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# Balancing Conscience and Confidentiality for Attorney Whistleblowers

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Attorneys—in-house and outside counsel alike—often stand at the crossroads of corporate misconduct. At one time, attorneys' duty to maintain corporate clients' confidences was thought to be virtually absolute. But that changed over time, as relevant rules and laws gave lawyers greater discretion to make public disclosures to avert clients' anticipated or ongoing wrongdoing. And now, following the enactment of the whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, attorneys will sometimes have not only discretion but a financial incentive to blow the whistle, as well as employment protections.

Imagine this scenario: You are in-house counsel to a public corporation. In the course of your legal work, you discover that your employer—your client—is making materially false statements about the corporation's financial performance in its soon-to-be-filed annual report. You have reported the problem up the issuer's chain of command and tried to persuade your client to correct the false statements. Can you report your client's misconduct to the U.S. Securities and Exchange Commission, and what will happen if you do so?

Arguably the most sweeping financial reform effort since the Great Depression, Dodd-Frank was a potent response to a long series of corporate scandals—beginning with Enron and continuing into the current economic crisis—that have defrauded countless investors and shaken the financial markets. One of Dodd-Frank's key provisions required the SEC to establish a whistleblower program that would offer significant employment protections and monetary awards to individuals who report possible federal securities violations. Attorneys are eligible to participate in this important investor protection program.

Under Dodd-Frank, the SEC is required to pay monetary awards—between 10 and 30 percent of the total monetary sanctions collected by the SEC and in other related enforcement actions—to individuals who voluntarily provide the SEC with original information leading to an enforcement action in which the agency obtains at least $1 million in sanctions.

The statute also provides robust employment protections that prohibit retaliation against an employee who provides information about possible securities violations to the SEC in accordance with the program's implementing rules. In the event retaliatory action is taken, it establishes significant remedies, including reinstatement with equivalent seniority, two-times back pay with interest, attorney fees, and other related expenses. Significantly, whistleblowers may report possible violations anonymously if represented by counsel.

Although Dodd-Frank permits attorneys to participate in the SEC Whistleblower Program, their ability to receive monetary awards is limited. Specifically, the implementing rules prohibit attorneys from using information obtained through a communication protected by the attorney-client privilege or through the representation of a client, unless the attorney-client privilege has been waived, or if disclosure of the otherwise confidential information is permitted either by SEC Rule 205.3 or by the applicable state attorney conduct rules.

Rule 205.3 generally requires an issuer's attorney to report fraud and other material securities violations up the organization's chain of command. There are three situations, however, in which an attorney is permitted to disclose confidential information to the SEC without the issuer's consent or without having first reported internally. The attorney may disclose the information if the attorney reasonably believes disclosure is necessary to:

1. prevent a material violation that is likely to cause substantial financial injury to the issuer or investors;
2. prevent the issuer from committing or suborning perjury, or perpetrating a fraud upon the SEC; or
3. rectify the consequences of a material violation, in the furtherance of which the attorney's services were used.

State professional conduct rules may also authorize attorneys to report corporate client misconduct. Rules governing confidentiality include exceptions that vary from state to state. Rule 1.6 of the American Bar Association's Model Rules of Professional Conduct generally permits disclosure of confidential information to prevent a client from committing a serious crime or fraud in which the attorney's services were used.

Like Rule 205.3, Rule 1.6 also permits disclosures to rectify or mitigate a crime or fraud that has or will cause substantial injury to the financial interests or property of another, and in furtherance of which the attorney's services were used. Many states follow this rule, although some give attorneys broader or more limited discretion to prevent or rectify client misconduct. When the client is an organization, most

state rules—based on ABA Model Rule 1.13—mandate that the attorney first report any wrongdoing up the organization's chain of command. Only if the organization fails to take proper action may the attorney then disclose the confidential information as permitted by Rule 1.6.

Rule 205.3 may occasionally conflict with state confidentiality rules. In that situation, an attorney could comply with Rule 205.3 and qualify as an SEC whistleblower, yet seemingly face a state bar disciplinary action. However, Rule 205.3 would almost certainly protect the attorney by preempting the state rule.

Under the federal Supremacy Clause, a regulation duly enacted by a federal agency preempts conflicting state law if its enactment was a valid exercise of congressionally delegated authority, and the federal agency intended to preempt state law when it promulgated the regulation.

There is little doubt that Rule 205.3 was validly enacted by the SEC because Congress required the agency to set minimum attorney-conduct rules in Section 307 of the Sarbanes-Oxley Act. Moreover, Rule 205 clearly manifests the SEC's intention to preempt conflicting state attorney-conduct rules with the rules set forth in Rule 205, including the disclosure rules of Rule 205.3. Accordingly, our view is that an attorney may disclose confidential information in accordance with Rule 205.3 without regard to conflicting state confidentiality rules.

After making a whistleblower submission to the SEC, an attorney must consider other relevant state professional conduct rules, particularly those governing conflicts of interest. Dodd-Frank does not preempt these rules. Whether an attorney whistleblower has a conflict of interest in the representation of a corporation will depend upon the circumstances. In many situations, the representation would be unaffected by the attorney's status as whistleblower. But in some situations it would be affected.

For example, if an attorney reports corporate misconduct to the SEC, the attorney could not advise the corporation how to respond to the inquiry, because the attorney could benefit financially if the SEC obtained civil sanctions. Outside counsel in this situation could simply decline or terminate the representation; in-house counsel could seek reassignment to matters unrelated to the reported violation.

An in-house lawyer denied reassignment would face an interesting quandary. Dodd-Frank's anonymity provisions generally protect employees from disclosing that they are whistleblowers, but it may be necessary for the attorney to disclose this status if a simple request for reassignment or assertion that "I have a conflict" is ineffective.

Attorneys should view whistleblowing as a last resort and proceed with care. In particular, they should keep in mind the following key points:

- In most cases, attorney whistleblowers will be obligated first to conscientiously report possible securities violations to their corporate clients in accordance with the procedures outlined in Rule 205.3 and state professional conduct rules. Confidentiality is an important professional value, and compliance with the federal securities laws is promoted when individuals and entities work together to root out wrongdoing and discipline those responsible.
- Although the implementing rules for the SEC whistleblower program require a whistleblower to have only a reasonable belief that a possible securities violation has occurred, is ongoing, or is about to occur, potential attorney whistleblowers should attempt to confirm the existence of a violation before reporting to the SEC. This practical step will help prevent unnecessary external reporting and minimize the risk of a later determination that reporting was impermissible.
- Where internal reporting is inappropriate or has been unsuccessful, potential attorney whistleblowers should consult independent counsel regarding the risks, rewards, and requirements (both ethical and procedural) associated with reporting possible securities violations to the SEC.
- Even though Rule 205.3 preempts state confidentiality rules, potential attorney whistleblowers must comply with other state attorney conduct rules—especially state conflict of interest rules.
- For those who fear retaliation by their employers (or unwarranted state ethics proceedings), it may make sense to report possible violations anonymously to the SEC with the assistance of counsel.

In the end, attorney whistleblowers are likely to be rare, but their very existence will represent a fundamental breakdown in corporate governance.

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