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The Ethical Boundaries of Attorney Whistleblowers

Understanding the Process

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In recent years, federal legislation has encouraged attorneys to become whistleblowers, first with the rules promulgated by the Securities and Exchange Commission (SEC) under the Sarbanes-Oxley Act of 2002 (SOX) that permit disclosure of client confidential information in certain circumstances and then with the additional whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) that create a financial incentive for disclosure of confidential information.

These whistleblower rules are in tension with the lawyer's duties of confidentiality and avoiding conflicts predicated on attorney self-interest. That's because they allow disclosure of client confidential information more broadly than do applicable ethics rules in many jurisdictions, and incentivize disclosure through monetary compensation to counsel.

In light of this tension fostered by the Dodd-Frank incentive program between counsel's loyalty to the client and a perceived societal need to learn of securities law violations, at least one bar association has opined that attorneys may not ethically serve as whistleblowers on their clients. This article describes the variance between SEC whistleblower rules and state ethics rules that led to the October 2013 New York County Bar Association ethics opinion that the federal whistleblower rules create risk of ethics violations such that attorneys should not be financially rewarded for revealing client confidences.

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The Dodd-Frank Whistleblower Award Program

Passed in response to the financial crisis of 2008-2009, Dodd-Frank created a whistleblower award program to promote the voluntary disclosure of information leading to successful SEC or related enforcement actions. Under the SEC's rules implementing the Dodd-Frank whistleblower award scheme, adopted in 2011, whistleblowers are awarded 10%-30% of collected fines for providing voluntarily "original information" that leads to the successful enforcement of an SEC action or related action resulting in monetary sanctions of more than $1 million.

Consistent with the policy of encouraging candid client communication with counsel, the SEC's rules generally bar attorneys from eligibility for whistleblower awards by excluding from the definition of "original information" obtained through a communication subject to the attorney-client privilege or in connection with the legal representation of a client. These exclusions recognize the possibility that potential awards of $100,000 or more could influence an attorney's judgment in determining whether to disclose client confidential information to the SEC. In the SEC's Adopting Release for the whistleblower award rules, the SEC made clear its intention to avoid rewarding attorneys for disclosures in violation of their ethical obligations, stating:

> The proposed exclusions … recognized the prominent role that attorneys play in all aspects of practice before the Commission and the special duties they owe to clients. We observed that compliance with the Federal securities laws is promoted when individuals, corporate officers, and others consult with counsel about possible violations, and the attorney-client privilege furthers such consultation. This important benefit could be undermined if the whistleblower award program created monetary incentives for counsel to disclose information about possible securities violations in violation of their ethical duties to maintain client confidentiality.

However, there are exceptions to the exclusions barring attorneys from becoming whistleblowers. An attorney may disclose client confidential information to the SEC and qualify for a whistleblower award if the disclosure would otherwise be permitted under SEC Rule 205.3, the applicable state attorney conduct rules, or "otherwise." Given that the SEC disclosure rules differ appreciably from most attorney ethics rules (as discussed below), a variety of conflicting law is incorporated into the whistleblower rules, raising difficult questions for attorneys considering "reporting out" to the SEC and collecting a whistleblower award.

SEC Attorney Conduct Rules

SEC Rule 205.3 appears in Part 205, the attorney conduct rules promulgated by the SEC in 2003 as required by SOX. Part 205 creates both mandatory and permissive reporting requirements for attorneys "appearing and practicing" before the SEC on behalf of an "issuer."

Part 205 requires mandatory reporting by attorneys "up-the-ladder," within the management structure of the corporate organization, if an attorney becomes aware of evidence of a "material violation" of federal or state law by an issuer. Once the attorney has reported a material violation up a prescribed chain of management and evaluated the response to such report, she has fulfilled her whistleblower responsibilities.

There is no further requirement that the attorney "report out" to the SEC and provide it with client confidential information. However, Part 205 provides for permissive reporting of client confidential information; specifically, under Rule 205.3(d)(2), an attorney may disclose such information to the SEC without the client's consent if the attorney reasonably believes disclosure is necessary for the following reasons:

- to prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
- to prevent the issuer from committing or suborning perjury in an SEC investigation or proceeding or perpetrating a fraud on the SEC; or
- to rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer in the furtherance of which the attorney's services were used.

As discussed next, this permissive reporting out of client confidences is not entirely consistent with the exceptions to the duty of confidentiality provided in the ABA Model Rules of Professional Conduct and the attorney ethics rules of many jurisdictions, which are more restrictive in significant respects.

Disclosure of Confidential Information Under Attorney Ethics Rules

All jurisdictions and the ABA Model Rules of Professional Conduct (Model Rules) provide for disclosure of confidential information without client consent in certain circumstances. These rules vary as to whether such disclosure is permissible, mandatory, or prohibited. This article refers to the Model Rules for ease of discussion.

Model Rule 1.6 gives effect to the attorney's duty of confidentiality. Under Model Rule 1.6(b), disclosure of confidential information is permitted — but not required — in six circumstances where the lawyer reasonably believes necessary, including the following:

- 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; or
- 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.

Thus, SEC Rule 205.3 deviates significantly from the Model Rules and many state ethics rules in permitting disclosure to prevent or rectify "material violations" of law that may not rise to the level of a crime or fraud, which is a disclosure trigger under Model Rule 1.6(b). Further, unlike Model Rule 1.6(b), SEC Rule 205.3 permits disclosure to prevent a material violation regardless of whether the attorney's services were used in furtherance of the violation.

Similarly, SEC Rule 205.3 is broader than Model Rule 1.13, which addresses the organization as client and, according to the comments to the rule, supplements Model Rule 1.6(b) by providing an additional basis for disclosure of confidential information. SEC Rule 205.3 permits disclosure of client confidences to prevent harm to investors as well as to the issuer, whereas disclosure under Model Rule 1.13 is limited to preventing harm to the organization. Specifically, under Model Rule 1.13(c), an attorney may reveal confidential information only where the organization's highest authority insists on or fails to address threatened or ongoing action that is clearly a violation of law and the attorney reasonably believes such violation is reasonably certain to result in substantial injury to the organization. Unlike certain of the exceptions in Model Rule 1.6(b), there is no requirement in Model Rule 1.13 that the lawyer's services be used in furtherance of the violation, although the matter must be related to the lawyer's representation of the organization.

The SEC recognized that its rules could conflict with an attorney's ethical duty of confidentiality and included a statement of preemption in Part 205: "Where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with this part, this part shall govern." The SEC also included a safe harbor provision in Part 205: "An attorney who complies in good faith with the provisions of this part shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices." At least three bar associations have questioned the SEC's position, and it remains an open question whether the SEC rules in fact preempt state ethics rules.

The "reporting out" provisions of Part 205 generated much controversy and comment at the time, and the controversy has continued with Dodd-Frank creating incentives for whistleblowers. The prospect that an attorney may reap a significant financial benefit for disclosing client confidential information increases the tension between the whistleblower rules and attorney ethics rules, leading to at least one local bar association opinion on the subject.

The 2013 NYCLA Ethics Opinion

In October 2013, due to the tension created by the "prospect of government-rewarded lawyer whistleblowers," the New York County Lawyers' Association (NYCLA) Committee on Professional Ethics issued a formal opinion (Formal Op. 746) concluding that New York lawyers "presumptively may not ethically serve as whistleblowers for a bounty against their clients under the Dodd-Frank … Act, because doing so generally gives rise to a conflict between the lawyers' interests and those of their clients."

This conclusion was based on an analysis of New York Rules of Professional Conduct 1.7 and 1.9, addressing lawyers' responsibilities to current and former clients to avoid conflicts of interest and to safeguard confidential information. The opinion recognized that a conflict of interest between the personal interest of a lawyer and the interest of her client is presented where the lawyer pursues a whistleblower award. The opinion also compared exceptions to the duty of confidentiality under the New York Rules of Professional Conduct with the SEC whistleblower rules, and concluded that "New York lawyers, in matters governed by the New York [Rules of Professional Conduct], may not disclose confidential information under the Dodd-Frank whistleblower regulations, except to the extent permissible under the Rules of Professional Conduct."

The NYCLA opinion echoes earlier opposition to the SEC whistleblower rules from two other bar associations in Washington and California. Shortly after the SEC adopted Part 205, the Washington State Bar Association reached the same conclusion as NYCLA and, in an interim formal ethics opinion that was later withdrawn, warned Washington lawyers not to reveal client confidences and secrets unless authorized to do so by the Washington Rules of Professional Conduct. Wash. State Bar Assoc., Interim Formal Ethics Op. Re: The Effect of the SEC's Sarbanes-Oxley Regulations on Washington Attorneys' Obligations Under the RPCs (available at http://bit.ly/1gVmcUb).

Not long after, the Corporations Committee of the California State Bar published a comprehensive analysis of the intersection of the SEC rules with California attorney conduct rules and cautioned that "[a]n attorney relying upon the SEC's safe harbor in disclosing client confidences to the SEC would be doing so at his or her own peril." Corps. Comm. of Bus. Law Section, Cal. State Bar, Conflicting Currents: The Obligation to Maintain Inviolate Client Confidences and the New SEC Attorney Conduct Rules, 32 *Pepp. L. Rev.* 89, 149 (2004). In contrast, in a 2005 ethics opinion, the North Carolina State Bar reached the opposite conclusion, stating, in reliance on a presumption that the SEC rules preempted state law, that a North Carolina attorney "may, without violating the North Carolina Rules of Professional Conduct, disclose confidential information as permitted by Rule 205 although such disclosure would not otherwise be permitted by the NC Rule." N.C. State Bar, 2005 Formal Ethics Op. 9.

Conclusion and Considerations

In most cases, an attorney fulfills her responsibilities under both the SEC rules and state ethics rules by reporting up problematic conduct within the client organization. However, for an attorney who contemplates also reporting out of the organization as a whistleblower, the conflicts between the SEC whistleblower rules and state attorney conduct rules create an uncertain pathway. Applicable attorney ethics rules may render improper such a disclosure — even where it is consistent with the SEC rules.

Indeed, there are several examples of attorneys facing disciplinary or other sanctions for disclosures made as whistleblowers in other contexts (*see e.g., U.S. ex rel. Fair Lab. Practices Assocs. v. Quest Diagnostics Inc.*, 734 F.3d 154 (2d Cir. 2013) (affirming district court holding that former general counsel to defendant violated ethical obligations by participating in *qui tam* action pursuant to False Claims Act and holding that the district court did not err in dismissing complaint and disqualifying plaintiff, its general partners including former general counsel, and outside counsel from subsequent litigation)) and a developing body of case law that considers the limitations ethical obligations such as the duty of confidentiality impose on whether attorneys may state claims for retaliation under whistleblower protection laws.

Moreover, where such reporting out of an organization is expressly permitted under applicable state ethics rules, the conflict of interest raised by the prospect of a substantial financial reward to counsel may itself create a violation of ethics rules. In the face of this, more state and local bar associations are likely to follow NYCLA and make clear that "disclosure of confidential information in order to collect a whistleblower bounty is unlikely, in most instances, to be ethically justifiable."