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Barry R. Temkin

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5353 Wayzata Blvd., Suite 600
Minneapolis, MN 55416-4758
phone 800.845.0778 or 952.746.2580

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Barry R. Temkin *is a Partner at Mound Cotton Wollan & Greengrass LLP and a member of the New York County Lawyers' Association Professional Ethics Committee. The views expressed in this article are the authors' alone, and not those of NYCLA or Mound Cotton Wollan and Greengrass LLP. .*

Lawyers As Whistleblowers: Recent Developments

by Barry R. Temkin

Several courts have recently addressed the issue of whether lawyers may serve as whistleblowers against their former clients when doing so results in the disclosure of confidential client information. The Second Circuit, in *Fair Laboratory Practices Associates v. Quest Diagnostics,* held that a lawyer disclosed far more confidential information than was necessary when bringing a *qui tam* whistleblower case against a former client under the False Claims Act.[1] More recently, in a highly-publicized case against mutual fund giant Vanguard Group, a New York state court judge followed *Fair Laboratory Practices* to dismiss a *qui tam* claim brought by a terminated in-house tax lawyer under New York law.[2] A similar claim brought against Vanguard by the same lawyer was dismissed by a federal judge in the Eastern District of Pennsylvania, citing collateral estoppel grounds.[3]

These recent cases have important implications for employer liability. In addition, there could be potential professional liability for lawyers who are found to have breached their professional duties to their clients. A client could have a potential claim against a lawyer for precipitous disclosure of confidential information. Conversely, an employer who retaliates against a lawyer-whistleblower could face regulatory fines and civil liability. Moreover, a lawyer who accepts a whistleblower bounty from the government could potentially face a conflict of interest claim from an erstwhile client who contends that its confidences were revealed in exchange for a government payout.

Lawyer and employer liability in the whistleblower context should be viewed against the backdrop of regulations promulgated by the SEC under the authority of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which authorize the payment of significant bounties to whistleblowers who report corporate wrongdoing to the government. SEC Rule 21F-4(b) presumptively excludes the use of privileged or confidential information from its definition of eligible original information under the Dodd-Frank whistleblower rule.[4] But there are exceptions to the SEC's general proscription of lawyers acting as whistleblowers. Where permitted by state ethics rules or by the SEC's own professional responsibility rules, SEC regulations authorize a lawyer to collect a whistleblower bounty. Ultimately, the courts will decide how to reconcile the government's encouragement of whistleblowers—including lawyers—with the traditional state regulation of lawyer ethics, including conflicts of interest and client confidentiality.

Client Confidentiality & Client Fraud

Legal ethicists continually attempt to balance lawyers' competing duties of client confidentiality with their duties of honesty to tribunals and others. Lawyers confronted with material, ongoing client fraud must analyze their duty of confidentiality to the client to determine whether disclosure is permissible under state and federal ethics rules. The ABA Model Rules, which serve as guidelines but lack the force of law, exhort lawyers to maintain the confidentiality of information learned by the lawyer in the course of the representation. However, ABA Model Rule 1.6 permits (but does not require) disclosure of confidential information in six circumstances: (1) to prevent death or substantial bodily harm; (2) to prevent 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"; (3) to prevent or rectify financial injury from client crime/fraud "in furtherance of which the client has used the lawyer's services"; (4) to obtain advice about the lawyer's own compliance with the ethics rules; (5) for the lawyer to defend herself against a claim relating to the representation; and (6) to comply with law or a court order.[5] Exceptions (2) and (3) to Model Rule 1.6(b) were added in 2003 in the wake of the Enron and WorldCom financial scandals.

Different states have varying formulations of lawyer professional responsibility when confronted with known ongoing client fraud and illegality. For example, the New York Rules of Professional Conduct are different from their ABA counterparts, as they do not include the so-called Enron exceptions in Rule 1.6 (b) (2) and (3). The New York Rules prevent a lawyer from disclosing client confidential material, but provide exceptions. A New York lawyer may (but is not required to) reveal client confidences: (1) to prevent reasonably certain death or substantial bodily harm; (2) to prevent a client from committing a crime; (3) to withdraw a lawyer's opinion or representation based on inaccurate information or which is being used to further a crime or fraud; (4) to get legal advice about the lawyer's own conduct; (5) for the lawyer to defend himself; (6) to collect a fee; (7) when permitted to reveal confidences under the RPC, to comply with law or a court order. While the foregoing exceptions are permissive, in the case of known client perjury, the lawyer is required to take reasonable remedial action, "including, if necessary, disclosure to the tribunal."[6]

Lawyers who represent corporations and other organizations have additional ethical obligations in the event of known client violations of law. Under ABA Model Rule 1.13, a lawyer for an organization with knowledge of corporate wrongdoing that poses a substantial risk of injury to the organization must report the violation up the proverbial corporate ladder. A corporate lawyer who knows that an officer or employee of the organization has engaged in illegal conduct related to the representation which is likely to result in substantial injury to the organization, "shall proceed as is reasonably necessary in the best interest of the organization." Under the ABA rules, up-the-ladder reporting, including to the board of directors, is ethically mandated: "Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law."[7]

However, the ethics rules in various states, including New York, vary from the ABA formulation.[8] New York RPC 1.13 requires a corporate attorney aware of client misconduct that constitutes a violation of law or of a legal duty to the corporation to take reasonable measures within the organization to prevent harm to the organization, but does not contain independent support for reporting outside the organization if such reporting might result in disclosure of confidential information in violation of the state confidentiality rule.[9]

In addition, lawyers for public corporations have ethical obligations under Securities and Exchange Commission professional responsibility rules. For example, SEC Rule 205.3, like the ABA Model Rules, requires a lawyer who is aware of a material violation of the federal securities laws to report the violation up the corporate ladder to the highest authority which can act on behalf of the corporation, including, if necessary, the full board of directors. If all else fails, and if necessary to prevent further harm to the corporation or to investors by client perjury or a material violation of the securities laws, the Chief Legal Officer is authorized by SEC rules to disclose client confidences outside the company.[10]

However, state and federal ethics rules are not in complete agreement about when it is permissible for lawyers to reveal—and benefit from—client violations of the securities laws.

NYCLA Ethics Opinion 746

A potential conflict between federal and state ethics rules was addressed by the Professional Ethics Committee of the New York County Lawyers' Association (NYCLA), whose 2013 ethics opinion considered the question, "May a New York lawyer ethically participate in the whistleblower bounty program under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 by revealing confidential information about the lawyer's client and then seek a bounty?"[11] NYCLA Opinion 746 concluded that a New York lawyer, acting on behalf of a client, is presumptively barred from participating in a whistleblower bounty program by the New York Rules of Professional Conduct (RPC). Among other things, the committee reasoned that attorney participation in the SEC whistleblower program might permit or encourage the disclosure of confidential client information beyond that permitted by the New York Rules of Professional Conduct. In addition, the ethics committee found that the prospect of receiving a substantial monetary bounty from the government might give rise to a significant risk of a conflict between the lawyer's interests and those of the client.

The NYCLA Ethics Committee further wrote that participation in a whistleblower bounty program would be unlikely to fall under the confidentiality exceptions of the Rules of Professional Conduct that permit disclosure of confidences "to the extent the lawyer reasonably believes necessary" to prevent the client from committing a crime or to prevent or rectify a known fraud on a tribunal.[12] It reasoned that collecting a monetary bounty from the government is rarely necessary, and that "preventing wrongdoing is not the same as collecting a bounty."[13]

Additionally, the NYCLA Committee reasoned that the prospect of a lawyer seeking a whistleblower bounty raises a potential conflict of interest. A lawyer seeking to benefit personally from the disclosure of confidential information could run afoul of RPC 1.7, which precludes representation of a client, absent waiver, where a reasonable lawyer would conclude that "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests."[14] The Committee reasoned that the prospect of a financial bounty might adversely affect the lawyer's professional judgment on behalf of the client. In other words, if a lawyer is required to disclose confidential client information, it should be because the law requires it—not because the lawyer stands to benefit financially.

Fair Laboratory v. Quest Diagnostics

In 2013, the U.S. Court of Appeals for the Second Circuit decided *Fair Laboratory Practices Associates v. Quest Diagnostics*, a *qui tam* case brought by an in-house lawyer-whistleblower who alleged that his former employer had violated the federal False Claims Act.[15] In that case, Mark Bibi, the defendant's former general counsel, brought a federal *qui tam* action against his erstwhile employer. The defendant company claimed that Bibi had breached state ethics rules by using confidential information to bring his claim. Bibi opposed the defendant's motion to dismiss, arguing that the False Claims Act preempted state ethics rules. Alternatively, he argued that the disclosure fell within an exception to the predecessor to New York RPC 1.6(b) in order to prevent the client from committing a crime.

The district court dismissed the plaintiff's action because he unnecessarily and improperly revealed confidential client information. The Second Circuit affirmed the dismissal, reasoning that the False Claims Act did not preempt the confidentiality provisions of the Rules of Professional Conduct, which would permit the disclosure of confidences only to the extent "reasonably necessary" to prevent a crime—including a federal crime. There was no conflict between state and federal interests, because it was not necessary for the general counsel to reveal stale confidential information from years earlier in order to prevent fraud that was apparently no longer ongoing. Moreover, the court reasoned that, whatever one's view of the evidence, it was not reasonably necessary to bring a *qui tam* action—and recover monetarily—in order to redress the alleged past improper conduct by the defendant laboratory. According to the Second Circuit: "We agree that the attorney in question, through his conduct in this *qui tam* action, violated N.Y. Rule 1.9(c) which, in relevant part, prohibits lawyers from "us[ing] confidential information of [a] former client protected by Rule 1.6 to the disadvantage of the former client," N.Y. Rule 1.9(c), except "to the extent that the lawyer reasonably believes necessary . . . to prevent the client from committing a crime.""[16]

The Second Circuit, relying in part on NYCLA Ethics Opinion 746, held that Bibi's revelation of confidential information exceeded what was reasonably necessary to prevent any alleged ongoing fraudulent scheme.[17] As the court explained, it was simply not necessary, within the meaning of the ethics rules, for the plaintiff lawyer to reveal confidential information in order to remedy or prevent supposed client wrongdoing several years earlier:

> We agree with the District Court that the confidential information [plaintiff] Bibi revealed was greater than reasonably necessary to prevent any alleged ongoing fraudulent scheme in 2005. By [the plaintiff's] own admission, it was unnecessary for Bibi to participate in this *qui tam* action at all, much less to broadly disclose Unilab's confidential information. . . . Instead, Bibi chose to participate in the action and disclose protected client confidences in violation of N.Y. Rule 1.9(c).[18]

The court thus concluded that the entire case was infected by the attorney's unethical disclosures, and was not improperly dismissed by the district court.

Danon v. Vanguard Group Inc.

In November 2015, the Supreme Court of New York, County of New York followed *Fair Laboratory Practices* and NYCLA Ethics Opinion 746 to dismiss a state court complaint brought by a lawyer in *State of New York ex rel. Danon v. Vanguard Group, Inc.*[19] In that case, David Danon, a former in-house tax attorney for Vanguard Group, brought *a qui tam* action against his former employer. Danon alleged that Vanguard was engaged in illegal tax evasion in violation of the New York State False Claims Act. He repeatedly raised his concerns with his co-workers and supervisors, but was told to desist. His persistence purportedly resulted in Vanguard retaliating against him by firing him. Before leaving Vanguard, Danon amassed a trove of confidential documents to support his anticipated whistleblower claim, which he presented to the IRS, SEC, and New York Attorney General's Office. As of this writing, none of these agencies has brought an enforcement action against Vanguard.

As part of the ensuing action, Danon sought a bounty under the New York False Claims Act. In its response to Danon's complaint, Vanguard moved to dismiss, asserting that the suit was poisoned by Danon's breach of ethics. Specifically, Vanguard argued that Danon violated his duty of confidentiality by publicizing the tax documents to which he had access as the company's tax attorney. Danon did not deny that the documents—which he accessed in his representation of Vanguard—were confidential. Rather, he contended that the ethics rules allow such a breach of confidentiality, because doing so was necessary to prevent a crime or fraud.

The court found for Vanguard on a motion to dismiss and dismissed Danon's claim, reasoning that Danon's breach of confidentiality was in violation of New York's Rules of Professional Conduct 1.6 and 1.9(c). The court reasoned that the crime-fraud exception to the duty of confidentiality did not apply because Danon had alternative means to prevent the alleged tax violation, such as reporting his claims to the tax authorities; therefore, revealing Vanguard's confidential material was not "reasonably necessary" to prevent Vanguard from committing a crime. According to the court, this ethical violation undermined the evidence supporting the tax fraud accusations against Vanguard and poisoned the entire action.

The *Danon* court relied extensively on *Fair Laboratory Practices*, determining that not only was the lawyer whistleblower disqualified from collecting a False Claims Act bounty, but that the breach of confidentiality was so egregious that it warranted dismissing the case outright. In fact, the court in *Danon* found that Danon's ethical violations were worse than those addressed in *Fair Laboratory Practices* because Danon gathered confidential documents and commenced his action while still in Vanguard's employ.

Undeterred, Danon pursued similar claims against Vanguard under the Sarbanes-Oxley Act, Dodd-Frank and the Pennsylvania Whistleblower law, in a separate action in the Eastern District of Pennsylvania. These claims were dismissed on collateral estoppel grounds by the court.[20] Both *Danon* decisions are on appeal.

Interestingly, in 2015, Danon participated in an action in Texas in which he successfully collected a bounty for information he provided.[21] His role was that of "confidential informant," and not an active participant in the investigation. Thus, it is not entirely clear if he utilized the same confidential materials that tainted his case in New York. The Texas comptroller awarded Danon the sum of $117,000 for his assistance.

Conclusion

Lawyers confronted with client fraud or other material violations of the law must tread cautiously by balancing their competing duties under state and federal ethics rules, particularly given the developing nature of the law in this area. Generally speaking, lawyers must engage in choice of law analysis to determine which jurisdiction's professional responsibility law applies, and to determine whether disclosure is permissive, mandatory or precluded under the applicable ethics rules. In addition, lawyers must weigh and balance their own potential liability to potentially defrauded third parties—or government regulators—against their ethical duty of maintaining client confidentiality.

Both NYCLA Ethics Opinion 746 and the Second Circuit's decision in *Fair Laboratory* caution that the disclosure of client confidential information in exchange for a government bounty raises significant ethical issues for lawyers.The *Danon* decision reinforces these opinions and stands to admonish attorneys against pursuing whistleblower bounties, especially if doing so reveals confidential materials beyond what is reasonably necessary to prevent client crime or fraud.

Endnotes

1 *Fair Laboratory Practices Associates v. Quest Diagnostics Inc.*, 734 F. 3d 154 (2d Cir. 2013).

2 *Danon v.Vanguard Group, Inc.*, No. 100711/13, 2015 WL 7594570 (N.Y.Sup.).

3 *Danon v.The Vanguard Group, Inc.*, No. CV 15-6864, 2016 WL 2988987 (E.D. Pa. 2016).

4 Securities Exchange Commission, *Implementation of the Whistleblower Provisions of Section 21F*, Exchange Act Release No. 34-64545, at 50-52, 60-66, 249-50 (Aug. 12, 2011), available at http://www.sec.gov/rules/final/2011/34-64545.pdf.

5 ABA Model Rule 1.6 (b).

6 NY RPC 3.3.

7 ABA RPC 1.13.

8 Cf. NY RPC 1.13.

9 NY RPC 1.13.

10 SEC Rule 205.3 (d); https://www.law.cornell.edu/cfr/text/17/205.3

11 NYCLA Ethics *Opinion 746,* at 1, https://www.nycla.org/siteFiles/Publications/Publications1647_0.pdf. (The author is a member of the NYCLA Ethics Committee which issued Ethics Opinion 746).

12 NY ST RPC Rule 1.6(b); 3.3(b).

13 NYCLA, *supra* note 5, at 9.

14 *Id.* at 11.

15 *Fair Laboratory Practices Associates v. Quest Diagnostics Inc.,* 734 F. 3d 154 (2d Cir. 2013).

16 *Id.* at 157-58.

17 *Id.* at 19.

18 Id. at 165.

19 *Danon v. Vanguard Group, Inc.,* No. 100711/13, 2015 WL 7594570 (N.Y.Sup.).

20 *Danon v. The Vanguard Group, Inc.*, No. CV 15-6864, 2016 WL 2988987 (E.D. Pa. 2016).

21 Jesse Drucker, *Vanguard, Facing Whistler-Blower Cases, Agrees to Pay Texas Taxes*, Bloomberg (Nov. 20, 2015), http://www.bloomberg.com/news/articles/2015-11-20/vanguard-facing-whistle-blower-cases-agrees-to-pay-texas-taxes.