

Morgan Lewis

C O U N S E L O R S A T L A W



LABOR AND EMPLOYMENT LAW SEMINAR

**Ethical Issues Arising Under
Sarbanes-Oxley**

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October 27, 2005

Presentation Overview



- How do state ethics rules on protecting client confidences intersect with the reporting requirements of Sarbanes-Oxley?
- What are the ethical rules applicable to an attorney conducting a Sarbanes-Oxley investigation for a corporate client?

Mandatory “Up the Ladder” Reporting Under Sarbanes-Oxley

- Who is covered by the mandatory reporting requirements under Sarbanes-Oxley?
 - Attorneys “appearing and practicing” before the SEC in the representations of issuers



Which Organizations are “Issuers”?

- Any company registering securities under 15 U.S.C. § 78I
- Any company required to file reports under 15 U.S.C. § 78o(d)
- Any company that files or has filed a registration statement that has not yet become effective and that the company has not withdrawn (other than a foreign government issuer)

Who Appears and Practices Before the SEC?



- Attorneys transacting business with the SEC (including correspondence)
- Attorneys representing issuers in SEC proceedings
- Attorneys providing advice on securities laws or SEC rules and regulations regarding documents to be filed with the SEC
- Attorneys advising issuers as to whether any document must be filed with the SEC

What Triggers the Reporting Requirement?

- An objective standard, based on “credible evidence” that material violation has occurred, is ongoing or is about to occur
- Violations covered are material violations of federal or state securities law, breaches of fiduciary duty arising under federal or state law or similar violations of ANY United States federal or state law

Mandatory “Reporting Up” Requirement

- What is the “reporting up” requirement?
 - Report evidence of material violation by an issuer or its officer, director, employee or agent
 - Report to chief legal officer or qualified legal compliance committee

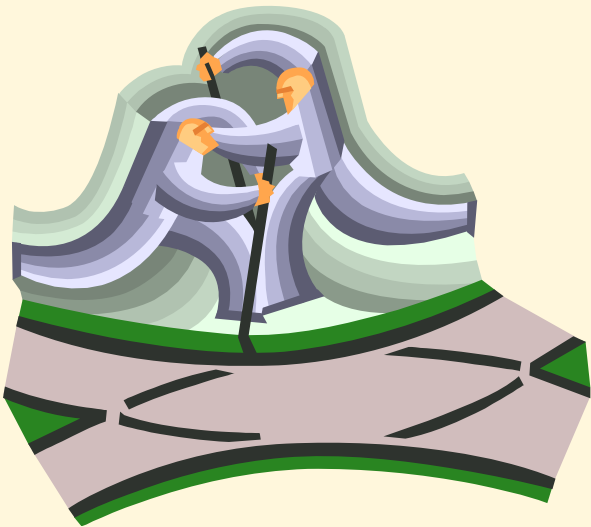
Permissive “Reporting Out” by Attorneys

- SEC permits disclosure where violation would likely cause **substantial injury to the financial interest or property of the issuer or investor**
- This standard has been adopted in ABA Model Rule 1.13(c)

Permissive “Reporting Out” by Attorneys

- A few states have adopted Model Rule 1.13(c)
- Many other states only permit withdrawal when the highest authority of the corporation insists on a criminal action that will substantially injure the corporation

When There is a Conflict on Permissive Disclosure, What Rule Governs?



- Under 17 C.F.R. § 205.1, SEC regulations preempt all conflicting state rules that prohibit such disclosures
- Many states question the SEC's authority to preempt state ethics rules, and suggest that their own rules should govern
- ACCA's position is that using privileged information for whistleblowing is prohibited

Safe Harbor for Reporting



- The SEC regulation 17 C.F.R. § 205.6(c) states that an attorney who complies in good faith with the SEC permissive disclosure rule cannot be subject to discipline under inconsistent state standards
- But the Washington state bar has said that it will ignore the safe harbor regulation

Retaliatory Discharge of an In-House Counsel Whistleblower

- Sarbanes-Oxley appears to permit retaliation actions by attorney whistleblowers
- Is it possible for an attorney to ethically:
 - pursue a retaliation claim or
 - reveal client confidences in the course of pursuing the retaliation claim?

Are Attorney Retaliation Suits Ethical?

- ABA Model Rule 1.13 requires an in-house attorney to consider only remedial measures that minimize disruption to the organization and the risk of revealing confidential information



Are Attorney Retaliation Suits Ethical?

- Some state courts have held that the common-law wrongful discharge cause of action is not available to attorney whistleblowers
- These courts reason that permitting such actions would damage all attorney-client relationships

Disclosure of Confidences in Retaliation Action Before the DOL

- In an analogous administrative action, the DOL followed Supreme Court Standard 503(d)(3), which only allows defensive use of privileged information in litigation
- Under this standard, confidential or privileged information cannot come into a whistleblower suit unless it falls within the crime/fraud exception

Disclosure of Confidences in Retaliation Suit in Federal Court

- ABA Model Rule 1.6 permits disclosure to the extent necessary to establish a claim or defense on behalf of a lawyer in a controversy with a client
- The majority of states do not extend this exception to whistleblower retaliation actions, but a few do

Proper Conduct of In-House Counsel in Leading a Sarbanes-Oxley Investigation

- Explain the identity of the client as the corporation and not its employees or agents
- Conversation with the employee is only subject to attorney-client privilege if:
 - undertaken at direction of the employee's superior
 - to obtain legal advice
 - the employee is aware that the communication is for that purpose
 - the communication concerns matters within scope of employees duties
 - the communication is kept confidential

Dual Representation in Defending Against Allegations of Material Violation

- Is there a potential conflict of interest between the corporation and the agent or employee?



Dual Representation (cont.)

- If there is a potential conflict:
 - The lawyer must reasonably believe that the lawyer will be able to provide competent and diligent representation to each client
 - Representation cannot involve assertion of a claim by one client against another client
 - Each affected client must give informed consent
 - The representation can not be prohibited by law

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