's role is to get the information, get the analysis, spell out clearly the risks to the people who have been chosen to make decisions for the corporation, and say "you decide." Of course, there is that very specific injunction that applies to all lawyers that we can't participate or aid knowingly in the commission of a crime.[1] So it's possible that the corporate decision-makers could decide, based on the economics to take their chances and violate the law, but you as the lawyer have a fundamental obligation not to participate, not to assist.[2] In a practical disclosure situation, that means you cannot participate in the drafting of the disclosure document.

Let's look at a specific case: a public issuer has lost a significant customer at the end of the third quarter. You, as disclosure counsel, think that this information should be disclosed in the 10-Q, the quarterly report. The CFO and the general counsel with whom you work think that disclosure is not necessary. You ask why, and they say that they think the company will sign up other customers before the end of the fourth quarter that will replace the business lost because of the departure of this major customer. Now you as disclosure counsel can say that you understand that argument, and perhaps it's an acceptable justification for not disclosing, but your conclusion is the company must disclose. The real practical question is, can you leave that decision to the CFO and the general counsel? How high in the corporate structure must that kind of a decision go? In other words, who's going to make that decision?

Now let's make it easy. Suppose the CFO and the general counsel have large blocks of stock subject to pledge, and if the unhappy third quarter news comes out, it's likely that the stock price will come down and they'll have to put up more money on their pledge. You certainly might conclude, under those circumstances, the decision should not be left to those two people. Accordingly, you're going to have to move that decision up either to the CEO or to the Audit Committee. And I think if you look at

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[1] MODEL RULES OF PROF'L CONDUCT R. 1.2 (2003).

[2] *See id.*

Model Rule 1.13,[3] if you look at the underlying philosophy of Sarbanes-Oxley,[4] if you look at the ABA Task Force on Corporate Responsibility,[5] I think that would be expected to occur.

The question then becomes, assuming that's analytically correct, is it a difficult decision to implement? And that of course is the rub, because the CFO and the general counsel, in our hypothetical are probably the ones who hired disclosure counsel, and they have a working relationship. Disclosure counsel may have a very limited, if any, relationship with the CEO, and perhaps none with the Audit Committee or with the board. Accordingly, going over the head of the CFO or the general counsel in that circumstance is going to be personally very difficult. Indeed, in your career with that corporation, you may only be given one opportunity to do that. Given these realities, the problem is: what's the best way to get lawyers actually to do this sort of reporting, which analytically is required?

One approach is to mandate such reporting, either through SEC rules or ethics principles. The problem with attempting to force action pursuant to outside mandates, however, is that by forcing counsel to go over the head of people with whom counsel works, there is an inevitable disruption of the relationship between counsel and the business people with whom she works. And one of the things that any effective counsel will try to do with the business people with whom she works is to create, loosely speaking, a partnership. Such a partnership is vital because counsel wants to be brought in early so that she can help structure around conduct that is illegal or get an unlawful scheme off the table early in the process before people have become committed to it.

So one of the practical problems is whether counsel can be both a partner and a cop. I've also alluded to the fact that if you go up over the head of the person you work with, that may be a career threatening response. Those consequences must have a certain impact on the way that you draft either the SEC rules or the ethics rules. For example, you will tend to put a subjective knowledge requirement on the obligation to go over the CFO or general counsel's head, because that will limit the triggering event for counsel. In contrast, if you say "should know," you very much expand that triggering event, and when, as in Sarbanes-Oxley, you say if you have "evidence of,"[6] it potentially expands that triggering event even more. Moreover, these same practical considerations will mean that you will

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[3] *Id.* at R. 1.13.

[4] *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 404, 116 Stat. 789 (to be codified at 15 U.S.C. § 7262).

[5] ABA Task Force on Corporate Responsibility, Preliminary Report (2002), *available at* www.abanet.org/buslaw/corporateresponsibility/preliminary_report.pdf (last visited Mar. 18, 2003) (on file with the Connecticut Law Review).

[6] Sarbanes-Oxley Act of 2002 § 307, 116 Stat. 784 (to be codified at 15 U.S.C. § 7245).

phrase the lawyer's mandate not as "you must," but "you may," because "may" allows for discretion, for weighing a lot of factors. And if you look at 1.13, that's the way it's put together.[7]

Now let me give you another approach, which may end up at the same place, but help on some of these practical problems. We might attempt to view the role of counsel as part of the corporate governance process. What that means to me is that the chairman of the Audit Committee should say to the general counsel something like this: "Every time the Audit Committee meets, count on the fact that you and I are going to sit down and we're going to have a little conversation, just the two of us. And I'll tell you the questions I'm going to ask, because I'd like you to be thinking about it. One, I want to know, have there been any violations of law that you are aware of. If there have been, what have you done to deal with that situation? And what have you done to see that such violations don't happen again? And I also want you to tell me about anything else that you think is concerning to you and that you think I might be interested in." Now, the first time such a conversation takes place, counsel might provide only a very guarded response. But as the conversation becomes routine, as the chairman of the Audit Committee builds a relationship with the general counsel, that conversation becomes a much more open and productive one.

This approach also has one other very important aspect. When the general counsel knows that she is going to have that conversation with the Audit Committee chairman the next morning, that afternoon, she will quite properly go into the CEO's office and say: "Tomorrow I'm meeting with the chairman of the Audit Committee and you know the questions I am going to be asked. Now I think it would be a very good idea if you talk to the CEO about the A and the B problems, because I know you'd want to do that anyway." Given such a conversation, it's very likely that on the very same evening the CEO will corner the chairman of the Audit Committee and say "There are a couple of things I want you to know." Then tomorrow's conversation is not a surprise. Now you've got a system of reporting up without the abrasion that typically occurs.

The next step is to develop a comparable process between the general counsel and outside counsel, at least the outside counsel who does a lot of work for the company. Again, that means the general counsel or designated assistant general counsels have to develop a relationship and spell out the expectation, so the duties are not created by an externally generated set of mandates, but are instead understood as being what the corporation wants, because the corporation has made its own management judgment that this is the best way to run this organization.

Of course, the two approaches I have sketched out for you are not mutually exclusive, but I think in emphasizing the corporate governance ap-

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[7] MODEL RULES OF PROF'L CONDUCT R. 1.13 (2003).

proach and giving it room to work, one may enhance the likelihood of information and analysis actually getting to the appropriate decision-makers in the corporation, and that, at the end of the day, is the name of the game.