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Lawyers' Ethics Committee Deems New York Lawyers Ineligible for Dodd-Frank Whistleblower Bounties

By Linda Jackson and Eric Savage

The issue of whether attorneys may “blow the whistle” on conduct they reasonably believe violates securities laws, and thereby collect bounties under federal whistleblower laws, is controversial.

On October 7, 2013, the Professional Ethics Committee of the New York County Lawyers' Association (NYCLA) issued NYCLA Ethics Opinion 746 – *Ethical Conflicts Caused by Lawyers as Whistleblowers under the Dodd-Frank Wall Street Reform Act of 2010* – which concludes that New York lawyers may not ethically collect Dodd-Frank whistleblower bounties for revealing confidential client information.

Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) authorizes payment of bounties to whistleblowers who voluntarily provide original information regarding corporate wrongdoing to the Securities and Exchange Commission (SEC). The bounty awards range from 10 percent to 30 percent of the penalty that the government collects from the corporate wrongdoer for any penalty collected over \$1 million. Thus, the minimum bounty for any qualifying penalty is \$100,000. There is no cap on the bounties, and the awards can reach into the millions of dollars.

The whistleblower component of Dodd-Frank also amended the Sarbanes-Oxley Act (SOX). SOX became law in 2002, and was passed in response to a number of prominent corporate and accounting scandals. SOX required that the SEC adopt standards governing the professional conduct of attorneys who practice before the Commission, including a rule regarding attorney disclosure of a client's violation of securities laws or breach of fiduciary duty. Accordingly, the agency adopted SEC Rule 205, which requires lawyers to report corporate misdeeds internally, but does not require reporting outside the corporation. Rather, if the internal reporting fails, the lawyer may, if necessary, report to regulators. Reporting out – and seeking a bounty – is permissible, but not mandatory under SEC regulations.

SEC regulations implementing Dodd-Frank's whistleblower provisions specifically exempt from the definition of “whistleblowers” attorneys who learn information via an attorney-client communication, unless either SEC Rule 205 or state law permits them to disclose information.¹

¹ See 17 C.F.R. § 240.21f4(b)(4).

The issue for the NYCLA was the extent to which the prospect of a bounty may “tend to cloud a lawyer’s professional judgment” in determining whether to report out. In addressing the question, the NYCLA recognized that Rule 205 permits a lawyer practicing before the SEC on behalf of an issuer of securities to reveal confidential information related to the representation when the lawyer reasonably believes it necessary to: 1) prevent the issuer from committing a material violation of securities laws that is likely to cause substantial financial injury to the interests or property of the issuer or investors; 2) rectify the consequences of a material violation of securities laws in which the attorney’s services have been used; or 3) prevent the issuer from committing or suborning perjury in an SEC proceeding. The NYCLA also noted, however, the potential conflict between Rule 205 and New York Rules of Professional Conduct (RPC) 1.6 as to client confidences and 1.7 as to conflicts of interest.

As to client confidences, RPC 1.6(b) provides several exceptions to the general rule preventing a lawyer from disclosing a client’s confidential information. The NYCLA recognized that certain exceptions may relate to and perhaps even overlap with the purpose of Rule 205, but it concluded that the exceptions are different. Indeed, the Opinion specifically notes that, even when the RPC permits disclosure, it is for the purpose of preventing wrongdoing rather than collecting a bounty, and is limited to reasonably necessary information.

The NYCLA concluded that disclosure of confidential information “in order to collect a whistleblower bounty is unlikely, in most instances, to be ethically justifiable,” and that RPC 1.6 does not permit disclosure “in order to collect a Dodd-Frank whistleblower bounty, even in compliance with the SEC Rules, if that disclosure does not fit within an exception under . . . RPC 1.6 or is not necessary to correct a fraud, crime or false evidence within the meaning of RPC 3.3.”

The NYCLA also concluded that a presumptive conflict of interest exists when a corporate lawyer functioning as a lawyer (as opposed to a lawyer acting in a non-lawyer role) seeks a whistleblower bounty. In addressing this point, the NYCLA noted that lawyers confronted with potential wrongdoing must evaluate potentially conflicting issues, such as: is the potential violation material? Is it Criminal? Should it be reported internally? Should it be reported out and, if so, when and to whom? The NYCLA further noted that these decisions “call for the exercise of objective, dispassionate professional judgment,” and that “under these delicate circumstances, a financial incentive might tend to cloud a lawyer’s professional judgment.” The Opinion is, however, expressly limited to permissive whistleblowing and does not address the “rare and exceptional situation” in which the lawyer is required to report out.²

In short, New York lawyers acting as attorneys on behalf of clients are presumed unable to serve ethically as whistleblowers for a bounty against their clients. This presumption applies regardless of whether the lawyer is a current or former lawyer for the client and regardless of whether the lawyer serves an in-house or outside counsel role. This Opinion may be a welcome one for companies concerned about the growing trend of whistleblower claims by in-house counsel. While the Opinion precludes the collection of bounties, however, it may not preclude the ability of in-house lawyers to report out if they disclaim a bounty.³

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² See, e.g., the RPC 3.3(b) disclosure requirements regarding client perjury.

³ For more on whistleblower claims by in-house lawyers, see Greg Keating, Ed Ellis, Linda Jackson, Allan King, Chip Jones, Trish Martin, Amy Mendenhall, Roberta Ruiz, and Jeanne Barber, *Retaliation and Whistleblower Claims by In-House Counsel*, Littler Report (March 29, 2013), available at <http://www.littler.com/publication-press/publication/retaliation-and-whistleblower-claims-house-counsel>.