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The SEC properly expanded protection for attorney whistleblowers

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In the recent investigations of the Rupert Murdoch empire, the British Parliament was very happy to obtain information from the Murdochs' former attorneys, with the attorney-client privilege being waived after the Murdochs alleged that their former law firm made mistakes.

Here, across the Atlantic, in the wake of our recent financial scandals, Congress has widened the exceptions to the attorney-client privilege in order to protect those attorneys who want to "blow the whistle" on corporate crime. First with the Sarbanes-Oxley Act of 2002, and then in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Congress protected attorneys who disclose information to the U.S. Securities and Exchange Commission (SEC) about potential securities violations, by carving out exceptions to the attorney-client privilege. These exceptions serve the public interest by ensuring that the attorney-client privilege is not used to shield financial misconduct, and by deterring employers from retaliating against attorneys who report corporate misconduct. After all, attorneys are very likely to have the best information about financial misconduct, as fiduciaries of major corporations.

The recent Dodd-Frank regulations, codified at 17 C.F.R. Part 240.21F, effective on Aug. 12, continue the SEC's efforts to protect attorneys who seek statutory rewards for reporting securities violations from retaliation by their corporate employers, or discipline by state bars for breaching confidentiality. However, land mines still exist for attorneys who come from states with more restrictive rules about preserving client confidences. To be safe, before an attorney blows the whistle on his or her employer in order to seek a reward under Dodd-Frank, it is important that he or she understand the full set of exceptions to the attorney-client privilege that have been created by these two laws, and the limits of those exceptions.

The new regulations for the Dodd-Frank whistleblower reward program confirm that, as set forth in the Sarbanes-Oxley regulations, 17 C.F.R. 205.3(d), attorney whistleblowers may report otherwise privileged information to the SEC in the following situations. First, the rules allow disclosure in order to prevent an issuer from committing a material violation of the securities laws that is likely to cause substantial injury to the financial interest or property of the issuer, or investors in the future. Second, the rules allow an attorney to disclose otherwise privileged information to prevent perjury in an SEC investigation or administrative proceeding. Third, the rules allow an attorney to disclose otherwise privileged information "to rectify the consequences of a material violation" of the securities law "in the furtherance of which the attorney's services were used."

These were new exceptions, created first in the Sarbanes-Oxley rules, and confirmed in the Dodd-Frank rules, that generally were not permitted under state bar rules. The SEC has not yet implemented rules for the Dodd-Frank whistleblower retaliation provisions, which is a separate set of protections in which limited disclosure may be necessary to establish the protected conduct element of a retaliation claim.

The Dodd-Frank rules also provide that an employer's confidentiality agreement cannot be used to prevent

an employee from communicating with the SEC about potential securities law violations.

The biggest change with the Sarbanes-Oxley rules was that Sarbanes-Oxley trumped conflicting state bar rules to permit attorneys to disclose past violations of the securities laws, as opposed to potential future illegalities. As a result of the Sarbanes-Oxley rules, the American Bar Association amended the Model Rules of Professional Conduct in 2003 to permit disclosure of client confidences to prevent future injuries to financial interests or property, or to prevent, mitigate or rectify past financial crimes, in which the attorney's services were used. The courts and the Department of Labor upheld the predominance of the Sarbanes-Oxley rules over state bar rules. See, e.g., Jordan v. Sprint Nextel Corp., ARB No. 66-105, ALJ No. 2006-SOX-041 (ARB Sept. 30, 2009); Van Asdale v. Int'l Game Tech., 577 F.3d 989, 995-96 (9th Cir. 2009).

The last exception in the Sarbanes-Oxley and Dodd-Frank rules concern disclosures about "past material violations," and identifies the situation in which attorneys may find themselves in jeopardy. If the disclosures the attorney is making about a past material violation of the securities law is not one in which he was involved, then his report does not fit within the exception to the attorney-client privilege, under Sarbanes-Oxley or Dodd-Frank. Therefore, he must look to whether it fits within an exception to the confidentiality rules of the state bar rules under which he is licensed. If the state bar rules do not allow him to disclose otherwise privileged information, then he is out of luck. In other words, if he observed or has knowledge of a past material violation, but his services were not used to further that violation, then Sarbanes-Oxley and Dodd-Frank do not necessarily protect him.

In many states, bar rules are more restrictive in terms of the situations in which an attorney may disclose past violations of the securities law. For example, an attorney whistleblower in the District of Columbia who witnessed or came to learn of the past violations but whose services were not used to further past violations, does not fit within the Dodd-Frank exceptions, or exceptions contained in the D.C. bar rules. Under D.C. Rule 1.6(d), adopted in 2007, an attorney may disclose otherwise privileged information only if the disclosure will lead to the prevention or remedying of "crime or fraud" that is "reasonably certain to result [in the future]" or has resulted in "substantial injury to financial interests or property of another." However, in either case, the D.C. rules require the "crime or fraud" must have been furthered by the attorney's services, in order to provide an exception from confidentiality.

As another example, if a California licensed attorney cannot meet the "authorized by law exception" in the Sarbanes-Oxley and Dodd-Frank rules, then he is unlikely to be able to report otherwise privileged information to the SEC. Under the California rules, an attorney may disclose otherwise privileged information only to the extent necessary to prevent death or "substantial bodily harm." Calif. Bus. & Prof. Code § 6608 (e); Calif. R. Prof. Conduct 3-100(b) & 3-600(B)-(D). No exception is created in the California rules for financial or property crimes. In practice, if a California attorney made disclosures in order to remedy a past violation, and his services played no part in those past violations, then he will not meet the Sarbanes-Oxley § 205.3 exception, and he will not be protected from liability for breach of the attorney client privilege.

What an attorney should take away from this is that if he cannot be certain that the proposed disclosures made to the SEC fit within the exceptions created under the Sarbanes-Oxley and Dodd-Frank rules, the attorney should make certain that he is able to make the disclosures in the state where he is licensed. While Congress and the SEC have significantly expanded the ability of attorneys to disclose attorney-client privileged information in order to report and prevent financial misconduct, that additional protection does not extend to reporting of past crimes in which an attorney did not participate.

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