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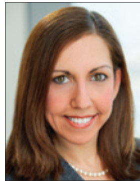
LABOR RELATIONS

Expert Analysis

Attorneys as Whistleblowers



By **David E. Schwartz**
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Attorneys owe their clients certain duties to, among others, preserve confidentiality and remain loyal. While ethical rules governing attorneys' professional conduct vary across states, attorneys generally may not undertake representation or otherwise participate in activity that would be adverse to their clients' interests. Yet, in May 2017, a former in-house attorney was awarded almost $8 million in damages in connection with a whistleblower claim against his former employer. See *Wadler v. Bio-Rad Laboratories*, No. 15-cv-2356 (N.D. Cal. May 10, 2017). The federal government's increasing reliance on whistleblowers to uncover and prosecute fraud brings an interesting question to the fore: What happens when an attorney uses confidential information to blow the whistle on his or her current or former client? This article reviews recent decisions addressing this issue and examines key considerations governing attorney conduct in whistleblower cases.

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Preempted Rules

In December 2016, a California federal district court ruled in *Wadler*, 212 F. Supp. 3d 829 (N.D. Cal. 2016), that federal common law allows in-house attorneys to use privileged and confidential materials under limited circumstances in support of a whistleblower retaliation claim. The court further held that whistleblower protections under federal laws such as the Sarbanes-Oxley Act of 2002 (SOX) and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) prevail over conflicting state ethical rules governing the scope of attorney-client privilege and confidentiality.

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The case was brought by Sanford Wadler, who served as general counsel of a life science and clinical diagnostics company from 1989 until June 2013 when the company terminated his employment. He claimed the company violated the whistleblower provisions of SOX, Dodd-Frank and California state law by terminating him in retaliation for raising concerns—both internally and to the company's audit committee—about the company's alleged violations of the Foreign Corrupt Practices Act. Just before trial, the company moved to exclude "all testimony that may be based on information [Wadler] learned in the course of his service as [the Company's] general counsel," arguing neither SOX nor Dodd-Frank evidences a clear intent to preempt state ethical rules regulating an attorney's duty of confidentiality.

The court determined pursuant to Rule 501 of the Federal Rules of Evidence that, because Wadler brought retaliation claims under state and federal law, federal common law should govern the key question of whether the supporting information for his claims was subject to attorney-client

privilege. Under federal common law, the applicable standard is found in Rule 1.6 of the Model Rules of Professional Conduct, which allows attorneys to reveal confidential or privileged information only “to the extent the lawyer reasonably believes necessary … to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client.” The court thus concluded that a lawyer may use privileged and confidential information, with appropriate protections, to establish whistleblower retaliation claims under federal common law.

The *Wadler* court grappled with the question of whether regulations promulgated under SOX governing the professional conduct of attorneys in connection with whistleblower cases preempted the significantly more restrictive ethical rules on privilege in California. On the one hand, California state ethical rules prohibit an attorney from disclosing a client’s confidential information except when reasonably necessary to prevent substantial bodily harm or death of an individual. By comparison, SOX regulations governing privilege are decidedly more lenient due in part to their requirement that an attorney, upon learning of material violations, report them “up the [company] ladder” until there is an “appropriate response.” 17 C.F.R. § 205.3(b). Under such regulations, an attorney also is entitled to use any such reports (or records thereof) in any litigation or proceeding in which the attorney’s compliance with such reporting requirement is at issue. Because these SOX regulations explicitly state that they prevail over any conflicting or inconsistent state laws, the *Wadler* court found these federal rules, rather than California state ethical rules, controlled and that Wadler’s revelation of privileged information was permissible.

In February 2017, a federal jury awarded Wadler $2.96 million in back pay (which, according to his attorneys, gets doubled under Dodd-Frank) and an additional $5 million in punitive damages. Pursuant to Dodd-Frank’s and SOX’s fee-shifting provisions, the company also was required to pay Wadler’s attorney fees and costs totaling $3.5 million. The defendants’ renewed motion for judgement as a matter of law was denied in May 2017.

Crime-Fraud Exception

Many state ethical rules, such as New York’s Rules of Professional Conduct, include a crime-fraud exception to the attorney-client privilege. This exception allows an attorney to disclose client confidences “to the extent the lawyer reasonably believes necessary … to prevent the client from committing a crime.” N.Y.R. Prof. Conduct 1.6(b)(2). The cases discussed below are instructive examples of how courts and professional responsibility boards interpret and apply this important exception in whistleblower cases.

In *Fair Laboratory Practices Assocs. v. Quest Diagnostics*, 734 F.3d 154 (2d Cir. 2013), the Second Circuit strictly construed the crime-fraud exception and found it applied only in respect of preventing continuing or future crimes. The court held the former general counsel of a company could not use confidential information in a qui tam whistleblower suit against his former employer over kickbacks because the information was not necessary to prevent an alleged crime. It found the former general counsel’s disclosures, were unnecessary because his co-plaintiffs also were former executives with knowledge relevant to the alleged fraud, and his disclosures, which dated back to 1996 went beyond what was “reasonably necessary” to prevent an ongoing crime in 2005.

Similarly, a New York trial court in *Danon v. Vanguard Group*, No. 100711/13 (N.Y. Sup. Ct. Nov. 13, 2015), granted a leading mutual fund provider’s motion to dismiss a qui tam action filed by its former in-house tax counsel under New York’s False Claims Act (FCA), on the basis that the in-house counsel violated the rules of attorney professional conduct in bringing the action. The plaintiff filed the qui tam lawsuit in 2013, alleging the company engaged in large-scale tax fraud. The company sought dismissal of the case, arguing that in bringing the lawsuit, plaintiff violated ethical rules on confidentiality and conflicts of interest. Plaintiff asserted his disclosure of privileged information in connection with the lawsuit was permitted by the crime-fraud exception of Rule 1.6(b)(2) of the New York Rules of Professional

Conduct. However, relying on *Quest Diagnostics*, the court found the crime-fraud exception to be inapplicable because plaintiff's disclosures were "broader than reasonably necessary to stop the alleged tax violation." In particular, the complaint provided details for alleged violations dating back to 2004, although the claims were predicated on alleged violations that occurred from 2011 to 2013. In addition, plaintiff had already exercised alternate means of preventing future tax violations by providing certain privileged information to the IRS, SEC and the New York State Attorney General in January 2013.

In a separate action against the company in Pennsylvania, plaintiff alleged he was wrongfully terminated for engaging in protected activity in violation of the whistleblower protections of SOX, Dodd-Frank and the Pennsylvania Whistleblower Law. In April 2017, the U.S. Court of Appeals for the Third Circuit held the New York court's dismissal of plaintiff's qui tam suit under the FCA should not preclude him from pursuing a federal complaint under the Dodd-Frank Act (although it upheld dismissal of his SOX and Pennsylvania law claims for procedural reasons). See *Danon v. Vanguard Group*, Case No. 16-2881 (3d Cir. April 12, 2017). The case is now on remand before the District Court for the Eastern District of Pennsylvania.

On Aug. 30, 2017, in *In re Koeck*, D.C. Ct. App. Bd. On Prof'l Responsibility, No. 14-BD-061 (Aug. 30, 2017), the D.C. Court of Appeals Board on Professional Responsibility suspended a former in-house counsel at a well-known technology and energy solutions company for 60 days for failing to sufficiently tailor her disclosures of privileged information to advance her whistleblower claim. While working as in-house counsel, Koeck reported an alleged tax fraud she believed her employer was perpetrating in Brazil. Koeck was fired shortly afterwards for reasons her employer stated were independent from her reporting of the alleged tax fraud. Subsequently, Koeck filed a SOX complaint alleging, among other things, that her former employer terminated her employment in retaliation for her reports about the fraud. Koeck had downloaded certain privileged documents from her company computer prior to her termination of employment and she used those documents to support the allegations in her SOX complaint. Koeck also shared those documents with a number of reporters, one of whom published a story based on Koeck's documents.

The hearing committee that was convened to evaluate Koeck's professional conduct in the case found, as the First, Third, Fifth and Ninth federal appellate courts had done, that under federal common law, Koeck was entitled to use privileged materials to establish a retaliatory discharge claim in a SOX whistleblower action. However, the committee found neither the whistleblower protections of SOX nor the crime-fraud exception contained in the District of Columbia Rules of Professional Conduct extended to the disclosure Koeck made to newspaper reporters. It reasoned that she and her attorney "sought to use the press not to report crime or to protect financial interests, but rather to gain leverage in the advancement of Koeck's [SOX] claim … ." Koeck's whistleblower attorney also was admonished by the disciplinary panel for allegedly advising Koeck to leak the confidential documents to the press.

Conclusion

As the above cases demonstrate, the rights of attorneys to disclose client confidences in connection with whistleblower claims remains unsettled. To minimize whistleblower claims by corporate counsel, companies should review internal reporting requirements to ensure prompt reporting of any misconduct. Whistleblower concerns raised through internal channels should be addressed promptly and thoroughly through independent investigation. In addition, companies should ensure that in-house attorneys are familiar with state ethics rules that generally prohibit them from disclosing confidential information without company authorization. Finally, companies may wish to tailor confidentiality agreements entered into with its employees to address whistleblower concerns.

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