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OATH TAKING, TRUTH TELLING, AND REMEDIES IN THE BUSINESS WORLD

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCE, TRADE, AND CONSUMER PROTECTION

OF THE

COMMITTEE ON ENERGY AND
COMMERCE
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

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OATH TAKING, TRUTH TELLING, AND REMEDIES IN THE BUSINESS WORLD

FRIDAY, JULY 26, 2002

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE, TRADE,
AND CONSUMER PROTECTION,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2123, Rayburn House Office Building, Hon. Cliff Stearns (chairman) presiding.

Members present: Representatives Stearns, Deal, Shimkus, Bryant, Terry, Tauzin (ex officio), and Towns.

Also present: Representatives Chambliss, Collins, and Isakson.

Staff present: Ramsen Betfarhad, policy coordinator and majority counsel; Shannon Vildostegui, majority counsel; David Cavicke, majority counsel; William Carty, legislative clerk; J.P. Guzzardo, legal intern; Bruce Gwinn, minority professional staff; and Consuela Washington, minority counsel.

Mr. STEARNS. The subcommittee will come to order, and we would like to have our panelists come down. I would like to welcome all of you, especially our witnesses, and thank them for their appearance and testimony before the subcommittee. Today we will examine business ethics and oath taking in light of the recent scandals that have colored this country's recent corporate history.

The Energy and Commerce Committee has been at the forefront of congressional investigations examining Enron, Global Crossing and WorldCom. Those investigations, in addition to uncovering disturbing facts about illegal and questionable practices that permeate these companies and others, also highlighted a seemingly pervasive disregard of ethics by business executives and professionals.

In the earnings race of the mid to late 1990's, many business executives and professionals seemed to have traded their own integrity and the good name of their company, albeit incrementally, for greed and a chance to beat analysts' earnings estimates. I don't think this phenomenon is unique to the 1990's. America's corporate and economic history is replete with stories of disastrous failures in business ethics during boom periods. The 1990's were no exception.

As with other postboom periods in our history, markets' self-correcting mechanisms have kicked in to better align corporate practice with business ethics. In the recent months investors have severely punished companies by driving down their share prices where there was a slight hint of questionable behavior such as ac-

counting irregularity. This is how the market reacts in helping to mitigate against a crisis of confidence and trust that pervades corporate America today.

Economic history also shows that when there are such crises of confidence and trust in American business, that government must act. It enacts new laws just as we did yesterday. It enforces existing laws much more rigorously, as the SEC and the Department of Justice are now doing. The new laws and more rigorous enforcement of existing laws are all designed to address current ills that stem from lapses in business ethics and hope to prevent similar future problems.

Both prudent government intervention and market self-corrections will go a long way toward remedying this problem, but no lesser luminaries than Warren Buffett and Alan Greenspan have reminded us that the attitudes and actions of the CEO and other officers of companies are what determine corporate conduct, good or bad. Obviously, markets' self-correcting mechanisms and legal prohibitions and sanctions help keep that conduct in check. CEOs can be fired, and worse, they can go to jail for bad conduct, and we have just seen that recently.

Yet it seems to me, just as Warren Buffett wrote in a recent editorial when he said, quote, to clean up their acts on these fronts, CEOs don't need independent directors, oversight committees or auditors who are absolutely free of conflicts of interest. They simply need to do what is right, end quote. Doing the right thing means having and exercising good business ethics. We cannot legislate integrity or personal responsibility. Laws can only encourage good behavior. But Congress will legislate enforcement and stiff penalties if CEOs do not do the right thing.

At today's hearing we are hearing from law and business professors that teach our future corporate executives and business professionals ethics. We will learn what are the existing codes of ethics that govern the professions. We will also learn whether those codes should be improved and/or better instilled in the students of today. We will hear from prominent business executives—a prominent business executive speaking to the role and the significance of the CEOs and other corporate officers in the business ethics that pervade their companies.

So I look forward to our witnesses today, and I want to thank them for their participation, and now we will have an opening statement from the distinguished ranking member, the gentleman from New York Mr. Towns.

[The prepared statement of Hon. Cliff Stearns follows:]

PREPARED STATEMENT OF HON. CLIFF STEARNS, CHAIRMAN, SUBCOMMITTEE ON COMMERCE, TRADE, AND CONSUMER PROTECTION

Good morning. I would like to welcome you all, especially our witnesses for their appearance and testimony before the subcommittee. Today, we will examine business ethics and oath taking in light of the recent scandals that have colored this country's recent corporate history.

The Energy and Commerce Committee has been at the forefront of Congressional investigations examining Enron, Global Crossing, and Worldcom. Those investigations, in addition to uncovering distributing facts about illegal and questionable practices that permeated those companies and others, also highlighted a seemingly pervasive disregard of ethics by business executives and professionals.

In the earnings race of the mid to late 90s, many business executives and professionals seem to have traded their own integrity and the good name of their company, albeit incrementally, for greed and a chance to beat analysts earnings estimates. I don't think this phenomenon is unique to the 90s. America's corporate and economic history is replete with stories of fantastic failures in business ethics during "boom" periods. The 90s were no exception.

As with other post-boom periods in our history, the markets' self-correcting mechanisms have kicked in to better align corporate practice with business ethics. In the recent months, investors have severely pushed companies by driving down their share prices where there was a slight hint of questionable behavior, such as "accounting irregularities". This is how the markets react in helping mitigate against the crisis of confidence and trust that pervades corporate America today.

Economic history also shows that when there are such crises of confidence and trust in American business, the Government acts. It enacts new laws, as we did yesterday. It enforces existing laws more rigorously, as the SEC and Department of Justice are doing. The new laws and more rigorous enforcement of existing laws are all designed to address current ills that stem from lapses in business ethics and hope to prevent similar future ills.

Both prudent government intervention and market self-corrections will go a long way towards remedying the problem. But no lesser luminaries than Warren Buffet and Alan Greenspan remind us that the attitudes and actions of the CEO and other officers of companies are what determine corporate conduct, good or bad. Obviously, markets' self-correcting mechanisms and legal prohibitions and sanctions help keep that conduct in check. CEO's can be fired and worst can go to jail for bad conduct, as we have seen happen recently. Yet, it seems to me that as Warren Buffet wrote in a recent editorial: "[t]o clean up their act on these fronts, C.E.O.'s don't need "independent" directors, oversight committees or auditors absolutely free of conflicts of interest. They simply need to do what's right." Doing the right thing means having and exercising "good" business ethics. We cannot legislate integrity or personal responsibility. Laws can only encourage good behavior.

At today's hearing we'll hear from law and business professors that teach our future corporate officers and business professionals ethics. We will learn what are the existing codes of ethics that govern business professionals. We'll also learn whether those codes should be improved and/or better instilled in the students. We will hear from a prominent business executive speaking to the role and significance of the CEO and other corporate officers in the business ethics that pervades a company.

I thank the witnesses for their participation and look forward to their testimony.

Mr. TOWNS. Mr. Chairman, I have an opening statement that I will just place in the record, but I would just like to make a few comments. First of all, I would like to thank you for holding this hearing. I think it is important that we do it at this time. Ethics is something that we cannot legislate, but I think that we cannot sit around and just watch and see what is happening, because it is important that we have the confidence of the general public, and, of course, if we do not do something, I am certain that that confidence will not be there. So I want to salute you, Mr. Chairman, for taking the lead in this particular issue and to say to you that even though the business community have done a few things, but I still don't think it is enough, and that in the event that we do not do something, then I think that we are going to jeopardize, you know, a lot of people in a lot of areas, and the confidence just will not be there.

So I want to salute you for moving forward with this hearing today and to say to you that I look forward to hearing from the witnesses, because I think that when we talk about ethics, we can't talk about it enough. So thank you very much, Mr. Chairman. And I yield back.

Mr. STEARNS. Okay. The gentleman yields back. And by unanimous consent his opening statement will be made part of the record.

My colleagues, by unanimous consent the gentleman from Georgia, the Honorable John Isakson, will participate if there is no exception. So ordered.

Now, the vice chairman of our subcommittee the gentleman, also from Georgia, Mr. Nathan Deal.

Mr. DEAL. Thank you, Mr. Chairman, and thank you for holding this hearing today, and in a few minutes I look forward to introducing one of the very special panel members here, Mr. Truett Cathy, who is certainly one of the premiere business people in our Nation and from our State of Georgia, and we are proud to have him here. And I also welcome my colleague Mr. Isakson to this hearing today.

As you have indicated, Mr. Chairman, we hear a lot about the bad things that go on in business, in corporate America. Today as we listen to those from the academic community who train the CEOs and the legal advisors to major corporations, and as we listen to a businessman who has shown that success in the marketplace does not depend on dishonesty, but, in fact, it depends on exactly the opposite, that is that you play by the rules, that you treat your customers fairly, and that you display the kind of leadership that people in the everyday world who invest in corporations expect, I think we get the message out that that is the foundation on which American business has truly been built. And the ones who have deviated from that are the exceptions to the rule and not the rule itself.

Certainly all of us, as we have come through our own educational background, have been taught that morality and ethics are, in fact, the cornerstones of not only a successful personal life, but a successful business and professional life. And I think that we need to send a message, especially to the young people of this country today, that as they make their choices about professions, as they make their choices about what they are going to do with their lives, that they understand very clearly that from the halls of Congress to the business communities itself, that the concept of honesty and fair dealing is important and, in fact, is essential.

I am pleased that we have these outstanding members of this panel to reinforce that concept as we proceed to this hearing, and I look forward to introducing Mr. Cathy in a few moments. Thank you, Mr. Chairman.

Mr. STEARNS. Thank my colleague.

And Mr. Shimkus.

Mr. SHIMKUS. Thank you, Mr. Chairman.

It is great to have you all here today, and it is a shame that we have to have you here today, because this shouldn't be something that we have to advertise. This just should be the way we operate.

You know, one of the Founding Fathers was quoted—and I won't try to remember which one. He says, though good laws do well, good people do better. And it talks about a moral foundation of truth that is instilled throughout our society, although sometimes we lose our way.

I am a West Pointer, so I didn't wear my class ring for a long time. Actually I put it on not to get—I put it on during the impeachment issues because I had to keep asking a lot of questions. The code at West Point is duty, honor, country. And I have my

class ring here. And General MacArthur said, duty, honor, country. Those three words reverently dictate what you ought to be, what you can be, what you will be. His speech to the corps of cadets at the end of his career indicates how the Academy has attempted to imbed into a culture that would permeate through the military.

Other things that are done at West Point is the honor code: A cadet will not lie, cheat or steal, nor tolerate those who do; and part of the cadet prayer, which says, help me to do the harder right over the easier wrong, not being content with the half truth when the whole can be won.

This background, when I had to make some tough decisions, caused me to focus back on my educational background, and not only that, but also my family background and my training there. But we all know that this also tries to permeate itself through the Army Officer Corps where an officer's word is his bond. The moral foundation of the United States Army tends to depart from the background at West Point, but it always continues and takes more work, just like a successful marriage takes work, a good corporate culture takes work.

We are glad that you are here to help get the word out that there are goods actors out there instilling good corporate cultures, and if we are concerned about having character education in our schools, which is a big thing now—unfortunately we have to do that, because they are not getting it at home—then it is good to tell the story that that there needs to be character core education in the boardrooms.

We thank you all for being here. We are excited about listening to your stories, and we hope our other folks who are creating jobs and wealth in this country will take heart that there are good folks out there.

And, Mr. Chairman, thank you for the extension of my time, and I yield back.

Mr. STEARNS. Thank you. I want to thank the gentleman.

Mr. Terry, gentleman from Nebraska.

Mr. TERRY. Thank you, Mr. Chairman. I have a statement, and I will just submit it.

Mr. STEARNS. So ordered.

[The prepared statement of Hon. Lee Terry follows:]

PREPARED STATEMENT OF HON. LEE TERRY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Thank you, Mr. Chairman, and thank you for holding this hearing on a very important issue: the accountability of chief executive officers for the financial statements their companies issue to the public.

I am not a promoter of more laws, just better ones. I do not support increased regulations; rather, enforcing the ones we already have on the books. This Committee and this Congress have taken strong steps this session to streamline accounting laws and oversight regulations. We have closed loopholes, filled in gaps, tightened grips, and made our economy's future strong by doing so.

Issue by issue, Mr. Chairman, your leadership has led to real-time financial disclosures, transparent investor information, plain language documentation, and harsher penalties for those who knowingly commit the crimes that lead to Enrons, Worldcoms, and ImClones. Yet more needs to be done, which is why this hearing today is so important.

Like a quarterback for a football team, CEOs get to take all of the credit when things go well and have to take all of the blame when things go badly. Yet legally, they are not held accountable. When a quarterback fumbles, throws a few interceptions, maybe even throws the game, the coach has a responsibility to bench him,

so that no more follies will occur. Mr. Chairman, the federal government must be the coach every once in a while, and we have a responsibility to bench CEOs who lie, cheat, hide, and steal. President Truman said it best: "The buck stops here." At the end of the day, CEOs have a duty to ensure ethical behavior of their companies. By signing on the dotted line that their financial statements are accurate and true, CEOs will be held accountable to the letter of the law.

Thank you again, Mr. Chairman, for holding this hearing, and I look forward to the testimony.

Mr. STEARNS. Mr. Bryant, the gentleman from Tennessee.

Mr. BRYANT. Thank you, Mr. Chairman.

Having walked in late, I apologize to the panel. I will be very brief here.

I would say that listening to Mr. Shimkus's speech, I would tell him that I would take full credit for that, although I am not sure I actually did. I actually taught at West Point during that time, and I claim him when he is on his best behavior that he was one of my students; but usually when he is not on his best behavior, I disavow him completely. But I will certainly agree with what he says and thank the panel for coming.

I can't help but think not just the cause—but I cannot help but think back just a few short years ago with what we went through in Washington as a part of the actual impeachment of a President and actually being firsthand involved in that myself, knowing what was there and the example that was not only, I think—the very bad example that was not only set to our youth, but I think something we missed was the bad example it set for our corporate executives and other people in business and certainly, I believe, lowered the standard, if you will, of truth and integrity. And I think it was a very bad example. I am not saying that is all of it by any means. Certainly at the core is simply greed, the human nature of greed. But we have to do what we can as a body, as a Congress, to correct that.

We always hear you can't legislate morality, but we do attempt to do it in many ways. But certainly we have to do that. Also we have to set an example ourselves as Members of Congress. But I can sound like I am starting to preach here, and I am not.

But let me yield back my time and thank this very distinguished panel for being here today and so we can move on and hear them. Thank you.

Mr. STEARNS. I thank my colleague.

I think that what we are going to do is have—the vice chairman introduce one of our CEOs, the distinguished Mr. Cathy, and then, Mr. Isakson you will have an opportunity after Mr. Deal speaks to also do an opening statement and to provide anything further.

So with that we will move to our panel and Mr. Deal.

Mr. DEAL. Thank you, Mr. Chairman.

Probably the guest that we have today in the form of a panel member is best recognized by some of the ads that feature the "Eat Mor Chikin." this is certainly one of the more successful advertising recognition symbols in our country. It is the recognition of Chick-fil-A, and we are very pleased, especially Mr. Isakson and I as Georgians, to have a native Georgian on the panel today, Mr. Truett Cathy.

Mr. Cathy grew up in Atlanta. He began his business activities running a Coca-Cola stand in Atlanta. He carried the concepts of

good business practices from those early years, in his preteen years, all the way through his career here until today and is certainly, I think, the model for the kind of business that all of us would like to see succeed in our country.

Chick-fil-A has over 1,040 franchises across the country. It is a business that for 34 consecutive years have each year posted sales growth, and that in itself is phenomenal. It is a business that has adhered to the importance of never having a customer who leaves dissatisfied; that the customer is first and most important, because that is what keeps a business, especially a business like the restaurant business, going on a daily basis.

But he has a unique distinction. The restaurant business is a very competitive business, and Sundays are sometimes regarded as the most important day in the restaurant business because people are off working generally, and they go out to eat. But because it is Sunday, Mr. Cathy has consistently adhered to the concept that his restaurant is closed on Sunday, and the reason is that he wants his employees to have time to worship, if they choose, and also to have time with their families. So it is not the typical business model, and he is certainly not in many respects the typical business entrepreneur, but is the example that all of us, I think, should adhere to. He is a very kind and gentle man, and it is indeed my pleasure to have him on this panel today.

Mr. STEARNS. I thank the gentleman.

Mr. Isakson, you are welcome to make introductory remarks.

Mr. ISAKSON. I will just be very brief, and I appreciate all the things that Congressman Deal said. And Congressman Collins is also—all of us from Georgia are here because in my—I don't know a finer man than Truett Cathy, and I have known him for a number of years. I practiced business in Atlanta for 34 years before I came to Congress. It was a real estate business, so we from time to time dealt with Chick-fil-A people looking for sites. My kids were raised on Chick-fil-A because it is the favorite thing they like to eat.

But the point I wanted to make is this: Truett Cathy is not one of those people that writes a book or comes up with a cute phrase and puts it on for pretense. He is a guy that every day lives the life that he is here to tell you about, and I can tell you in advance he will be more humble than he should be because he is that type of a man.

I just lament that, having attended the Enron hearings here in Washington a few months ago and seeing standing-room-only crowds coming to hear about a tragedy, that we don't have a standing-room-only crowd here today to hear about what most American business is really like, but what I think Atlanta and Georgia's finest businessman is. Truett Cathy walks the walk. He talks the talk. He has changed the lives of thousands of children, and he has made it possible for hundreds of his employees to get college educations who would otherwise never have had a chance. But every Sunday, for, I think, 50 years, he has taught 13-year-old boys Sunday school, trying to point them in the right direction in life, and many of them today are walking examples just like Truett is.

So it is a real honor for me to be here around my role model and my idol Truett Cathy. Thank you, Mr. Chairman.

Mr. STEARNS. Thank you.

And the gentleman Mac Collins from Georgia is also recognized, not a member of the committee, but certainly welcome his comments.

Mr. COLLINS. Thank you, Mr. Chairman. And I join my two colleagues as well as the other colleagues in welcoming the panel, particularly the Cathy family, Mr. Truett, his son Dan, and two grandsons.

You know, I have know Mr. Cathy for, oh, 10, 15 years since I have been campaigning in Clayton County and Henry County, Georgia, for political office. I know him as a man of honor, a man of integrity and a man of faith. And I know that he has, as a father, raised a family with those same traits. Not only has he raised a family who are people of faith, but he has taken in a lot of foster children; homes in the United States that he has for foster children, funded them, visits with them, and lets them know of his faith, and through faith has been successful to him and will be successful for them if they follow that route. But not only here, but in Peru, he has helped children there.

It has been mentioned he has been teaching Sunday school for a number of years. I have attended some of his classes because I wanted to hear him. I welcome them. I am glad to call them friends, and I am glad that they live in the Third District of Georgia.

Thank you for all you do, all your family. And one last thing. Mr. Cathy, when each of his children became the age of driving, at that time it was 16 in Georgia, they could get them an automobile, but on the steering wheel of that automobile would be an engraving. It would be a Bible verse of their choice. That is the type of man Truett Cathy and his wife and family are. Thank you, Mr. Truett.

Mr. STEARNS. I thank the gentleman.

Also we have also from the great State of Georgia Mr. Saxby Chambliss, who is offering a quick opening statement or comment.

Mr. CHAMBLISS. Thank you, Mr. Chairman, and just adding to what my colleagues have said about Mr. Cathy, he is a remarkable man who has had a remarkable life and has had just a profound influence on any number of other not just Georgians, but Americans, and he is somebody that we Georgians are extremely proud of. And just one quick story.

His son Dan and Mr. Cathy invited me to an event back the Saturday before the Fourth of July, which is an annual event they have at their ranch, which is located in my district, and it is a ranch on which they have a home for children. And it is—the home itself is a remarkable story, it says a lot about Mr. Cathy and Dan and that whole family. And we were there that Saturday night. There were probably, I don't know, 3,000, 3,500 folks there at Mr. Cathy's and Dan's invitation. And there were, gee, a lot more children than there were adults just enjoying life, celebrating the great country that we live in, and having an opportunity to see the work that Mr. Cathy has done for so many children in our part of the State who have not had the advantages that most of us have had. And it was truly a great night for America, but it was a great night to pay tribute to the Cathy family.

Mr. Cathy, unfortunately, by the time I got there, had already gone, and he had gone for the right reason. He had left Upson County and had headed somewhere—I don't believe it was back home, Mr. Cathy. I know it was north of Atlanta. But he was gone to teach Sunday school or gone home so he could get a good night's sleep so he could teach Sunday school the next morning. And all Georgians are extremely proud of—I am very proud of you. We are proud to have your facility in my district, and we appreciate you being here today, and thank you and Dan and your whole family.

Mr. STEARNS. I thank the gentleman.

[Additional statements submitted for the record follow:]

PREPARED STATEMENT OF HON. CHARLES F. BASS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW HAMPSHIRE

Mr. Chairman, thank you. I am pleased that this subcommittee is addressing the issue of business ethics. In light of recent corporate responsibility scandals, it is appropriate that we examine how the federal government may be able to rectify the institutional problems that exist within our business models.

Although I do not believe it is the role of Congress to legislate honesty mandates, as Americans, it is incumbent upon us to reevaluate the significance of social responsibility and its effects on our business and economic systems. The failure to adhere to a professional code of ethics by some executives has contributed to the current economic melange. I believe this hearing will serve as a positive step in redressing the wrongs that have led to this point so that they should not have to occur in the future.

I yield back to the Chairman.

PREPARED STATEMENT OF HON. W.J. "BILLY" TAUZIN, CHAIRMAN, COMMITTEE ON ENERGY AND COMMERCE

Thank you, Mr. Chairman, and I'd like to thank you for holding this hearing and for continuing to focus on the myriad problems that have been exposed in the business community in recent months. Straight truth, favorable or not, from our public companies and their governors is the foundation for trust in our free market system, and we in Congress must find the best way to encourage ethical behavior by business leaders and protect investors from corporate malfeasance.

Our business community, and the investor culture that thrives therein, is based upon concepts that we've heard more and more about since these corporate scandals have unfolded. The notions of "transparent accounting," "auditor independence" and "investor confidence" are more than Boardroom phrases. Because of the technology boom of the late 90's and the democratization of the financial markets, these concepts are now discussed around American dinner tables. Investors simply must have confidence in financial reporting, and we must do everything we can to ensure the veracity of reporting and the continued strength of our market system. The first and, I think, most important, step in this process is to restore the fundamental trust of the general public in the integrity of business leaders and the financial reports they issue.

Swearing an oath has long been a very public way for those in a position of leadership—in government and in the private sector—to take explicit responsibility for their actions with regard to that position. For example, Members of Congress take an oath to uphold the Constitution. Public avowal serves as an assurance to the public—investor or constituent—that the leader raising her right hand will act in the interest of those she serves. But in addition to that, it shores up confidence in the system as a whole. It shows that the system is comprised of men and women who are accountable not only to those they serve directly, but also to the entire community.

Mr. Chairman, the investors who have lost huge amounts of money are irate with the shady dealings of their corporate representatives. So too are those of us who believe in the virtues of the free market. In fact, it is the most stalwart of defenders of free markets that are most offended by those who have abused the system.

The business community is just that, a community, and when people cook the books in an attempt to line their own pockets, they do an incredible disservice to all of those who try to inform themselves completely and invest responsibly. Yesterday we took meaningful steps to protect investors by passing the Conference report

for HR 3763. I look forward to hearing from our witnesses today about further steps, legislative or otherwise, that need to be taken to restore confidence in our market system.

Again thank you, Mr. Chairman, for holding this hearing and for investigating possible remedies to the problems we face.

I yield back the balance of my time.

Mr. STEARNS. We want to welcome——

Mr. COLLINS. Mr. Chairman, would you yield for a moment, please?

Mr. STEARNS. I would be glad to yield.

Mr. COLLINS. This is the Commerce Committee, and we are so proud to be over here with you. And, you know, we are from Georgia, and Georgia is the poultry capital of the world. We are having trouble based on some conflict that we have with Russia. It might be a good suggestion if we send Mr. Cathy over to Russia. I believe he could convince those people over there they need to eat more chicken, and if they eat more chicken, then they will probably bring down that barrier and settle that conflict.

Mr. STEARNS. Probably so. Does vodka go with chicken?

Mr. DEAL. Not at Chick-fil-A.

Mr. STEARNS. Let me welcome our panel.

Mr. COLLINS. They are already indulging in enough of that, but they need to eat more chicken.

Mr. STEARNS. Okay. Of course, we have Samuel Truett Cathy, who is founder and chairman and chief executive officer of Chick-fil-A. We have Murphy Smith, assistant department head, department of accounting, Texas A&M University. And we have Sherman Cohn, professor of law, Georgetown University Law School; and Lyrissa Barnett Lidsky, a professor of law, Levin College of Law, the University of Florida.

So let me welcome all of you this morning, and we will go from my left to my right with opening statements, and, Mr. Cathy, we will start with you. What we need you to do is turn on the mike and then move the mike a little closer to you.

STATEMENT OF SAMUEL TRUETT CATHY, FOUNDER, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CHICK-FIL-A, INC.

Mr. CATHY. Okay. Great. It is indeed an honor for me and humbling in spirit to be here with you and hearing all these glorying remarks. I could sit here and enjoy this the rest of the day, and I will be here, be glad to listen to you. I love to hear such kind remarks, and I am grateful for those. But I am thankful that you invited me to speak, realizing when I was in school I was tongue-tied. The best I could do was the name Truett Cathy, and here you are inviting me to speak to a very distinguished group. So I am indeed honored. People ask me, do you get many speaking engagements, and I say, well, I get a lot of first-time speaking engagements, but seldom does anyone ask me back. So I appreciate this first opportunity I have had to speak to such a distinguished group.

As I think about ethics and the business ethics, I realize there is no such thing as a business ethics. It is individual ethics. People make the business. I am proud of all my representation of Chick-fil-A folks. They know what dedication and commitment is and loyalty among our people. We are a private company. That is why we don't have a board of directors to answer to, thank goodness. And

we do not have to answer to stockholders that arereally the bosses of these companies. They are the ones that ought to be protected and watch after their own interest. But today I am grateful that we are still a private company, family owned, and operate on some principles that have been very meaningful to me throughout my business life.

Here back in 1982 we were experiencing some kind of difficult situations. No. 1 is we just moved into a $10 million corporate headquarters. It was fully financed. Business interest on borrowing money was 20 and 21 percent. We saw some decline in our sales because all the major chains were getting in the chicken breast sandwich business, which caused the product to be inflated, and I was disturbed at the time because everything that I had at that time was predicated on the success of Chick-fil-A.

And so I called a meeting among our executive committee. All of these gentlemen have more than 20 years of service with Chick-fil-A. They are fully dedicated and committed to operating a business on Christian principles, and so I asked the question, why are we here? Why are we alive, and why are we in business anyway? We never established a corporate purpose. But among the conversation of the eight of us spending 2 days there, we came away that this might be our corporate purpose, that we might glorify God by being a faithful steward for all that is entrusted to our care, and that we might have a positive influence on all the people that we come in contact with.

We came back and shared this with our staff people, and they said, well, what else do you do? I said, well, we didn't have an answer to the current problems, but we did establish where our goals were, where our corporate purpose was and asked them to cooperate with. They were kind enough to give to me at Christmastime a plaque identifying my corporate purpose. So it was meaningful to them, but it is meaningful even today that where my responsibility is, how I should conduct myself over telephone calls and salespeople and people that are not doing the job that is expected of them.

So being in the restaurant business, I feel kind of a divine calling to do those things—meeting people's needs, their physical needs, their emotional needs and even the spiritual needs. It is a privilege that we have to employ 40,000 or 50,000 young people in our various businesses, and I am motivated by what I see in young people. A lot of them work because they have to work. Others work because they just like to work. I have never seen any objections to people enjoying their work. I find people that enjoy their work if they are putting their heart into it and performing at their very best. When we get in trouble is when we are doing less than what is expected of us.

But it was brought out the fact of I do teach 13-year-old boys in Sunday school, and the reason that I do that is I feel it is the last opportunity to establish some values in life that will get them over the critical years of a teenager. So I tell them, you know, it is important that you make good decisions. Good decisions mean goods results; fair decisions, fair results; and the sad part about it, bad decisions equal bad results. So even teaching, I have my former students, some in prison today that have gone wayward and doing

those things, and I ask, you know, I wondered if I had had just a little bit more time to spend with that individual.

Also I pointed out—I asked one morning, how many of you would like to have a million dollars? And all the hands went up. They could have everything they wanted. Dad could have a pickup truck with shotgun shelf, and Mom could have a new dress. He could have a Go Kart. And I said, well, let me tell you something better than a million dollars; that the Bible says a good name is rather to be chosen than great riches.

I think that is something we all need to realize, that God has a plan in our life. I consider the Bible as a blueprint, a road map for our life. I think instinctively we are all born with the idea that we want to be somebody and achieve goals that might be worthy, but somehow or another we are getting our priorities mixed up. I was asked by a reporter one time, how would you like to be remembered when you leave here? After thinking a moment or two, I said, I guess I would like to be remembered that I kept my priorities in the proper order, because I have observed business people, highly successful business, being a complete failure when it comes to the important things like your conduct with your family and in society and community.

It is very, very important that we take a look at the important things. We realize we are in a changing world, but the important things never have changed. I still feel the principles of the Bible. I see no conflict between biblical principles and good business practice. They are there. They are outlined for us. And we need to read the Bible, and not only read it, but interpret it.

I have been impressed with attending the national prayer breakfast where the President was there and his wife, and the Vice President and his wife, and numerous other peoples. And a Jewish person read from the Old Testament, and a Protestant read from the New Testament. Prayer is prayer.

To get in my office and find that a kindergarten group was coming through, elementary school group, and I have a book at that time, It Is Easier to Succeed Than to Fail, and I told the children, I don't have books for each of you, but I will give you three and put them in the library. And I am signing this book, and under it I will put Proverbs 22:1. I am not going to tell you what Proverbs 22:1 is. You look it up, and you can find it in the Bible. I said, when you go to check out the book, take a look at what Proverbs 22:1 says. I said, you do have a Bible in your school, don't you? The teacher said, I am sorry, Mr. Cathy, we are not allowed to have a Bible in our school. How is it that people of higher authorities rely on prayer and Bible reading and character building, yet a child going to school cannot carry a Bible in their hands?

Mr. STEARNS. Mr. Cathy, I am going to have to interrupt you. We have a vote on the floor, so I am going to recess the committee, and we will come back momentarily. We just have one vote. So the committee stands in recess.

[Brief recess.]

Mr. STEARNS. The subcommittee will reconvene, and Mr. Cathy was just finishing up his opening statement.

So, Mr. Cathy, as a courtesy, if you don't mind wrapping up your opening statement, and then we will hear from Dr. Smith.

Mr. CATHY. Thank you for the time that has already been given to me. I want to make a closing statement or two that I would like to relate to you.

Many other things I would like to share with you at the proper time, but I will close by maybe telling you about a picture that I have on the wall of my office that was sent to me by my daughter as a teenager. But on that is a picture of a mountain climber, had proper attire with his safety rope on, with the caption that no goal is too high if we climb with care and confidence. And that is a reminder to all my people there that no goal is too high, but we have to be careful, and we have to practice biblical principles and do those things that will cause us to continue to experience success.

So I would like to close by just making the statement I see no conflict between biblical principles and our faith, and we could do well to consider the things that are important in our life. And I feel that some of our people have been misguided to think that pressure put on them about the bottom line. We concentrate on people. And I know sometimes the stock companies concentrate on the bottom line. We should forget about the bottom line. It is important that we do things right and do things right long enough that you will receive the rewards that you are looking for. That is my closing remark.

[The prepared statement of Samuel Truett Cathy follows:]

PREPARED STATEMENT OF S. TRUETT CATHY

Mr. Chairman and members of the Committee, I am honored that you have asked me to be here today. I cannot think of a greater privilege than to speak to the leaders of our nation. Further, that you thought me fit to speak on the issue of ethics is personally humbling.

After agreeing to appear before you today, I had to ask myself "what is the meaning of 'business ethics'?" I concluded that there is really no such thing as business ethics. There is only personal ethics. I believe no amount business school training or work experience can teach what is ultimately a matter of personal character. Businesses are not dishonest or selfish, people are. Thus, a business, successful or not, is merely a reflection of the character of its leadership.

I am deeply disturbed, as you are, by the lack of character I see in the marketplace. In order to satisfy the increased pressure for greater profits, some business leaders are making bad choices which ultimately hurt thousands of employees, stockholders, and the economy.

We all know that the scorecard of any business is the profit it produces. Without profit, we cannot take care of our employees, our families, or contribute to the betterment of our communities. The question is: How do we balance the pursuit of profit and personal character?

For me, I find that balance by applying biblical principles. I see no conflict between biblical principles and good business practices. We've tried to operate Chick-fil-A that way from the beginning . . . 1946 . . . Comments.

In grade schoo . . . (My Proverbs 22:1 story) . . .

There also is the book, "Everything I Need To Know I Learned In Kindergarten", and some of these things are . . . Comments.

So, personal character is something we must teach our children and enforce through our actions. That is one reason we close on Sunday. Not everyone has personal convictions about closing on Sunday, but I believe most people respect my personal convictions in doing so. I once asked the group of 13 year old boys I teach Sunday school . . . (the hypocrite story) . . . Comments.

I have a framed poster on my wall of a mountain climber given to me by my daughter, Trudy when she was just a young teenager, which says, "No goal is too high if we climb with care and confidence". Many businesses today are overextended and have gotten themselves into financial trouble. I have always tried not to overextend. I am satisfied stepping from one plateau to the next, making sure we are doing everything right so that we can move on with confidence. I have always said I want to make sure we are getting better before we get bigger.

Mr. Chairman and members of the committee, in closing, I would like to say that the important things in life haven't changed: those are faith, family values, and good character among others. I was asked the other day how I wanted to be remembered. My reply was that I would like to be remembered as one who kept their priorities in order; that while I've tried to build a successful business, I've kept focused on my family, the reputation of my name, on influencing others, and on incorporating my faith into every part of my life. In other words, Mr. Chairman, I believe faith works on both Main Street and Wall Street. Thank you again for the opportunity to be here today.

Mr. STEARNS. I thank you.

Dr. Smith, your opening statement.

STATEMENT OF L. MURPHY SMITH, ASSISTANT DEPARTMENT HEAD, DEPARTMENT OF ACCOUNTING, TEXAS A&M UNIVERSITY

Mr. SMITH. Well, first, thanks for allowing me to be here today.

Ethical values provide the foundation on which a civilized society exists. Without that foundation, civilization collapses. On a personal level everyone must answer the following question: What is my highest aspiration? The answer might be wealth, fame, knowledge, popularity or integrity, but if integrity is secondary to any of the alternatives, it will be sacrificed in situations where a choice must be made, and those situations will inevitably occur in every person's life. Allegations of unethical behavior by top management at Enron helped destroy the company's ability to function.

A goal of a business firm should be to increase its owner's wealth. To do so requires the public's trust. In the long run, that trust depends on ethical business practices. In the United States and other free societies, people often have the freedom to make their own decisions about the right thing to do. Before the American Republic, a common belief was that where there was liberty, anarchy would result, because people would be unable to govern themselves. Yet Americans were free and well-behaved. How could this be?

The great English writer G.K. Chesterton observed that America was the only Nation in the world founded on a creed. He said that creed was set forth with dogmatic and even theological lucidity in the Declaration of Independence. Chesterton was referring to the second paragraph of America's founding document: We hold these truths to be self-evident that all men are created equal; that they are endowed by their Creator with certain unalienable rights; that among these are life, liberty and the pursuit of happiness.

Whether a person derives ethical values from religious principle, history and literature, or personal observation, there are some basic ethical guidelines to which everyone must agree. In considering the impact of ethical values on a society, nationally syndicated columnist Chuck Colson made the following observation: Societies are tragically vulnerable when the men and women who compose them lack character. A nation or a culture cannot endure for long unless it is undergirded by common values, such as valor, public-spiritedness, respect for others and for the law. It cannot stand unless it is populated by people who will act on motives superior to their own immediate interests.

The purpose of ethics in business is to direct businessmen and women to abide by a code of conduct that facilitates, if not encour-

ages, public confidence in their products and services. Educators sometimes wrestle with the question, can ethics be taught? The 26th President of the United States, Theodore Roosevelt, put it this way: To educate a person in mind and not in morals is to educate a menace to society. More recently the National Commission on Fraudulent Financial Reporting indicated that the business curricula should integrate the development of ethical values with the acquisition of knowledge and skills.

When societal values are deteriorating, maintaining high ethical standards in accounting and business grows increasingly difficult. People will undoubtedly ask if everyone else is cheating, then how can an ethical person succeed? The answer is in the definition of success. The real measure of success is a person's character, not fame and fortune. Genuine success is living a life that reflects high ethical values. President Abraham Lincoln said it well: Honor is better than honors.

What can government do? Perhaps America's first President can help answer that question. In George Washington's farewell speech to public life, he said, the survival of freedom on American soil would have nothing to do with him and everything to do with the character of its people and the government they would elect. He said, of all the dispositions and habits which lead to political prosperity, religion and morality are indispensable supports. Reason and experience both forbid us to expect that national morality can prevail in the exclusion of religious principle. Passing additional laws and regulations are often necessary to punish criminal behavior and to provide moral guidance to law-abiding citizens; however, even more effective leadership would be for government to inspire its citizens to act with virtue and honor.

As President Washington pointed out, there is no better source of inspiration than religious principle. The fact that governmental institutions have downplayed the role of religion, particularly Christianity, starting in the last half of the 20 century is arguably a key factor in the decline of national morality, including the recent ethical failures in business. Government should include and encourage the active participation of people of faith and the inclusion of religious principle in the public arena. This would almost certainly be a step in the right direction of inspiring ethical behavior in American society, including the business community.

In the aftermath of 9/11, I am encouraged by the refocus on valor, public-spiritedness and other godly values. As President Bush leads our Nation, I am grateful that he reads the Bible and spends time in prayer. He affirms our national motto, In God We Trust.

Rules and regulation of government cannot preserve a free and ethical society whose people lack integrity. Ethics is the heart of America's economic and social freedom. Unethical behavior is a dagger in the heart. According to business textbooks, top management sets the ethical direction for the firm. Company policies and internal controls are ineffective without ethical leadership from the top. Likewise, the political leaders of our Nation set the tone for its citizens. Laws and regulations will do far less than your example.

And finally, I just thank you for your efforts and all the Members of Congress who are striving to pass appropriate legislation and to provide ethical leadership for our country.

[The prepared statement of L. Murphy Smith follows:]

PREPARED STATEMENT OF L. MURPHY SMITH, PROFESSOR OF ACCOUNTING, TEXAS A&M UNIVERSITY

Ethical values provide the foundation on which a civilized society exists. Without the foundation, civilization would collapse. On a personal level, everyone must answer the following question: What is my highest aspiration? The answer might be wealth, fame, knowledge, popularity, or integrity. But if integrity is secondary to any of the alternatives, it will be sacrificed in situations in which a choice must be made. Such situations will inevitably occur every person's life.

Allegations of unethical behavior by top management at Enron helped destroy the company's ability to function. A goal of a business firm should be to increase its owners' wealth; to do so requires the public's trust. In the long run, that trust depends on ethical business practices.

In the United States and other free societies, people often have the freedom to make their own decisions about the "right" thing to do. Before the American Republic, a common belief was that where there was liberty, anarchy would result because people would be unable to govern themselves. Yet Americans were free and well behaved. How could this be? The great English writer, G.K. Chesterton, observed that America was the only nation in the world founded on a creed. He said that creed was set forth with dogmatic and even theological lucidity in the Declaration of Independence. Chesterton was referring to the second paragraph of America's founding document: "We hold these truths to be self-evident, that all men are created equal, that they are endowed by the Creator with certain unalienable rights, that among these are life, liberty and the pursuit of happiness."

Whether a person derives ethical values from religious principle, history and literature, or personal observation, there are some basic ethical guidelines to which everyone must agree. In considering the impact of ethical values on a society, nationally syndicated columnist Chuck Colson made the following observation. "Societies are tragically vulnerable when the men and women who compose them lack character. A nation or a culture cannot endure for long unless it is under-girded by common values such as valor, public-spiritedness, respect for others and for the law; it cannot stand unless it is populated by people who will act on motives superior to their own immediate interest."

The purpose of ethics in business is to direct business men and women to abide by a code of conduct that facilitates, if not encourages, public confidence in their products and services. Educators sometimes wrestle with the question: Can ethics be taught? The twenty-sixth president of the United States, Theodore Roosevelt put it this way: "To educate a person in mind and not in morals is to educate a menace to society." More recently the National Commission on Fraudulent Financial Reporting (Treadway Commission) indicated that business curricula should integrate the development of ethical values with the acquisition of knowledge and skills. John C. Burton, former dean of the Columbia University Business School, in a speech to the American Accounting Association, stated that the declining influence of social institutions has increased the role educators must play in shaping values.

When societal values are deteriorating, maintaining high ethical standards in accounting and business grows increasingly difficult. People will undoubtedly ask: If everyone else is cheating, then how can an ethical person possibly succeed? The answer is in the definition of success. The real measure of success is a person's character, not fame and fortune. Genuine success is living a life that reflects high ethical values. President Abraham Lincoln said it well: "Honor is better than honors."

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Mr. STEARNS. Thank you, Dr. Smith.

Professor Cohn.

STATEMENT OF SHERMAN L. COHN, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. COHN. Thank you very much for the invitation and for hearing us out on these very important issues.

I associate myself with what my two colleagues to my right have already said, and I am not going to repeat it.

Mr. STEARNS. You might just move the microphone just a little. That is good.

Mr. COHN. Thank you. I would like to focus on the role of lawyers. I teach legal ethics at Georgetown. I practice it in many ways. I tell my students that the most important ethical question is the one you ask yourself in front of the mirror as to who you are, and that every lawyer at some point will have to ask that question in a very hard situation. There are many such situations.

The problem, once you get from the broad ethical precepts to application, is that there are so often conflicting precepts and how they apply. For the lawyer, you have two very fundamental values that come into conflict. One is your duty to your client, which we all hold as very important. Those of you who have had occasion to employ lawyers know that you want that lawyer to be loyal to you and to exercise the duty to you, not to the other side. But then we have the value of the duty to the system and to the public.

In the business world, where we have set up a system by which there should be checks and balances, the accountant and the accountant statements which we thought we could rely on until recently, that is a very important protection. That is a part of what our whole securities law is built on and our system is built on. The lawyer who stands there should be able to say, no, you can't do that, or I will not participate in it. And that is the conflict that occurs, because there should be some balance where the lawyer is not entirely the handmaiden of the client.

Now, clients don't generally like to hear that. They want the lawyer to do their bidding. But the lawyer should have independent judgment and should be able to say to the CEO, no matter who he is, or the financial person, or anyone else, no, this can't be done that way, and I will not participate in it if it is done. Now, that

may mean, and I tell my students this, you keep your resume ready, particularly if you are in-house counsel. Whether it is government or private, you have to be ready to walk and to give up a job and to give up all the income that comes with that position. And this is true even in large law firms where quite often you have a client such as an Enron or a Xerox or a WorldCom that gives so much into the bottom line of that business called the law firm, and at some point with your integrity you have to say, no, I can't do that, and I am ready to walk.

That is the message we convey. It is a lot harder to carry it out, and, therefore, we have set up various ethical guideposts. I have given you some excerpts from the rules of professional conduct. 1.13 says that when the corporate person with whom the lawyer is dealing is doing something wrong, it is up to the lawyer to then take it up to the highest level, which would include the board of directors, and say, there is something wrong here. Now, of course, once you do that, once you go past the person who hired you, you have to be ready to find a new job or find a new client. That is a part of it. But you go up as far as the board. If the board does not go along with you, and you think it is wrong, then at that point you have the ability and, I suggest, the duty to withdraw.

The one thing you can't do is breach your duty of confidentiality. You can't make it public. All you can do is resign. That is our system, because the duty of confidentiality is so very important. You can't participate in fraud. You can't aid it. You can't abet it.

Now, one of the aspects is where does the SEC fit in all this? Now, the SEC, does enforce illegal ethics, not as much as we would like to have them do it. One of the problems is resources. Government always has a problem with resources, and that is why this Congress almost 100 years ago, created a concept which has often been called private attorneys general in the Clayton Act, having to do with antitrust. Antitrust was so important to this Congress that it established a process of treble damages plus attorney's fees when the plaintiff wins in order to encourage private litigation. In the case of securities regulation, this Congress, in its wisdom, in 1995, went the other way and said, we just want the SEC to enforce these matters. And in the Private Securities Litigation Act they pulled back on the private attorney general concept in this area.

Now, about 30 years ago there was a case before the Supreme Court called J.I. Case Company v. Borak, in which the issue was whether there was to be a private cause of action to enforce a public duty. The SEC, in an amicus brief, said, we think there should be. Why? Because we don't have enough resources to enforce. I suggest that is something that needs to be rethought.

Thank you, Mr. Chairman.

[The prepared statement of Sherman L. Cohn follows:]

Testimony of

PROFESSOR SHERMAN L. COHN
Georgetown University Law Center

U.S. House of Representatives
Committee on Energy and Commerce
Subcommittee on Commerce, Trade,
and Consumer Protection

July 26, 2002

"Oath-Telling, Truth-Telling & Remedies in the Business World"

I. My Focus: the ethics of lawyers in this context.

II. Conflict of Roles of the Lawyer

- A. Duty to the Client.
- B. Duty to the System and the Public.

III. Lawyers Ethics

- A. Role of the American Bar Association.
- B. Role of the State Supreme Courts.
- C. Role of Federal Agencies.

IV Ethical Codes

- A. Canons of Professional Ethics - 1908
- B. Code of Professional Responsibility - 1969
- C. Rules of Professional Conduct - 1983
- D. Ethics 2000 Commission on Evaluation of the Rules of Professional Conduct - February 2002

V. The Ethical Obligations of the Lawyer for an Entity

Rule 1.13 (attached)
Rule 1.16 (attached)

VI The Duty of Confidentiality

Rule 1.6 (attached)
Code of Prof. Resp. Disciplinary Rule 4-101 (attached)

VII The Savings & Loan Scandals & the RTC

ABA Model Rules of Professional Conduct
as amended February 2002

Note: New material added in February 2002 is underlined.
Material stricken in February 2002 has a line through it.

Rule 1.13

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 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 is likely to result in substantial injury to the organization, 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 the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act ~~in~~ on behalf of the organization as determined by applicable law.

(c) If, despite the lawyer's efforts in accordance with paragraph (b), the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of law and is likely to result in substantial injury to the organization, the lawyer may resign in accordance with Rule 1.16.

(d) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when ~~it is apparent~~ 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) 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

[1] An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders and other constituents. Officers, directors, employees and shareholders are the constituents of the corporate organizational client. The duties defined in this Comment apply equally to unincorporated associations. "Other constituents" as used in this Comment means the positions equivalent to officers, directors, employees and shareholders held by persons acting for organizational clients that are not corporations.

[2] When one of the constituents of an organizational client communicates with the organization's lawyer in that person's organizational capacity, the communication is protected by Rule 1.6. Thus, by way of example, if an organizational client requests its lawyer to investigate allegations of wrongdoing, interviews made in the course of that investigation between the lawyer and the client's employees or other constituents are covered by Rule 1.6. This does not mean, however, that constituents of an organizational client are the clients of the lawyer. The lawyer may not disclose to such constituents information relating to the representation except for disclosures explicitly or impliedly authorized by the organizational client in order to carry out the representation or as otherwise permitted by Rule 1.6.

[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 when the lawyer knows that the organization may be substantially injured by action of a constituent that 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.

[4] ~~In an extreme case, it may be reasonably necessary for the lawyer to refer the matter to the~~ The organization's highest authority. ~~Ordinarily, that is~~ 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] The authority and responsibility provided in ~~paragraph (b)~~ 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. If the lawyer's services are being used by an organization to further a crime or fraud by the organization, Rule 1.2(d) can be applicable.

Government Agency

[6] The duty defined in this Rule applies to governmental organizations. ~~However, when the client is a governmental organization, a different balance may be appropriate between maintaining confidentiality and assuring that the wrongful official act is prevented or rectified, for public business is involved. In addition, duties of lawyers employed by the government or lawyers in military service may be defined by statutes and regulation. Therefore, defining~~ Defining precisely the identity of the client and prescribing the resulting obligations of such lawyers may be more difficult in the government context and is a matter beyond the scope of these Rules. See Scope [18]. Although in some circumstances the client may be a specific agency, it ~~is generally~~ may also be a branch of government, such as the executive branch, or the government as a whole. For example, if the action or failure to act involves the head of a bureau, either the department of which the bureau is a part or the relevant branch of government ~~as a whole~~ may be the client for ~~purpose~~ purposes of this Rule. Moreover, in a matter involving the conduct of government officials, a government lawyer may have authority under applicable law to question such conduct more extensively than that of a lawyer for a private organization in similar circumstances. Thus, when the client is a governmental organization, a different balance may be appropriate between maintaining confidentiality and assuring that the wrongful act is prevented or rectified, for public business is involved. In addition, duties of lawyers employed by the government or lawyers in military service may be defined by statutes and regulation. This Rule does not limit that authority. See ~~note on~~ Scope.

Clarifying the Lawyer's Role

[7] There are times when the organization's interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interest the lawyer finds adverse to that of the organization of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation. Care must be taken to assure that the individual understands that, when there is such adversity of interest, the lawyer for the organization cannot provide legal representation for that constituent individual, and that discussions between the lawyer for the organization and the individual may not be privileged.

[8] Whether such a warning should be given by the lawyer for the organization to any constituent individual may turn on the facts of each case.

Dual Representation

[9] Paragraph (e) recognizes that a lawyer for an organization may also represent a principal officer or major shareholder.

Derivative Actions

[10] Under generally prevailing law, the shareholders or members of a corporation may bring suit to compel the directors to perform their legal obligations in the supervision of the organization. Members of unincorporated associations have essentially the same right. Such an action may be brought nominally by the organization, but usually is, in fact, a legal controversy over management of the organization.

[11] The question can arise whether counsel for the organization may defend such an action. The proposition that the organization is the lawyer's client does not alone resolve the issue. Most derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit. However, if the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer's duty to the organization and the lawyer's relationship with the board. In those circumstances, Rule 1.7 governs who should represent the directors and the organization.

ABA Model Rules of Professional Conduct
as amended February 2002

Note: New material added in February 2002 is underlined.
Material stricken in February 2002 has a line through it.

Rule 1.16

Rule 1.16 Declining or Terminating Representation

(a) Except as stated in paragraph (c), a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:

(1) the representation will result in violation of the rules of professional conduct or other law;

(2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client; or

(3) the lawyer is discharged.

(b) Except as stated in paragraph (c), a lawyer may withdraw from representing a client if:

(1) withdrawal can be accomplished without material adverse effect on the interests of the client~~, or if:~~;

~~(1)~~ (2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;

~~(2)~~ (3) the client has used the lawyer's services to perpetrate a crime or fraud;

~~(3)~~ (4) a the client insists upon ~~pursuing an objective~~ taking action that the lawyer considers repugnant or ~~imprudent~~ with which the lawyer has a fundamental disagreement;

~~(4)~~ (5) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;

~~(5)~~ (6) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or

~~(6)~~ (7) other good cause for withdrawal exists.

(c) A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.

(d) Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law.

COMMENT

[1] A lawyer should not accept representation in a matter unless it can be performed competently, promptly, without improper conflict of interest and to completion. Ordinarily, a representation in a matter is completed when the agreed-upon assistance has been concluded. See Rules 1.2(c) and 6.5. See also Rule 1.3, Comment [4].

Mandatory Withdrawal

[2] A lawyer ordinarily must decline or withdraw from representation if the client demands that the lawyer engage in conduct that is illegal or violates the Rules of Professional Conduct or other law. The lawyer is not obliged to decline or withdraw simply because the client suggests such a course of conduct; a client may make such a suggestion in the hope that a lawyer will not be constrained by a professional obligation.

[3] When a lawyer has been appointed to represent a client, withdrawal ordinarily requires approval of the appointing authority. See also Rule 6.2. Similarly, court approval or notice to the court is often required by applicable law before a lawyer withdraws from pending litigation. Difficulty may be encountered if withdrawal is based on the client's demand that the lawyer engage in unprofessional conduct. The court may ~~wish~~ request an explanation for the withdrawal, while the lawyer may be bound to keep confidential the facts that would constitute such an explanation. The lawyer's statement that professional considerations require termination of the representation ordinarily should be accepted as sufficient. Lawyers should be mindful of their obligations to both clients and the court under Rules 1.6 and 3.3.

Discharge

[4] A client has a right to discharge a lawyer at any time, with or without cause, subject to liability for payment for the lawyer's services. Where future dispute about the withdrawal may be anticipated, it may be advisable to prepare a written statement reciting the circumstances.

[5] Whether a client can discharge appointed counsel may depend on applicable law. A client seeking to do so should be given a full explanation of the consequences. These consequences may include a decision by the appointing authority that appointment of successor counsel is unjustified, thus requiring self-representation by the client.

[6] If the client ~~is mentally incompetent~~ has severely diminished capacity, the client may lack the legal capacity to discharge the lawyer, and in any event the discharge may be seriously adverse to the client's interests. The lawyer should make special effort to help the client consider the consequences and~~, in an extreme case,~~ may ~~initiate proceedings for a conservatorship or similar protection of the client. See~~ take reasonably necessary protective action as provided in Rule 1.14.

Optional Withdrawal

[7] A lawyer may withdraw from representation in some circumstances. The lawyer has the option to withdraw if it can be accomplished without material adverse effect on the client's interests. Withdrawal is also justified if the client persists in a course of action that the lawyer reasonably believes is criminal or fraudulent, for a lawyer is not required to be associated with such conduct even if the lawyer does not further it. Withdrawal is also permitted if the lawyer's services were misused in the past even if that would materially prejudice the client. The lawyer may also withdraw where the client insists on ~~a~~ taking action that the lawyer considers repugnant or ~~imprudent objective~~ with which the lawyer has a fundamental disagreement.

[8] A lawyer may withdraw if the client refuses to abide by the terms of an agreement relating to the representation, such as an agreement concerning fees or court costs or an agreement limiting the objectives of the representation.

Assisting the Client upon Withdrawal

[9] Even if the lawyer has been unfairly discharged by the client, a lawyer must take all reasonable steps to mitigate the consequences to the client. The lawyer may retain papers as security for a fee only to the extent permitted by law. ~~Whether or not a lawyer for an organization may under certain unusual circumstances have a legal obligation to the organization after withdrawing or being discharged by the organization's highest authority is beyond the scope of these Rules.~~ See Rule 1.15.

Rule 1.2 Scope of Representation and Allocation of Authority Between Client and Lawyer

(a) A Subject to paragraphs (c) and (d), a lawyer shall abide by a client's decisions concerning the objectives of representation, subject to paragraphs (c), (d) and (e), and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. A lawyer shall abide by a client's decision whether to accept an offer of settlement of settle a matter. In a criminal case, the lawyer shall abide by the client's decision, after consultation with the lawyer, as to a plea to be entered, whether to waive jury trial and whether the client will testify.

(b) A lawyer's representation of a client, including representation by appointment, does not constitute an endorsement of the client's political, economic, social or moral views or activities.

(c) A lawyer may limit the objectives scope of the representation if the limitation is reasonable under the circumstances and the client consents after consultation gives informed consent.

(d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

(e) When a lawyer knows that a client expects assistance not permitted by the rules of professional conduct or other law, the lawyer shall consult with the client regarding the relevant limitations on the lawyer's conduct.

COMMENT

Scope of Representation Allocation of Authority between Client and Lawyer

[1] Both lawyer and client have authority and responsibility in the objectives and means of representation. The Paragraph (a) confers upon the client has the ultimate authority to determine the purposes to be served by legal representation, within the limits imposed by law and the lawyer's professional obligations. Within those limits, a client also has a right to consult with the lawyer about the means to be used in pursuing those objectives. At the same time, a lawyer is not required to pursue objectives or employ means simply because a client may wish that the lawyer do so. A clear distinction between objectives and means sometimes cannot be drawn, and in many cases the client-lawyer relationship partakes of a joint undertaking. In questions of means the lawyer should assume responsibility for technical and legal tactical issues, but should defer to the client regarding such questions as the expense to be incurred and concern for third persons who might be adversely affected. Law defining the lawyer's scope of authority in litigation varies among jurisdictions. The decisions specified in paragraph (a), such as whether to settle a civil matter, must also be made by the client. See Rule 1.4(a)(1) for the lawyer's duty to communicate with the client about such decisions. With respect to the means by which the client's objectives are to be pursued, the lawyer shall consult with the client as required by Rule 1.4(a)(2) and may take such action as is impliedly authorized to carry out the representation.

[2] On occasion, however, a lawyer and a client may disagree about the means to be used to accomplish the client's objectives. Clients normally defer to the special knowledge and skill of their lawyer with respect to the means to be used to accomplish their objectives, particularly with respect to technical, legal and tactical matters. Conversely, lawyers usually defer to the client regarding such questions as the expense to be incurred and concern for third persons who might be adversely affected. Because of the varied nature of the matters about which a lawyer and client might disagree and because the actions in question may implicate the interests of a tribunal or other persons, this Rule does not prescribe how such disagreements are to be resolved. Other law, however, may be applicable and should be consulted by the lawyer. The lawyer should also consult with the client and seek a mutually acceptable resolution of the disagreement. If such efforts are unavailing and the lawyer has a fundamental disagreement with the client, the lawyer may withdraw from the representation. See Rule 1.16(b)(4). Conversely, the client may resolve the disagreement by discharging the lawyer. See Rule 1.16(a)(3).

[3] At the outset of a representation, the client may authorize the lawyer to take specific action on the client's behalf without further consultation. Absent a material change in circumstances and subject to Rule 1.4, a lawyer may rely on such an advance authorization. The client may, however, revoke such authority at any time.

~~[2]~~ [4] In a case in which the client appears to be suffering ~~mental disability~~ diminished capacity, the lawyer's duty to abide by the client's decisions is to be guided by reference to Rule 1.14.

Independence from Client's Views or Activities

~~[3]~~ [5] Legal representation should not be denied to people who are unable to afford legal services, or whose cause is controversial or the subject of popular disapproval. By the same token, representing a client does not constitute approval of the client's views or activities.

~~Services Limited in Objectives or Means~~ Agreements Limiting Scope of Representation

~~[4]~~ [6] The ~~objectives or~~ scope of services to be provided by a lawyer may be limited by agreement with the client or by the terms under which the lawyer's services are made available to the client. ~~For example, a retainer may be for a specifically defined purpose. Representation provided through a legal aid agency may be subject to limitations on the types of cases the agency handles.~~ When a lawyer has been retained by an insurer to represent an insured, for example, the representation may be limited to matters related to the insurance coverage. ~~The~~ A limited representation may be appropriate because the client has limited objectives for the representation. In addition, the terms upon which representation is undertaken may exclude specific ~~objectives or~~ means that might otherwise be used to accomplish the client's objectives. Such limitations may exclude ~~objectives or means~~ actions that the client thinks are too costly or that the lawyer regards as repugnant or imprudent.

[7] Although this Rule affords the lawyer and client substantial latitude to limit the representation, the limitation must be reasonable under the circumstances. If, for example, a client's objective is limited to securing general information about the law the client needs in order to handle a common and typically uncomplicated legal problem, the lawyer and client may agree that the lawyer's services will be limited to a brief telephone consultation. Such a limitation, however, would not be reasonable if the time allotted was not sufficient to yield advice upon which the client could rely. Although an agreement for a limited representation does not exempt a lawyer from the duty to provide competent representation, the limitation is a factor to be considered when determining the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation. See Rule 1.1.

~~[5]~~ [8] ~~An agreement~~ All agreements concerning ~~the scope of~~ a lawyer's representation of a client must accord with the Rules of Professional Conduct and other law. ~~Thus, the client may not be asked to agree to representation so limited in scope as to violate Rule 1.1, or to surrender the right to terminate the lawyer's services or the right to settle litigation that the lawyer might wish to continue.~~ See, e.g., Rules 1.1, 1.8 and 5.6.

Criminal, Fraudulent and Prohibited Transactions

~~[6]~~ [9] ~~A~~ Paragraph (d) prohibits a lawyer from knowingly counseling or assisting a client to commit a crime or fraud. This prohibition, however, does not preclude the lawyer ~~is required to give~~ from giving an honest opinion about the actual consequences that appear likely to result from a client's conduct. ~~The~~ Nor does the fact that a client uses advice in a course of action that is criminal or fraudulent ~~does not,~~ of itself~~,~~ make a lawyer a party to the course of action. ~~However, a lawyer may not knowingly assist a client in criminal or fraudulent conduct.~~ There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity.

~~[7]~~ [10] When the client's course of action has already begun and is continuing, the lawyer's responsibility is especially delicate. ~~The lawyer is not permitted to reveal the client's wrongdoing, except where permitted by Rule 1.6. However, the~~ The lawyer is required to avoid ~~furthering the purpose~~ assisting the client, for example, by drafting or delivering documents that the lawyer knows are fraudulent or by suggesting how ~~it~~ the wrongdoing might be concealed. A lawyer may not continue assisting a client in conduct that the lawyer originally ~~supposes is~~ supposed was legally proper but then discovers is criminal or fraudulent. ~~Withdrawal~~ The lawyer must, therefore, withdraw from the representation~~, there-~~

~~fore, may be required~~ of the client in the matter. See Rule 1.16(a). In some cases, withdrawal alone might be insufficient. It may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm any opinion, document, affirmation or the like. See Rule 4.1.

~~[8]~~ [11] Where the client is a fiduciary, the lawyer may be charged with special obligations in dealings with a beneficiary.

~~[9]~~ [12] Paragraph (d) applies whether or not the defrauded party is a party to the transaction. Hence, a lawyer ~~should~~ must not participate in a ~~sham~~ transaction~~; for example, a transaction~~ to effectuate criminal or fraudulent ~~escape~~ avoidance of tax liability. Paragraph (d) does not preclude undertaking a criminal defense incident to a general retainer for legal services to a lawful enterprise. The last clause of paragraph (d) recognizes that determining the validity or interpretation of a statute or regulation may require a course of action involving disobedience of the statute or regulation or of the interpretation placed upon it by governmental authorities.

[13] If a lawyer comes to know or reasonably should know that a client expects assistance not permitted by the Rules of Professional Conduct or other law or if the lawyer intends to act contrary to the client's instructions, the lawyer must consult with the client regarding the limitations on the lawyer's conduct. See Rule 1.4(a)(5).

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as amended February 2002

Note: New material added in February 2002 is underlined.
Material stricken in February 2002 has a line through it.

Rule 1.6

RULE 1.6 Confidentiality of Information*

(a) A lawyer shall not reveal information relating to the representation of a client unless the client ~~consents after consultation, except for disclosures that are~~ gives informed consent, the disclosure is impliedly authorized in order to carry out the representation, ~~and except as stated in~~ or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal ~~such~~ information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

* The Ethics 2000 Commission's Report recommended amending Rule 1.6 to include the following exceptions to subsection (b) of the confidentiality rule:

(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;

The ABA House of Delegates rejected (b)(2) and the Ethics 2000 Commission withdrew (b)(3) from consideration.

(1) to prevent ~~the client from committing a criminal act that the lawyer believes is likely to result in imminent~~ reasonably certain death or substantial bodily harm; ~~or~~

(2) to secure legal advice about the lawyer's compliance with these Rules;

~~(2)~~ (3) 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

(4) to comply with other law or a court order.

COMMENT

~~[1] The lawyer is part of a judicial system charged with upholding the law. One of the lawyer's functions is to advise clients so that they avoid any violation of the law in the proper exercise of their rights.~~

~~[2] The observance of the ethical obligation of a lawyer to hold inviolate confidential information of the client not only facilitates the full development of facts essential to proper representation of the client but also encourages people to seek early legal assistance.~~

~~[3] Almost without exception, clients come to lawyers in order to determine what their rights are and what is, in the maze of laws and regulations, deemed to be legal and correct. The common law recognizes that the client's confidences must be protected from disclosure. Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld.~~

[1] This Rule governs the disclosure by a lawyer of information relating to the representation of a client during the lawyer's representation of the client. See Rule 1.18 for the lawyer's duties with respect to information provided to the lawyer by a prospective client, Rule 1.9(c)(2) for the lawyer's duty not to reveal information relating to the lawyer's prior representation of a former client and Rules 1.8(b) and 1.9(c)(1) for the lawyer's duties with respect to the use of such information to the disadvantage of clients and former clients.

~~[4]~~ [2] A fundamental principle in the client-lawyer relationship is that, in the absence of the client's informed consent, the lawyer ~~maintain confidentiality of~~ must not reveal information relating to the representation. See Rule 1.0(e) for the definition of informed consent. This contributes to the trust that is the hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. The lawyer needs this information to represent the client effectively and, if necessary, to advise the client to refrain from wrongful conduct. Almost without exception, clients come to lawyers in order to determine their rights and what is, in the complex of laws and regulations, deemed to be legal and correct. Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld.

~~[5]~~ [3] The principle of client-lawyer confidentiality is given effect ~~in two~~ by related bodies of law~~,~~: the attorney-client privilege, ~~(which includes~~ the work product doctrine~~) in the law of evidence~~ and the rule of confidentiality established in professional ethics. The attorney-client privilege ~~applies~~ and work-product doctrine apply in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to produce evidence concerning a client. The rule of client-lawyer confidentiality applies in situations other than those where evidence is sought from the lawyer through compulsion of law. The confidentiality rule, for example, applies not ~~merely~~ only to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source. A lawyer may not disclose such information except as authorized or required by the Rules of Professional Conduct or other law. See also Scope.

~~[6] The requirement of maintaining confidentiality of information relating to representation applies to government lawyers who may disagree with the policy goals that their representation is designed to advance.~~

[4] Paragraph (a) prohibits a lawyer from revealing information relating to the representation of a client. This prohibition also applies to disclosures by a lawyer that do not in themselves reveal protected information but could reasonably lead to the discovery of such information by a third person. A lawyer's use of a hypothetical to discuss issues relating to the representation is permissible so long as there is no reasonable likelihood that the listener will be able to ascertain the identity of the client or the situation involved.

Authorized Disclosure

~~[7]~~ [5] ~~A~~ Except to the extent that the client's instructions or special circumstances limit that authority, a lawyer is impliedly authorized to make disclosures about a client when appropriate in carrying out the representation~~, except to the extent that the client's instructions or special circumstances limit that authority~~. In ~~litigation~~ some situations, for example, a lawyer may ~~disclose information by admitting~~ be impliedly authorized to admit a fact that cannot properly be disputed or~~, in negotiation by making~~ to make a disclosure that facilitates a satisfactory conclusion to a matter. ~~[8]~~ Lawyers in a firm may, in the course of the firm's practice, disclose to each other information relating to a client of the firm, unless the client has instructed that particular information be confined to specified lawyers.

Disclosure Adverse to Client

~~[9]~~ [6] ~~The~~ Although the public interest is usually best served by a strict rule requiring lawyers to preserve the confidentiality of information relating to the representation of their clients, the confidentiality rule is subject to limited exceptions. ~~In becoming privy to information about a client, a lawyer may foresee that the client intends serious harm to another person. However, to the extent a lawyer is required or permitted to disclose a client's purposes, the client will be inhibited from revealing facts which would enable the lawyer to counsel against a wrongful course of action. The public is better protected if full and open communication by the client is encouraged than if it is inhibited.~~ Paragraph (b)(1) recognizes the overriding value of life and physical integrity and permits disclosure reasonably necessary to prevent reasonably certain death or substantial bodily harm. Such harm is reasonably certain to occur if it will be suffered imminently or if there is a present and substantial threat that a person will suffer such harm at a later date if the lawyer fails to take action necessary to eliminate the threat. Thus, a lawyer who knows that a client has accidentally discharged toxic waste into a town's water supply may reveal this information to the authorities if there is a present and substantial risk that a person who drinks the water will contract a life-threatening or debilitating disease and the lawyer's disclosure is necessary to eliminate the threat or reduce the number of victims.

~~[10] Several situations must be distinguished.~~

~~[11] First, the lawyer may not counsel or assist a client in conduct that is criminal or fraudulent. See Rule 1.2(d). Similarly, a lawyer has a duty under Rule 3.3(a)(4) not to use false evidence. This duty is essentially a special instance of the duty prescribed in Rule 1.2(d) to avoid assisting a client in criminal or fraudulent conduct.~~

~~[12] Second, the lawyer may have been innocently involved in past conduct by the client that was criminal or fraudulent. In such a situation the lawyer has not violated Rule 1.2(d), because to "counsel or assist" criminal or fraudulent conduct requires knowing that the conduct is of that character.~~

~~[13] Third, the lawyer may learn that a client intends prospective conduct that is criminal and likely to result in imminent death or substantial bodily harm. As stated in paragraph (b)(1), the lawyer has professional discretion to reveal information in order to prevent such consequences. The lawyer may make a disclosure in order to prevent homicide or serious bodily injury which the lawyer reasonably believes is intended by a client. It is very difficult for a lawyer to "know" when such a heinous purpose will actually be carried out, for the client may have a change of mind.~~

~~[14] The lawyer's exercise of discretion requires consideration of such factors as the nature of the lawyer's relationship with the client and with those who might be injured by the client, the lawyer's own involvement in the transaction and factors that may extenuate the conduct in question. Where practical, the lawyer should seek to persuade the client to take suitable action. In any case, a disclosure adverse to the client's interest should be no greater than the lawyer reasonably believes necessary to the purpose. A lawyer's decision not to take preventive action permitted by paragraph (b)(1) does not violate this Rule.~~

[7] A lawyer's confidentiality obligations do not preclude a lawyer from securing confidential legal advice about the lawyer's personal responsibility to comply with these Rules. In most situations, disclosing information to secure such advice will be impliedly authorized for the lawyer to carry out the representation. Even when the disclosure is not impliedly authorized, paragraph (b)(2) permits such disclosure because of the importance of a lawyer's compliance with the Rules of Professional Conduct.

~~Dispute Concerning a Lawyer's Conduct~~

~~[18]~~ [8] Where a legal claim or disciplinary charge alleges complicity of the lawyer in a client's conduct or other misconduct of the lawyer involving representation of the client, the lawyer may respond to the extent the lawyer reasonably believes necessary to establish a defense. The same is true with respect to a claim involving the conduct or representation of a former client. Such a charge can arise in a civil, criminal, disciplinary or other proceeding and can be based on a wrong allegedly committed by the lawyer against the client or on a wrong alleged by a third person, for example, a person claiming to have been defrauded by the lawyer and client acting together. The lawyer's right to respond arises when an assertion of such complicity has been made. Paragraph (b)~~(2)~~(3) does not require the lawyer to await the commencement of an action or proceeding that charges such complicity, so that the defense may be established by responding directly to a third party who has made such an assertion. The right to defend also applies, of course, ~~applies~~ where a proceeding has been commenced. ~~Where practicable and not prejudicial to the lawyer's ability to establish the defense, the lawyer should advise the client of the third party's assertion and request that the client respond appropriately. In any event, disclosure should be no greater than the lawyer reasonably believes is necessary to vindicate innocence, the disclosure should be made in a manner which limits access to the information to the tribunal or other persons having a need to know it, and appropriate protective orders or other arrangements should be sought by the lawyer to the fullest extent practicable.~~

~~[19]~~ [9] ~~If the lawyer is charged with wrongdoing in which the client's conduct is implicated, the rule of confidentiality should not prevent the lawyer from defending against the charge. Such a charge can arise in a civil, criminal or professional disciplinary proceeding, and can be based on a wrong allegedly committed by the lawyer against the client, or on a wrong alleged by a third person; for example, a person claiming to have been defrauded by the lawyer and client acting together.~~ A lawyer entitled to a fee is permitted by paragraph (b)~~(2)~~(3) to prove the services rendered in an action to collect it. This aspect of the rule expresses the principle that the beneficiary of a fiduciary relationship may not exploit it to the detriment of the fiduciary. ~~As stated above, the~~

~~lawyer must make every effort practicable to avoid unnecessary disclosure of information relating to a representation, to limit disclosure to those having the need to know it, and to obtain protective orders or make other arrangements minimizing the risk of disclosure.~~

[10] Other law may require that a lawyer disclose information about a client. Whether such a law supersedes Rule 1.6 is a question of law beyond the scope of these Rules. When disclosure of information relating to the representation appears to be required by other law, the lawyer must discuss the matter with the client to the extent required by Rule 1.4. If, however, the other law supersedes this Rule and requires disclosure, paragraph (b)(4) permits the lawyer to make such disclosures as are necessary to comply with the law.

[11] A lawyer may be ordered to reveal information relating to the representation of a client by a court or by another tribunal or governmental entity claiming authority pursuant to other law to compel the disclosure. Absent informed consent of the client to do otherwise, the lawyer should assert on behalf of the client all nonfrivolous claims that the order is not authorized by other law or that the information sought is protected against disclosure by the attorney-client privilege or other applicable law. In the event of an adverse ruling, the lawyer must consult with the client about the possibility of appeal to the extent required by Rule 1.4. Unless review is sought, however, paragraph (b)(4) permits the lawyer to comply with the court's order.

[12] Paragraph (b) permits disclosure only to the extent the lawyer reasonably believes the disclosure is necessary to accomplish one of the purposes specified. Where practicable, the lawyer should first seek to persuade the client to take suitable action to obviate the need for disclosure. In any case, a disclosure adverse to the client's interest should be no greater than the lawyer reasonably believes necessary to accomplish the purpose. If the disclosure will be made in connection with a judicial proceeding, the disclosure should be made in a manner that limits access to the information to the tribunal or other persons having a need to know it and appropriate protective orders or other arrangements should be sought by the lawyer to the fullest extent practicable.

[13] Paragraph (b) permits but does not require the disclosure of information relating to a client's representation to accomplish the purposes specified in paragraphs (b)(1) through (b)(4). In exercising the discretion conferred by this Rule, the lawyer may consider such factors as the nature of the lawyer's relationship with the client and with those who might be injured by the client, the lawyer's own involvement in the transaction and factors that may extenuate the conduct in question. A lawyer's decision not to disclose as permitted by paragraph (b) does not violate this Rule. Disclosure may be required, however, by other Rules. Some Rules require disclosure only if such disclosure would be permitted by paragraph (b). See Rules 1.2(d), 4.1(b), 8.1 and 8.3. Rule 3.3, on the other hand, requires disclosure in some circumstances regardless of whether such disclosure is permitted by this Rule. See Rule 3.3(c).

Withdrawal

~~[15]~~ [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). ~~[16]~~ After withdrawal the lawyer is required to refrain from making disclosure of the client's confidences, except as otherwise permitted in 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. ~~[17]~~ 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).

~~**Disclosures Otherwise Required or Authorized**~~

~~[20] The attorney-client privilege is differently defined in various jurisdictions. If a lawyer is called as a witness to give testimony concerning a client, absent waiver by the client, paragraph (a) requires the lawyer to invoke the privilege when it is applicable. The lawyer must comply with the final orders of a court or other tribunal of competent jurisdiction requiring the lawyer to give information about the client.~~

~~[21] The Rules of Professional Conduct in various circumstances permit or require a lawyer to disclose information relating to the representation. See Rules 2.2, 2.3, 3.3 and 4.1. In addition to these provisions, a lawyer may be obligated or permitted by other provisions of law to give information about a client. Whether another provision of law supercedes Rule 1.6 is a matter of interpretation beyond the scope of these Rules, but a presumption should exist against such a supersession.~~

Acting Competently to Preserve Confidentiality

[15] A lawyer must act competently to safeguard information relating to the representation of a client against inadvertent or unauthorized disclosure by the lawyer or other persons who are participating in the representation of the client or who are subject to the lawyer's supervision. See Rules 1.1, 5.1 and 5.3.

[16] When transmitting a communication that includes information relating to the representation of a client, the lawyer must take reasonable precautions to prevent the information from coming into the hands of unintended recipients. This duty, however, does not require that the lawyer use special security measures if the method of communication affords a reasonable expectation of privacy. Special circumstances, however, may warrant special precautions. Factors to be considered in determining the reasonableness of the lawyer's expectation of confidentiality include the sensitivity of the information and the extent to which the privacy of the communication is protected by law or by a confidentiality agreement. A client may require the lawyer to implement special security measures not required by this Rule or may give informed consent to the use of a means of communication that would otherwise be prohibited by this Rule.

Former Client

~~[22]~~ [17] The duty of confidentiality continues after the client-lawyer relationship has terminated. See Rule 1.9(c)(2). See Rule 1.9(c)(1) for the prohibition against using such information to the disadvantage of the former client.

DISCIPLINARY RULES

DR 4–101 Preservation of Confidences and Secrets of a Client.[10]

(A) "Confidence" refers to information protected by the attorney-client privilege under applicable law, and "secret" refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

(B) Except when permitted under DR 4–101(C), a lawyer shall not knowingly:

(1) Reveal a confidence or secret of his client.[11]

(2) Use a confidence or secret of his client to the disadvantage of the client.

(3) Use a confidence or secret of his client for the advantage of himself[12] or of a third person,[13] unless the client consents after full disclosure.

(C) A lawyer may reveal:

(1) Confidences or secrets with the consent of the client or clients affected, but only after a full disclosure to them.[14]

(2) Confidences or secrets when permitted under Disciplin%-ary Rules or required by law or court order.[15]

(3) The intention of his client to commit a crime[16] and the information necessary to prevent the crime.[17]

(4) Confidences or secrets necessary to establish or collect his fee[18] or to defend himself or his employees or associates against an accusation of wrongful conduct.[19]

(D) A lawyer shall exercise reasonable care to prevent his employees, associates, and others whose services are utilized by him from disclosing or using confidences or secrets of a client, except that a lawyer may reveal the information allowed by DR 4–101(C) through an employee.

Mr. STEARNS. And I thank you.

Professor Lidsky, welcome.

STATEMENT OF LYRISSA C. BARNETT LIDSKY, PROFESSOR OF LAW, LEVIN COLLEGE OF LAW, UNIVERSITY OF FLORIDA

Ms. LIDSKY. I thank you. It was nice to be invited to speak on this important topic, and I am glad that the committee has chosen to address truth-telling in the business world. I have gotten where I dread reading the papers, like most of the public, because I am worried that I will read about a web of lies that has taken down a corporation and taken its investors with it. But when I read the papers as a legal ethics professor, my question is, where were the lawyers? Now, I am not the first person to ask that question. A judge asked it about the lawyers in the S&L scandals. And so my second question is, what didn't we learn in the 1980's during the S&L crisis about how to prevent these kinds of things from happening?

Looking at the legal ethics rules, believe it or not, the legal ethics rules clearly state that lawyers may not tell outright lies, and the legal ethics rules also clearly state that a lawyer cannot remain silent and assist a client to lie to a court. But when it comes to transactional lawyers, the law is less clear about what a lawyer's duties are when a client is trying to perpetrate a lie on the public.

The problem with the recent cases is that they appear to involve a lot more than lawyers simply remaining silent and adhering to their duty of keeping a client's confidences. They actually seem to involve lawyer enablement or lawyers as enablers of client lies, and that is important because lawyers serve as gatekeepers for clients like Enron. If lawyers didn't assist Enron, it never could have gained access to the capital markets, securities markets, and so lawyer assistance was absolutely vital for it to do what it did.

Now, let me enter a disclaimer here. I am not claiming to know any more than the general public about the specific law firm's actions in Enron. In fact, Vincent and Elkins probably employs many of my former law school classmates. I am from Texas, and it is a big Texas firm. But nonetheless, it seems that there was lawyer enablement in the sense that lawyers were doing things like drafting press releases, structuring transactions that didn't have any substance behind them, drafting opinion letters, and so they were lending their expertise and credibility to a corporation that couldn't have done what it did without their assistance. Also, the assistance of the accountants and the bankers was crucial.

So the question is what should they have done to avoid enabling this kind of fraud by the client? The question for us today might be who is going to fix the problem? And I have to say that I don't have faith in the bar to fix the problem of its own. The bar is largely self-regulating, and the bar has shown a failure of will when it comes to resolving the conflict between the duty of confidentiality and the duty not to assist a client in fraud.

The bar recently had an opportunity to draft clear rules that told lawyers what they have to do to avoid enabling client fraud, and they just didn't do it. So I think it is going to require the government to take action. I think the SEC has to be involved with more civil enforcement actions against law firms that draft documents

they know to be false and enable the client to lie to the public. I think the SEC—it is useful if the SEC promulgates rules that clearly state the lawyer's disclosure obligations when a client is trying to lie to the public. That was what was done partly in the wake of the S&L scandal, and it has been somewhat successful for those lawyers that are involved in banking.

But I don't think that is enough. SEC simply doesn't have the resources to deal with a problem of this magnitude. And I don't think it is a problem restricted to a few bad apples. I think there is a systemic cultural problem where people just don't want to take responsibility for calling a halt to actions of a client that are improper. So I think the solution has to come from private litigation, unfortunately. And I say unfortunately, because private litigation has costs. Once you enable more lawsuits to be brought against law firms, it means that there are going to be a number of frivolous suits brought, too. But nonetheless, the prospect of having to be held accountable in dollars to investors who were harmed by a client's lies will make law firms sit up and take notice.

Attorneys who prosecute these type of actions have the resources to pursue them. They have the sophistication to deal with cases that involve complexity of the type that Enron, WorldCom, all of those cases present. And unfortunately, it is one of the few solutions to curbing this kind of lawyer enablement that we have been seeing. The criminal penalties don't hurt either, but they can only deal with the most extreme cases.

It was said earlier that you can't legislate morality. I agree, you can't legislate morality, but what you can do is create laws that support people who exercise moral courage, people like Sherron Watkins, and you can create cultures that support people who exercise moral courage, and that starts in law school. It starts with telling lawyers that there are things—young lawyers, they are not lawyers yet—that there are things more important than their law degree, things more important than their law license that they have to adhere to.

Mr. STEARNS. I thank you.

And, of course, I want to just recognize you come from the University of Florida. I had the opportunity to represent the university for 4 years, and now that is in a new congressional district where I am running, so I certainly want to commend you and that wonderful university.

I will start with my questions. I had the opportunity to participate in the oversight hearings on Enron in which we dealt with Vincent and Elkins, which was a law firm for Enron. And, Professor Lidsky, when you talk about lawyer enabling, when Sherron Watkins came to the CEO and said, there is a problem, he gave it to the law firm. Now, you would think at that point that law firm would recognize immediately, like we did on the committee, every Democrat, Republican recognized immediately, that she was, one, a whistle-blower, and, two, that this company is going to implode. Yet Vincent and Elkins put together a memo which created a camouflage, a smokescreen to the whole thing and allowed people to say there is not a big problem.

You are telling me right now the bar is not stepping forward to put in a code of ethics preventing enabling lawyers to help their

clients because they have fiduciary responsibility and confidentiality. But don't they have an ethical responsibility to say, no, we can't go forward? Sherron Watkins is telling the truth. There is no use camouflaging it. So what can the United States do with this lack of ethics, with lawyers enabling clients to participate in a cover-up or a smokescreen like we saw in the Enron situation?

Ms. LIDSKY. I think the only thing you can do is make it clear that they are going to be held accountable for that later. In the situation you described, what a law firm might tend to do when it is a huge client for the firm is they don't want to be complicit in the client's fraud, but one of the ways they try to assuage their own fears of being complicit in the client's fraud is by kind of avoiding knowing too much. And so you can comfort yourself by saying, I didn't tell an outright lie. I didn't know anything that would have made me change my opinion, because you put blinders on so you couldn't see what you know was going on around you.

And so I think that is kind of a tendency that a law firm might have in a situation like that, is to try to block off so you don't find out anything that would trigger a duty to have to put a halt to it if you were the whistle-blower yourself.

Mr. STEARNS. Professor Cohn, Professor Lidsky has alluded to the fact that we have to hold the lawyers personally responsible in terms of money. I think you had indicated that the way to solve this problem is to say a lawyer or a law firm that is involved with enabling, and is found guilty, has a monetary penalty on them, possibly jail.

I mean, the bar is not doing it; should Congress? I mean, how should we do something like she is talking about? And do you agree or disagree?

Mr. COHN. No. I agree that for those bad apples—and let us hope that the whole bushel isn't bad, either for the CEOs or the lawyers or the accountants; that there are a lot of good people out there. But for those who are tempted by greed—and that is what it is, even for the professionals, because the professionals see that fee coming in and want to keep it coming in.

Mr. STEARNS. Wants it to get larger.

Mr. COHN. And wants it to get larger, and wants to keep that client. So that there has to be a real sanction—and a real sanction.

Mr. STEARNS. Coming from the government and the Security Exchange Commission?

Mr. COHN. It can come from there. But we know through history that—and this Congress has recognized it for almost 100 years now—that government interest in an area goes up and down, sometimes depending on politics, sometimes depending on other demands. And there are never enough resources. And therefore we, this Congress, in the Clayton Act established the whole concept of the private attorney general to help enforce government policy that the Congress sets.

Mr. STEARNS. Okay. So are you saying that Congress should legislate something or the SEC should institute brand-new laws that make lawyers monetarily responsible in the event of enabling?

Mr. COHN. I think that the SEC probably has enough laws now. They need to enforce them.

Mr. STEARNS. So, is that your opinion, too?

Ms. LIDSKY. I think they have enough laws to enforce in terms of making lawyers pay. I think there should be more clear disclosure rules.

Mr. STEARNS. Okay. Dr. Smith, my questions are almost over. I have attacked this questioning from the lawyer side, but let me go from the accountant side. We also saw Arthur Anderson dealing with Enron—that Arthur Anderson was involved because they wanted more business. Is this same kind of problem that we saw in the attorney/client also true in the client and the accountant?

Mr. SMITH. Absolutely. I think when Professor Lidsky was talking about the challenge of practicing as a lawyer and facing a situation where you need to maintain your confidentiality with your client, but you are also trying to be sure you do the right thing, I mean, that is an issue that the accounting profession has to deal with.

I guess the question that came to my mind when Professor Lidsky was talking was it seems like when the accountants fail in their role, that they are being held accountable and they are being sued. And, obviously, that is one of the problems—well, one of the things that led to the demise of Arthur Anderson. Frankly, I was wondering, well, doesn't the same thing happen to law firms when they have a really difficult situation like the one with Enron?

Mr. COHN. The answer is yes. Yes, it is the same. And Vinson & Elkins, Kirkland & Ellis, and other law firms are being sued out of the Enron matter now.

Mr. STEARNS. Okay. My time has expired. We will go—we have a vote, but we are going to go to the ranking member for his questions.

Mr. TOWNS. Thank you very much, Mr. Chairman.

Of course, even though we may not be able to legislate morality, there is a role for government to establish legal boundaries for what is acceptable behavior in business and elsewhere. Would you all agree with that statement?

Mr. COHN. Absolutely.

Mr. SMITH. Absolutely.

Ms. LIDSKY. [Nodding in the affirmative.]

Mr. TOWNS. Yesterday both the House and the Senate passed the accounting standards bill and have now sent it to the President for signature. And let me ask you, Professor Cohn, Professor Lidsky, and, of course, Dr. Smith, whether you are familiar with the legislation and whether you think it sets out the appropriate boundaries for behavior in the business world.

Mr. COHN. I think it makes a good start. It is good increment—as Professor Coffee at Columbia said, and as is reported in the paper, it is a good incremental move. I don't think it goes far enough, but it is an important start.

Mr. TOWNS. When you say—could you sort of expound on that, far enough, some of the things you think that should be in it?

Mr. COHN. Well, I would certainly go back and reexamine that 1995 Private Securities Act, because, if you take a look there, it withdrew some very important threats against exactly what happened. What we did learn out of the savings and loan scandals is that you could go after law firms, and there were many law firms who paid tens of millions of dollars out of Lincoln Savings & Loan

and other scandals like that. And we also know there were a lot of private suits that were able to help the SEC or the OTC there in its work. And yet, in 1995, this Congress decided to pull that back and take that private attorney general concept and reduce it in the securities area, not in the antitrust area where it started, but the securities area, even though the SEC in the Borack case told the Supreme Court, we need this because we don't have enough resources to do the job.

So I suggest there is a contradiction there that this committee might address.

Mr. TOWNS. Next.

Mr. SMITH. Well, the day I arrived, yesterday, of course the stock market had a great day, and I think the general public clearly reacted very favorably to the fact that Congress was taking action. And people need reassurance. And I think, as you were saying, Mr. Towns, the point that government may not be able to legislate individual morality, but clearly it sets moral direction by the laws that are passed, and government is necessary to punish misbehavior.

But I guess I would like to go back and say that I just wanted to agree with something that Mr. Cathy said earlier. I think one of the tragedies in our country is that while people here today have had the freedom and felt very comfortable sharing their faith perspectives and showing appreciation to Mr. Cathy's example—which I totally agree with—you know, I think it is a shame that there is an educational system in America where many educators feel that they are unable to share their faith and feel that they are unable to have a Bible in the school. And I think without those foundational principles laid down early in children's lives, that you wind up—and the incredible pressure to make money and to, you know, be as successful as possible without regard to their character is a huge problem. And I think that would be something that will be great for this committee to address, along with the problems in law and business and accounting.

Mr. TOWNS. Thank you very much. Do you have something very quickly to add to this?

Ms. LIDSKY. Yes. I would say that there is the possibility of lawsuits against law firms, as Vinson & Elkins is finding out. But the 1995 act took away the biggest hammer, which was aiding and abetting liability for 10(b)(5) violations. And so I think that that needs to be rectified.

Mr. TOWNS. Thank you.

Mr. Chairman, I would like to enter into the record the accounting bill H.R. 3763, the Sarbanes bill: "not later than 180 days after the date of enactment of this Act, the Commission shall issue rules—".

Mr. STEARNS. So ordered.

[The information referred to follows:]

15 **SEC. 307. RULES OF PROFESSIONAL RESPONSIBILITY**
16 **FOR ATTORNEYS.**

17 Not later than 180 days after the date of enactment of
18 this Act, the Commission shall issue rules, in the public interest
19 and for the protection of investors, setting forth minimum
20 standards of professional conduct for attorneys appearing and
21 practicing before the Commission in any way in the representa-
22 tion of issuers, including a rule—

23 (1) requiring an attorney to report evidence of a mate-
24 rial violation of securities law or breach of fiduciary duty
25 or similar violation by the company or any agent thereof,
26 to the chief legal counsel or the chief executive officer of
27 the company (or the equivalent thereof); and

28 (2) if the counsel or officer does not appropriately re-
29 spond to the evidence (adopting, as necessary, appropriate
30 remedial measures or sanctions with respect to the viola-
1 tion), requiring the attorney to report the evidence to the
2 audit committee of the board of directors of the issuer or
3 to another committee of the board of directors comprised
4 solely of directors not employed directly or indirectly by the
5 issuer, or to the board of directors.

Mr. TOWNS. And the last thing I want to say before I yield back, Mr. Chairman, litigation is fine, you know. But, you know, it still doesn't get to the problem that I really—and the way I think we need to get there, and that is that the little people who have lost money, even though we litigate, it doesn't solve that problem. They are still out of their money. And I don't know what we do to be able to address that issue.

And do you have any comments on it? Because we have some folks that have lost everything. They are at the age to retire and they have absolutely nothing. I mean—and that to me is a very disturbing thing, and I don't know how we get there. Do you have any comments on that?

Mr. COHN. Well, that is the hard one. And it goes back decades and centuries where this has been going on, where greed will end up robbing the little people. I have seen my own retirement fund go down in the past year.

I suppose there is the possibility, though I am not sure that I favor it, of in effect a securities fund. I pay to the State of Mary-

land every year money into what is called the Attorneys Securities Fund. So for attorneys who steal from clients, there is some money to help them. That concept might somehow come into this with some kind of an insurance, a premium paid on every stock transaction. It is a possibility.

I haven't thought it through well enough to say I am even in favor of it, but there are certainly examples, as we did in the banking business. We did that, and the banks are insured up to—each one of us, up to $100,000 per account. And that is because of a premium that the banks pay into the FDIC, and that might very well be a precedent to take a look at.

Mr. TOWNS. Thank you.

I yield back, Mr. Chairman.

Mr. STEARNS. Thank you, my colleague. And again, we ask your patience and indulgence. The subcommittee is going to take a recess to go vote, and we will be right back.

[Brief recess.]

Mr. STEARNS. The subcommittee will reconvene. The gentleman, Mr. Deal, from Georgia is recognized.

Mr. DEAL. Thank you, Mr. Chairman.

Mr. Cathy, we are not going to ignore you. I am going to get back with you with some questions in just a minute, if I have the time, but I want to pursue an issue that Professor Cohn has raised, and also Professor Lidsky. And that relates to the 1995 securities reform legislation. As I am sure both of you recall, that was legislation that was bipartisanly supported, and in fact required—and, I believe, was the only instance in which we overrode the veto of President Clinton on that issue.

And what led to that legislation was the extreme abuse that had occurred by the plaintiffs trial bar with regard to what many of us would perceive to be frivolous litigation and, in fact, lawsuits being filed not for the purpose of trying to convince a jury, but simply to try to leverage, and in many instances to the extent to almost extort settlements from corporations, of what probably would have ultimately proven to be frivolous lawsuits. But obviously, because of the costs that were associated with it, plaintiff's counsel knew that it was going to probably settle because it was going to be cheaper to do so.

That was the abuse that the reform of 1995 was aimed at. It was a legitimate concern, one that I think is still—would have been a legitimate concern had we not taken corrective action.

With regard to the ruling about aiding and abetting, it is my understanding that the Supreme Court had ruled in the Central Bank case that the statute did not confer the control over aiding and abetting. And we simply did not, I suppose, incorporate that and extend that in the authority granted to the SEC. Perhaps that is something we might look at, but I don't think it is fair to say that we took it out of the 1995 act. We did not. I don't think it was ever there by virtue of the interpretation of the Supreme Court.

But let me ask you a related question, because I think this is one that as a member of the bar, and as one who at age 23 was very excited when I was admitted to the bar, and I think during my legal education was impressed with the fact that it was an ethical

profession and one that the bar itself would hold you to a standard by virtue of the licensing process, whether anyone else did or not.

As one who has been chairman of the judiciary committee at my State level for a number of years before coming to Congress, I was always concerned that we were granted a peculiar situation by virtue of my State law and, I am sure, in some other States. And that is, all other licensed professions were regulated through our Secretary of State's office, with someone assigned to monitor and control that activity. But the bar was unique in that it was an integrated bar, and that by law was assigned to the bar itself to do that.

And I think overall the bar has done a fairly good job of disciplining and disbarring its members, but invariably—one of the cases that I am familiar with—it has always been the situation where the lawyer was in effect defrauding or mistreating his client. It was rarely anything in a third-party atmosphere where the lawyer and his client were mistreating a third party.

Would either of you care to comment about whether or not disbarment for that kind of collusive activity is being dealt with by the bar through the disbarment process?

Ms. LIDSKY. Well, first I wanted to say that the lawyer self-regulation process does work very well for some things. Lawyers are held to ethical standards by the bar that are very high in some instances. So my condemnation of the bar's failure in this area shouldn't be taken as a global condemnation of the bar, because I do think they set high standards for lawyers in many instances.

And indeed, 41 States have said that—at least that lawyers may reveal fraud in some instances. But the problem is partly the complexity of the kind of transactions that we are taking about here—rarely are they going to go in after a transactional lawyer as opposed to a lawyer in litigation. So it is harder to find out about the fraud in the first place, ordinarily. Rarely will they go after a transactional lawyer who was in what is perceived to be a complicated situation in a lot of these circumstances.

I can't answer your question specifically; you know, name how many cases that the bar has pursued, but it is not their primary focus. I can say that with confidence.

Mr. COHN. You are absolutely right. There are very few situations in which the bar—and we are speaking of the bar here, we are speaking about something that is under the control of the Supreme Court of each State. So, it is not entirely separated from a public body. But it is very seldom that a non-client will be able to have charges brought against a lawyer, either civilly or in the disciplinary situation. There are some, but not very many.

In the area of fraud, it is interesting to me that until 1983, the ethical rules said that a lawyer could disclose any crime, and that included when fraud was criminal, a criminal fraud. That was taken out of the rules by the ABA in 1983 at the hue and cry of the corporate bar because of their dealing with their clients.

In the proposals that are now the Rules of Professional Conduct, the proposals of the Kutak Commission back there, there was an explicit provision about disclosure of fraud, fraud that would hurt the public. But at the house of delegates, that was shouted out mainly by the corporate bar.

Now, curiously too, to me, when that went out to the States, it was only a minority of States that followed what the ABA proposed. Most States at least permit the public disclosure of upcoming fraud—not past fraud, but upcoming fraud. And some States such as New Jersey require it. They make it mandatory.

The SEC has on occasion enforced this type of requirement on lawyers for public corporations on the theory that this feeds into the reports that get filed to the SEC. That needs more of that by either SEC having the resources to do it or expanding the possibility of private litigation.

I am aware that the 1995 act was meant to eliminate or at least deal with a very real problem of frivolous suits, which is real. It is still real. That is not going to go away so easily, either. But my personal view is that it also established an atmosphere by which anything seems to go. And so the act was—is a very important benchmark as to the atmosphere that Congress has conveyed to the public and the corporate public.

Mr. DEAL. Mr. Chairman, would you indulge, and I would just make a very brief concluding statement. I think this has been very revealing and I think a good discussion. I would hope that Congress has corrected any misinformation or misinterpretation that was sent anywhere by virtue of our actions this week. And I think in fact we have done exactly that.

I would simply say with regard to professional status of the bar in terms of self-regulation and licensing and the deferment that has being given by the States to them, that I would hope the ABA will go back and reexamine that disclosure rule, and I would also hope that we would see the bars of the States taking their own initiative, maybe even in the absence of an outside complaint, when by virtue of disclosure of information it becomes very obvious that something ethically was wrong. I think if the bar doesn't begin to do that on its own initiative, instead of waiting for the complaint process, then I think, very well, it is going to lose its peculiar ability to regulate itself that has been given to it.

But thank you very much. Thank you, Mr. Chairman.

Mr. STEARNS. Thank the gentleman.

The gentleman from Nebraska.

Mr. TERRY. Thank you, Mr. Chairman. And as a member of the bar from Nebraska, it has been an interesting discussion. And I agree with Mr. Deal; unless the bar associations are willing to do this sua sponte, without complaint, I am not sure how we can ever go after the lawyers who do this, because they are incognito; we don't know who they are as a shareholder. We can't file a specific complaint as required by most bar associations across the State. You just can't say, "I think a lawyer has been bad" to initiate an investigation into whether there has been an ethics violation.

So it has been an interesting violation, but I want to raise it from the lawyer level to the CEO level within the corporation, and ask in a philosophical question here—well, not so philosophical. But we are now mandating, and soon financial disclosure reports have to be filed with the signature of the CEO affirming the authenticity and truthfulness of the information therein.

I just wonder, though, philosophically—waxing philosophically here, without a code of conduct, is this enough to change behavior?

Do you think this goes far enough? Will the fact that we have just coupled them with mandated jail sentences change behavior?

What are your thoughts on this mandated signature and affirmation? And I will—anyone on the panel; it is not specific to anyone.

Mr. Cathy, since you or somebody in your position has to sign on that, what are your feelings?

Mr. CATHY. Well, you know, Chick-fil-A is still a private company, and we have a lot of privileges that I have. And I am sometimes asked, why don't you go public? That is the way to make money. That you can sell, you know, many, many times of what the company is worth and you can walk off with a gold mine in your hands.

But one reason I don't go public is, No. 1, is I might lose my job. Second, is if I had some friends and widows and so forth to invest their life savings in my company, I would feel personally responsible for that. I would think I ought to be the loser before they would be the loser. I think they should sacrifice—whoever might be identified as guilty—sacrifice what material things they might have to rectify some of the damage that has been done for those that cannot help themselves. And I would feel—that in itself led me to be able to borrow money that I needed to grow at the pace I wanted to grow, so I take the personal liability. And I feel that any CEO should take the responsibility to take care of that one who is a stockholder. And they should be making the calls, and then we should be—they should be protected, and that right might be right. And certainly we put too much confidence in signatures of maybe the chief executive officers and the auditors and so forth that has become wealthy because of some of the schemes that have been invented by those where pressure is put on them, the bottom line, the bottom line. It doesn't make any difference on how you reach it, but let us keep an eye on the bottom line.

Mr. TERRY. Yeah.

Mr. CATHY. And so we are more interested in people than the profits.

Mr. TERRY. Well, and you are a man of integrity and honor. And it is amazing that we have heard testimony in this room of CEOs that are willing to take all the credit when the company was going up, and had absolutely no knowledge of anything going on when it was going down. Which just baffles me because, as a captain of a ship, you take responsibility for the actions of your crew. And it is with great dismay that we have heard that type of testimony here.

Any of you other—Professor Lidsky, would you like to comment?

Ms. LIDSKY. I think a signature requirement is an excellent idea. If somebody put their name to something, there is a formality there that makes them really think about what they are doing. And truly dishonest people will still be dishonest and be willing to put their name on it, but people—it will make them think twice and make them really think about what they are doing. Especially with lawyers. There is a culture amongst lawyers that when you sign your name, you had better have read what you signed and understood it and know what it was about.

And I think that that would be an excellent formality that would make people really think about the significance of what they do before they do it.

Mr. COHN. And it has worked from the standpoint of the liability of people who sign prospectuses when stock is being offered on the market and—with their personal liability. So there is that precedent out there that, since the Securities Acts of the 1930's, has built a very good market.

Mr. SMITH. I would like to interject one thing on that. I think the general public needed reassurance that our elected leaders were taking the problems seriously. And so I can appreciate the legislation that has recently been—that has already been enacted and that is coming down the line.

But I would like to say, when I was an accounting student roughly 30 years ago, one of the things that is taught in all the business books and in the accounting books is that the financial statements are the responsibility of management. And so I think that there has always been that responsibility, and management could have always been held accountable.

I am always impressed when I get to meet legislators like yourselves, just what great people of integrity and wanting to do the right thing I see, and I really appreciate your efforts. But I guess you all know this: There is always that balance between when you have too much legislation. And sometimes I wonder if the legislation we had before the current economic or stock market crisis had been really rigorously enforced, maybe things would have been better. And you all have mentioned the ethics rules that lawyers have to face and deal with, and the idea that was shared that, if the bar did a better job of enforcing what is already there, maybe that would have helped us avoid the current dilemma.

Mr. STEARNS. I thank the gentleman. I think what we are going to do is—we have a vote, so I think we are each going to go around and probably ask one question, so we can get through and let you go so you don't have to wait for us.

Dr. Smith, do accounting programs have a mandatory accounting ethics course?

Mr. SMITH. No, they don't.

Mr. STEARNS. And, Dr. Cohn, they do, though, in the law.

Mr. COHN. Absolutely, since Watergate.

Mr. STEARNS. Since Watergate. And do you think, Dr. Smith, based upon all these problems that we have had, that the accounting industry should have a mandatory ethics course in the program?

Mr. SMITH. I don't know that a single course is absolutely necessary. I think ethics should be integrated into the existing courses. I teach ethics in my courses. Every course I teach, I integrate ethical issues into some of the other issues that we discuss, and I have 1 day in particular that I specifically talk about it.

Mr. STEARNS. When an accountant gets his degree, is there an oath he has to take?

Mr. SMITH. Yes.

Mr. STEARNS. And, obviously, for the law there is an oath. And is this oath, do you think, encompassing enough that it makes an impression, like Mr. Deal mentioned when he took the oath as a lawyer? I have never heard of the accountants talk too much about this oath.

Mr. SMITH. I think that is something for us in accounting to look at and think about.

Mr. STEARNS. Mr. Cathy, my last question is—I had the opportunity to run a very small operation, not like yours. But I notice I had sometimes employees would display unethical behavior; there would be stealing and other things like that. How do you create a climate of high morality and ethics? I know it starts from the leader down. But do you have a code of ethics that you have the employees read? I mean, what do you do when somebody, for example, has an ethical problem? When you encounter an ethical dilemma, what do you do?

Mr. CATHY. We used to place on cash registers the commandment, "Thou shall not steal."

Mr. STEARNS. Right. Okay.

Mr. CATHY. As a reminder to these individuals that you shouldn't steal. But we have some of that in spite of all the advantages we offer. We think maybe some try to discover a new way to do it that may be more profitable. But I think it starts from the top, as you say. We set the tone. And we think all of our operators know what is expected of them. They are expected to be honest, although some of the operators from time to time slip up and take a little bit more money than what they are getting. You know, Chick-fil-A is getting rich, I need the money. So they excuse themselves——

Mr. STEARNS. Rationalize.

Mr. CATHY. [continuing] for taking things that don't belong to them. Going back to the kindergarten situation. There are a lot of things, but you can't teach character unless you have got something to start with.

So if a person is going to lie, he is going to steal. So they go hand in hand. I have never seen anybody that has stolen that couldn't justify their actions by saying that they had a sick mother at home and didn't have any money and they needed that, or food, or other things that they can put up as an excuse. But they all—they should be accountable. And we don't mind discharging a person if we test the test. But I realize that others, in spite of all opportunities you offer, that is not good enough for them, they need a little bit more.

Mr. STEARNS. Thank you, Mr. Cathy.

And my ranking member.

Mr. TOWNS. Thank you very much, Mr. Chairman.

Let me begin by saying, Mr. Cathy, listening to you is a breath of fresh air. I want you to know that. Because when we look at where we are today and what is going on, and then to hear you and to listen to the way that you have gone about your business, I tell you, it makes a major difference. Your situation is very unique than what we see in here today. Let me just ask this question, Mr. Chairman—and I will conclude—to Professor Cohn, and I guess Professor Lidsky.

Are you familiar with section 307 of the Sarbanes bill that just passed the House and the Senate and that the President has indicated he will sign into law? That section 307 of the Sarbanes bill requires the SEC to adopt rules requiring outside counsel to report to chief legal counsel or chief executive officer of a corporation any material violation of security laws or any breach of fiduciary duty.

If neither of those officers take appropriate remedial or disciplinary actions, the outside legal counsel must then notify the audit committee or another committee comprised of independent directors of the board for that corporation.

Do you believe that this provision will help outside legal counsel to exercise more independent judgment in these issues?

I would like to get Professor Cohn and Professor Lidsky to comment on that.

Mr. COHN. I believe this is very helpful because it makes it clear and specific. However, this is now included in Rule 1.13, which every State has adopted, so that it is there now. That obligation is there now. I am interested to know what the SEC will do about enforcing it. If this gives the SEC enforcement power for what is now 1.13, then it is—in my judgment an advance forward and it is a good move. If the SEC doesn't enforce it and it just sits there, it is no more than 1.13 is now.

Ms. LIDSKY. I am in complete agreement. It is excellent, in the sense that it reiterates the duty under the current ethics rules to ascend the corporate ladder, to try to prevent a client who is trying to insist on committing a fraud. And it is nice, because it gives you enforcement potentially. But the question is, is anybody really going to enforce it. I think it can't but be helpful.

Mr. TOWNS. Let me—just a last comment, very quickly, Mr. Chairman.

You know, when you think about disbarment, you think about all these other things, but do you feel that severe penalties, more severe penalties—you know, as Mr. Cathy pointed out, that if you just take whatever they have and sort of give it back to the people that they have robbed from—you know, do you support that philosophy, having more severe penalties?

Mr. COHN. I think one thing that might be examined is whether the SEC now has the power to order a disgorgement of all profits made under an illegal situation or a fraudulent situation. And not disgorgement into the Federal Treasury, but back to the people who have been harmed. In some States you can get disgorgement and repayment to the people who have been hurt. And if the SEC does not have that power, I suggest that that is something this committee might take a look at.

Mr. STEARNS. Thank the gentleman. And last, to wrap up, the gentleman from Georgia, Mr. Deal.

Mr. DEAL. Thank you, Mr. Chairman. Again, thank you for having this hearing and for inviting this very distinguished panel. I am not going to ask a question, mainly because we have got only a few minutes left on this vote that is still pending right now. But particularly to all of you, and especially to Mr. Cathy and your son and your grandsons, we thank you for being here today setting the kind of example that all of us believe is the example that Corporate America should hear. And I especially like your slogan, "Eat More Chicken," because, as you know, my congressional district in north Georgia is the No. 1 chicken producing, poultry producing district in the entire United States. And we appreciate what you do for the poultry industry as well as what you do for setting the kind of corporate example.

You know, we just can't pass up those opportunities to plug what is happening in our district and our State. And we are proud of you, and I especially appreciate the fact that you would be here today.

Thank you, Mr. Chairman.

Mr. STEARNS. You are welcome. And that is an unpaid political advertisement.

Mr. Cathy, Dr. Smith, Professor Cohn, and Professor Lidsky, thank you very much for your patience. And the subcommittee is adjourned.

[Whereupon, at 12:43 p.m., the subcommittee was adjourned.]