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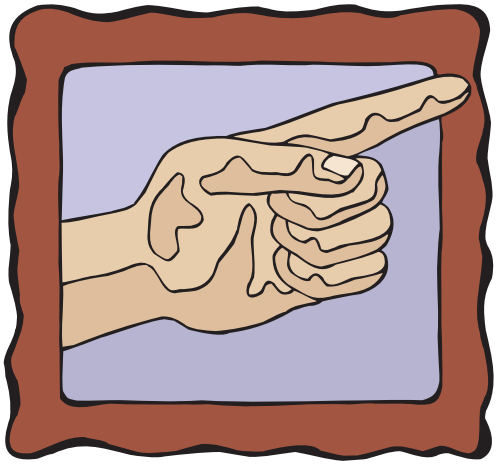
Finger a Dishonest Client?

New D.C. ethics rules clarify when lawyers may report clients' fraudulent activities.

By John C. Keeney Jr.

Today a lawyer who uses the federal authorization to report client securities fraud might face state bar discipline for disclosing client confidences.

That quandary is about to disappear for the District of Columbia. On Aug. 1 the D.C. Court of Appeals adopted new amendments to the Rules of Professional Conduct. The new rules, which go into effect Feb. 1, 2007, give lawyers more protection for making permissive disclosures authorized by post-Enron regulations of the Securities and Exchange Commission.



Currently, in the versions before the new amendments, D.C. Rule 1.6 (confidentiality of information) and Rule 1.13 (organization as a client) flatly prohibit the permissive disclosures the SEC encourages. SEC regulations of attorney conduct, 17 C.F.R. Part 5, authorize, but do not "require," a permissive disclosure of client confidences and secrets under specific circumstances. By contrast, current D.C. Rule of Professional Conduct 1.6(d)(2)(A) prohibits a D.C. lawyer from revealing such confidences unless "required" by law.

This created an ethics trap because a "permissive" disclosure under SEC regulations was not, by definition, "required" by law under the ethics rules. The new amendments create a new exception that largely accommodates permissive disclosure and no longer requires reliance on the "required by law" exception (which is still preserved in the rules).

IN THE OTHER WASHINGTON

The ethics trap for lawyers under the current D.C. rules never resulted in a bar or court interpretation in the District. But Washington state (not our city) had construed its similar Rule 1.6(d) to trump the SEC's rule. A July 26, 2003, Interim Formal Ethics Opinion, by a vote of 11-0, held that because SEC regulations authorized but did not require revelation, a Washington state lawyer was prohibited from revealing such confidences and secrets. The state further held that an attorney could not claim to be "complying in good faith" with state ethical obligations by relying on the SEC regulations.

The SEC objected strenuously. It informed Washington that the state Rule 1.6 could not ban disclosures permitted by SEC rules and that the state ethics opinion violated Supreme Court precedent. The SEC argued that its mission would be frustrated if a state disciplined lawyers for disclosures permitted under the Sarbanes-Oxley Act.

The Washington state disciplinary authority rejected the SEC's position. It emphasized its duty to give Washington practitioners guidance on ethical duties under Rule 1.6 unless and until its supreme court changed that rule. It concluded that "Washington lawyers must continue to observe their ethical obligations under the Washington Rules of Professional Responsibility" and disagreed that such ethics compliance should be interpreted as "any intent to 'thwart'" SEC goals. Ultimately, the Washington Supreme Court changed its Rule 1.6 by adding a new exception, similar to that of the District's.

THE FIX

The District's new Rule 1.6 (d) clarifies the ethical permissibility of disclosures by lawyers. The new amendment preserves much of the original structure but adds permissive disclosure options to the seven already permitted by Rule 1.6. One of these new permissive disclosure options under D.C. Rule 1.6(d) will allow a lawyer to reveal client confidences and secrets to the

extent reasonably necessary to prevent, mitigate, or rectify a client crime or fraud that has been furthered by use of the lawyer's services and that is reasonably certain to result (or to have resulted) in substantial injury to the financial interests or property of another.

This amendment, while retaining the District's traditional terminology about "confidences" and "secrets," essentially adopts Model Rule 1.6(b)(2) and (3) of the American Bar Association, as the ABA Corporate Responsibility Task Force recommended in 2003. It is consistent with the long-recognized crime-fraud exception to the attorney-client privilege. Historically, courts have denied the privilege when a client has abused a lawyer's services in furtherance of a crime or fraud.

Permissive disclosure is limited to the extent reasonably necessary to accomplish the stated ends. New Comment 20 also sets forth a list of factors for the practitioner to consider in exercising the discretion conferred by the rule. New Comment 21 encourages that, where practicable, a lawyer, in lieu of disclosure, seek to persuade the client to take suitable corrective action.

The effect of new Rule 1.6(d) is to provide a permissive disclosure option that tracks the permissive disclosure option in the SEC's Sarbanes-Oxley rules for most factual situations. The District's new Rule 1.6(d) also applies in many other areas besides securities law and governs the conduct of all D.C. lawyers, not only those practicing before the SEC.

REPORTING OUT

In addition to the change in Rule 1.6, Rule 1.13, which outlines a lawyer's duties toward an organization as a client, was also amended. There is no substantive change in "up the ladder" ethics duties that are compatible with reporting obligations of both Sarbanes-Oxley and SEC rules. Language from a comment is moved into a new section (b) in the rule, and the new section makes clearer the pre-existing obligation of a lawyer in certain circumstances to refer matters to a higher authority in the organization.

The D.C. rule and the ABA model rule are essentially the same about reporting within the organization. "Reporting out" beyond the client and its officers and board of directors is treated differently, however. D.C.'s new Rule 1.13 is not as broad as the SEC rules and the ABA model rule. The new D.C. Rule 1.13 permits reporting out only in circumstances consistent with the new Rule 1.6(d) exceptions. Thus, the amended D.C. Rules 1.6(d) and 1.13, read together, permit, but do not require, reporting out in the most common scenarios of a client's fraudulent use of a lawyer's services.

Even as amended, D.C. Rule 1.13 will prohibit one rare circumstance where otherwise the ABA and SEC allow permissive reporting out. The ABA Model Rule 1.13(c) permits, but does not require, disclosure outside the organization of client confidential information that the lawyer learned, even if not related to the services that he personally performed for the organization. The D.C. rule does not permit this. Under the D.C. rules, the lawyer's services would not be deemed to have been "used" to further a crime or fraud within the meaning of the amended exception to confidentiality in D.C. Rule 1.6(d)(1) and (2). The D.C. Court of Appeals has agreed with the D.C. Bar recommendations that the broader ABA language not be adopted.

CONFLICTING DUTIES

Although the new rules provide needed clarity to the D.C. practitioner, those practitioners with multiple bar admissions continue to confront conflicting ethical duties.

For example, the New York bar (with its high concentration of securities lawyers) opposes the changes to Rules 1.6 and 1.13 adopted by the American Bar Association and its Corporate Responsibility Task Force, and largely now the law in the District. The New York State Bar Association Committee on Standards of Attorney Conduct has comprehensive draft recommendations, but it does not recommend the adoption of Rules 1.6(d) and 1.13, either in the form adopted in the District or in the slightly broader ABA model rules.

Yet the new D.C. rules bring the District closer to Maryland's 2005 amendments. Maryland's version of the new D.C. Rule 1.6(d) is found in its amended Rule 1.6(b)(2)(3), which took effect in July 2005. Maryland's version tracks the ABA recommendation more closely and does not include the District's limitation of the exception to the particular circumstance "when a client has used or is using a lawyer's services to further a crime or fraud." Similarly, Maryland's Rule 1.13 is slightly broader in that the state permits reporting out in the circumstance in which the lawyer has knowledge, but the client has not used the lawyer's services to further a crime or fraud. Despite these nuanced differences, there will be a large practical overlap in factual scenarios for permitted disclosure in Maryland and in the District.

As for Virginia, its Rule 1.6(b)(3) broadly permits disclosure of client fraud upon third parties if it is committed during the course of a lawyer's representation.

Under the new rules, D.C. lawyers may now better avoid an ethical trap. Those of us who advise on legal ethics and securities disclosures owe thanks to the bar members who proposed the amendments and to the D.C. Court of Appeals that swiftly adopted them.

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