THE SEC'S PART 205.3(D)(2) AND *WADLER V. BIO-RAD LABS.* SHOULD BE REVISITED: THE SEC EXCEEDED AUTHORITY IN CREATING A REPORTING OUT PROVISION FOR IN-HOUSE ATTORNEYS

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INTRODUCTION

Congress passed the Sarbanes-Oxley Act of 2002[1] in response to corporate and accounting scandals, including those at Enron and WorldCom.[2] When the fraud and accounting scandals came to light, the share prices of these companies plummeted, costing investors billions of dollars.[3] The rules the Sarbanes-Oxley Act directed were not limited to those addressing accounting practices.[4] Some provisions were aimed at attorney practices.[5]

Section 307 of the Sarbanes-Oxley Act directed the Securities and Exchange Commission (SEC) to create rules setting forth standards of professional conduct for attorneys.[6] The SEC implemented Part 205 of Title 17 of the Code of Federal Regulations[7] in response to Section 307

1 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 and 18 U.S.C.).

2 *See The Dramatic Change Across the Corporate Landscape to Re-Establish Investor Confidence in the Integrity of Corporate Disclosures and Financial Reporting: Hearing on Implementation of the Sarbanes-Oxley Act of 2002 Before the S. Comm. on Banking, Hous. & Urban Affairs* 108th Cong. 6 (2003) (statement of William H. Donaldson, Chairman, U.S. Sec. & Exch. Comm'n).

3 *See id.*

4 *See, e.g.*, 15 U.S.C. § 7245 (2018).

5 *See id.*

6 *See id.*

7 Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer, 17 C.F.R. § 205 (2003).

of the Sarbanes-Oxley Act, which attorneys "appearing and practicing" before the SEC must follow.[8] Part 205 contains two main provisions.[9] Part 205.3(b) contains a comprehensive, mandatory reporting-up provision, which details the process an attorney representing an issuer must take in reporting up the ladder in the company if she discovers evidence of a material violation[10] of securities laws.[11] Part 205.3(d) contains a permissive reporting out provision, in which the attorney *may* report out evidence of the material violation to the SEC.[12]

This reporting out provision conflicts with the ethics laws of many states.[13] For example, Part 205.3(d)(i) permits reporting out in order to prevent substantial injury to the financial interest or property of the issuer company or the company's investors.[14] However, New York's Rules of Professional Conduct allow an attorney to report out in order to prevent death or substantial injury, and thus prevention of financial injury is not an exception in which an attorney may report out.[15] These circumstances, where Part 205.3(d) allows reporting out but state law prohibits disclosure of the same information, leave attorneys in conflict

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8 *Final Rule: Implementation of Standards of Professional Conduct for Attorneys*, SEC. & EXCHANGE COMMISSION, https://www.sec.gov/rules/final/33-8185.htm [https://perma.cc/S4EX-ZADP] (last updated Sept. 26, 2003) (Section 205.3(a)). In clarifying "appearing and practicing," Senator Enzi stated this refers to "just attorneys appearing and practicing before the Commission; that is, those who are dealing with documents that deal with companies listed by the Securities and Exchange Commission." 148 CONG. REC. S6551–55 (daily ed. July 10, 2002) (Amendment No. 4187) (statement of Sen. Enzi).

9 *See* 17 C.F.R. § 205.

10 Part 205.2(e) defines evidence of a material violation as "credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur." *Id.* Senator Edwards stated, "[f]irst, the way we have drafted the bill, the duty to report applies only to evidence of a material violation of the law. That means no reporting is required for piddling violations or violations that don't amount to anything. The obligation to report is triggered only by violations that are material—violations that a reasonable investor would want to know about. So we have been very careful there." *See* 148 CONG. REC. at S6552.

11 *See* 17 C.F.R. § 205.3(b).

12 17 C.F.R. § 205.3(d).

13 For a discussion on state laws that conflict with Part 205.3(d)(2), see *infra* Section I.C.

14 *See* 17 C.F.R. § 205.3(d)(i).

15 *See infra* Section I.C.

about whether they may or may not legally report violations to the SEC.[16]

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)[17] built on the Sarbanes-Oxley Act, following the stock market crash of 2008. The Dodd-Frank Act implemented broad changes to corporate regulation, including the expansion of oversight of financial companies, regulations on credit rating agencies, and oversight regarding corporate governance matters.[18] Section 922 of the Dodd-Frank Act creates further conflict with state law.[19] Section 922 creates a whistleblower bounty program, whereby individuals who disclose original information may receive payments based on successful civil penalties.[20] If a successful civil penalty results, the whistleblower may receive an award between ten and thirty percent of the imposed penalty.[21] However, this reward poses a potential conflict with state ethics laws prohibiting attorneys from representing clients in situations in which there are conflict of interests.[22]

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16 For a discussion on the different ways in which state bar associations in states with more limited confidentiality disclosure laws have responded to the conflict between Part 205 and their respective states laws, see *infra* Section I.C.

17 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 12, 15, and 26 U.S.C.).

18 *See generally* MORRISON & FOERSTER, THE DODD-FRANK ACT: A CHEAT SHEET (2010), http://media.mofo.com/files/uploads/Images/SummaryDoddFrankAct.pdf [https://perma.cc/7F6D-Z9HG] (providing a summary of the principal aspects of Dodd-Frank).

19 *See* Press Release, Sec. & Exch. Comm'n, SEC Adopts Rules to Establish Whistleblower Program (May 25, 2011), https://www.sec.gov/news/press/2011/2011-116.htm [https://perma.cc/5RG6-5778]; Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

20 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, § 922 (2010). This section sets forth monetary incentives and protection for whistleblowers, including an award to whistleblowers who voluntarily provided original information to the SEC that led to the successful enforcement of a covered judicial or administrative action brought by the SEC under the securities laws that results in monetary sanctions exceeding $1 million. It allows an award in an aggregate amount of between ten and thirty percent of the monetary sanctions collected. *See Frequently Asked Questions*, SEC. & EXCHANGE COMMISSION: OFF. WHISTLEBLOWER, https://www.sec.gov/whistleblower/frequently-asked-questions#faq [https://perma.cc/DST4-WEHL] (last updated Oct. 29, 2018).

21 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010)

22 *See, e.g.*, N.Y. Cty. Lawyers Ass'n Comm. on Prof'l Ethics, Formal Op. 746 (2013), https://www.nycla.org/siteFiles/Publications/Publications1647_0.pdf [https://perma.cc/2BBM-FMQ4].

This Note proceeds in three parts. Part I introduces relevant statutory law. Part I discusses federal law, notably Section 307 of the Sarbanes-Oxley Act and the SEC's Part 205.3(d)(2), as well as the American Bar Association (ABA) Model Rules and conflicting state law. Part II first examines case law involving the preemption of state ethics laws, including *Wadler v. Bio-Rad Laboratories*, which concluded broadly that Part 205 preempts California law.[23] Part II then examines the doctrine of federal preemption, which is followed by a preemption analysis of Part 205.3(d)(2). Part III recommends that Part 205.3(d)(2) should be revisited, as the SEC did not act within its statutorily authorized power in promulgating the rule.

I. BACKGROUND

A. *Federal Law*

1. Section 307 of the Sarbanes-Oxley Act of 2002

Section 307 of the Sarbanes-Oxley Act directed the SEC to promulgate what would be the SEC's Part 205 within 180 days of the passage of the Act.[24] Senators John Edwards, Michael Enzi, and Jon Corzine proposed amendment number 4187, which provided for Section 307.[25] This bipartisan amendment aimed to address the role of attorneys for corporations, as opposed to accountants, which many other provisions of the Sarbanes-Oxley Act addressed.[26] Section 307

The opinion states "[a] lawyer who blows the whistle prematurely could harm the client and be professionally responsible for the precipitous disclosure of client confidences." *Id.* at 10. However, this Note examines the issue of whether Part 205 may preempt state law itself, rather than whether attorneys who disclose confidential information about their in-house clients may then collect a bounty.

23 *See* Wadler v. Bio-Rad Labs., Inc., 212 F. Supp. 3d 829 (N.D. Cal. 2016).

24 *See* 15 U.S.C. § 7245 (2018).

25 148 CONG. REC. S6551 (daily ed. July 10, 2002) (Amendment No. 4187).

26 *Id.* Senator Enzi stated, "[a]s we beat up on accountants a little bit, one of the thoughts that occurred to me was that probably in almost every transaction there was a lawyer who drew up the documents involved in that procedure. I know as to the companies we looked at, that was the case. It seemed only right there ought to be some kind of an ethical standard put in place for the attorneys as well." *Id.* at S6554; *see also id.* at S6556 ("Addressing the role of

states that the SEC may issue rules that set the minimum standards of professional conduct, including a rule proscribing a specific hierarchy to whom in-house attorneys *must* report material violations.[27]

While Congress listed the necessary process for reporting up the corporate ladder to be imposed on attorneys, the language of Section 307 does not provide any discussion or indication of the potential of a reporting out provision.[28] Further, the legislative history provides no indication that Congress ever contemplated a reporting out provision.[29] First, the motivating factor for creating Section 307 was to improve upon a reporting up procedure within the corporate structure.[30] Second, Senator Corzine assured the senators, prior to the vote on the amendment, that any reporting an attorney would do pursuant to Section 307 would occur within the corporation.[31] The SEC promulgated Part 205 in response to Section 307.[32]

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corporate lawyers is just as important a step as it is with accountants and with corporate officers.").

27 15 U.S.C. § 7245 (2018). Section 307 states:

> [T]he Commission shall issue rules . . . setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule—(1) requiring an attorney to report evidence of a material violation . . . to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and (2) if the counsel or officer does not appropriately respond to the evidence . . . requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, § 307.

28 *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, § 307.

29 *See generally* 148 CONG. REC. S6551 (daily ed. July 10, 2002).

30 *Id.* at S6552. In explaining Section 307 to the Senate, Senator Edwards stated that the current Chairman of the SEC, Harvey Pitt, encouraged Congress to pass a law if Congress wanted the SEC to enforce an up-the-ladder reporting requirement. *Id.* While Senator Edwards stated that corporate in-house attorneys should have an explicit duty to advise corporate officers of serious legal violations, he notably did not mention any duty for the attorneys to report these violations to the SEC. *Id.* at S6555.

31 148 CONG. REC. at S6556. For a more in-depth analysis of the legislative history of Section 307, see *infra* Section II.B.3.

32 *See* discussion *infra* Section I.A.2.

2. The SEC Responds: Part 205.3

Part 205.3(b) contains the reporting up requirements an attorney appearing and practicing before the SEC must follow.[33] Once an attorney becomes aware of evidence of a material violation, the attorney must report this information to the issuer's chief legal officer or chief executive officer.[34] If the attorney does not believe the chief legal officer or chief executive officer responded appropriately, the attorney must report the violation to either the audit committee, a committee consisting of nonemployees of the issuer, or the board of directors.[35] This process mirrors that which is set forth by the first part of Section 307 of the Sarbanes-Oxley Act.[36]

Part 205.3(d)(2) permits an attorney appearing and practicing before the SEC to report confidential information about her client to the SEC without the issuer's consent in three specified circumstances.[37]

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33 *See* 17 C.F.R. § 205.3(a), (b)(1–10) (2019).

34 *Id.* § 205.3(b). Part 205.3(b)(1) begins:

> If an attorney . . . becomes aware of evidence of a material violation by the issuer or by any officer, director, employee, or agent of the issuer, the attorney shall report such evidence to the issuer's chief legal officer (or the equivalent thereof) or to both the issuer's chief legal officer and its chief executive officer (or the equivalents thereof) forthwith. By communicating such information to the issuer's officers or directors, an *attorney* does not reveal client confidences or secrets or privileged or otherwise protected information related to the attorney's representation of an issuer.

Id. § 205.3(b)(1) (emphasis added).

35 *Id.* § 205.3(b)(3)(i–iii).

36 For the full text of Sarbanes-Oxley Act § 307, 15 U.S.C. § 7245, see *supra* note 27. For the full text of 17 C.F.R. § 205.3(b)(1), see *supra* note 34.

37 *See* 17 C.F.R. § 205.3(d)(2).

> An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary: (i) [t]o prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors; (ii) [t]o prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, . . . suborning perjury, . . . or committing any act . . . that is likely to perpetrate a fraud upon the Commission; or (iii) [t]o rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.

First, the attorney may report out to prevent an issuer from committing a material violation that the attorney believes is likely to cause substantial injury to either the financial interest or the property of the issuer, or the investors of the issuer.[38] Second, the attorney may report out to prevent the issuer in an SEC investigation or proceeding from committing perjury, suborning perjury, or committing an act that is likely to perpetrate fraud upon the Commission.[39] Third, the attorney may report out to rectify the consequences of a material violation by an issuer that may cause substantial injury to either the financial interest or property of the issuer or investors, "in furtherance" of which her services were used.[40] The SEC notes in its Final Rule Implementation[41] that Part 205.3(d)(2) corresponds to a proposed version of ABA's Model Rule 1.6, which a "vast majority" of states have adopted.[42]

Part 205.3(d)(1) contains a defensive provision.[43] It provides that an attorney may use any report she has created in relation to Part 205 in connection with any investigation or litigation in which the attorney's compliance with Part 205 is at issue.[44] Part 205.3(d)(1) clarifies that an attorney may use documents created while fulfilling her reporting obligations to defend against any allegation of misconduct.[45] In its Final Rule Implementation, the SEC noted that this section corresponds with

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Id.

38 *Id.* § 205.3(d)(2)(i).

39 *Id.* § 205.3(d)(2)(ii).

40 *Id.* § 205.3(d)(2)(iii).

41 The SEC's Final Rule Implementation regarding 17 C.F.R. § 205 notes its effective date as August 5. Further, it describes each provision of the statute in detail. It contains comments received by the SEC regarding earlier versions of the rule and explains why or why not it chose to incorporate the commentator's proposed changes. *See Final Rule Implementation*, *supra* note 8.

42 *Id. Cf.* LATHAM & WATKINS LLP, ATTORNEYS AS SEC WHISTLEBLOWERS: CAN AN ATTORNEY BLOW THE WHISTLE ON A CLIENT AND GET A MONETARY AWARD? 6, 10–15 (2013), https://m.lw.com/thoughtLeadership/SEC-whistleblowers [https://perma.cc/KB9C-LWEP] ("But as our state-by-state chart . . . indicates, it was an exaggeration to say that the 'vast majority' of states had adopted exceptions that corresponded to the SEC's three exceptions.").

43 17 C.F.R. § 205.3(d)(1).

44 *Id.*

45 *Final Rule Implementation*, *supra* note 8.

ABA Model Rule 1.6(b)(3)[46] and self-defense confidentiality rules in all states.[47] Part 205.7 provides a safe harbor provision for attorneys, stating that nothing in Section 205 provides a private right of action against attorneys or law firms.[48]

B. *Model Rule 1.6*

Many states base their ethics rules off of the ABA Model Rules. ABA Model Rule 1.6(b)[49] allows an attorney to reveal information relating to a client to the extent the attorney believes that it is reasonably necessary under specified circumstances.[50] One circumstance in which an attorney may reveal confidential information about her client is to prevent reasonably certain death or substantial bodily harm.[51] Another instance is to prevent their client from committing crime or fraud that is reasonably certain to result in financial injury in furtherance of which the attorney's services were used.[52] However, some states, including New York, have declined to include this provision.[53] ABA Model Rule 1.6(b)(5) also contains a defensive provision.[54] Under this provision, an attorney may reveal confidential information she deems necessary to establish a claim or defense on behalf of the attorney in a conflict between the attorney and client, to establish a defense, or respond to allegations.[55]

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46 *See* MODEL RULES OF PROF'L CONDUCT r. 1.6(b)(3) (AM. BAR ASS'N 2018). Currently, this provision corresponds to ABA Model Rule 1.6(b)(5). For a discussion on the ABA's model rules, see *infra* Section I.B .

47 *See infra* Section I.B.

48 17 C.F.R. § 205.7(a) ("Nothing in this part is intended to, or does, create a private right of action against any attorney, law firm, or issuer based upon compliance or noncompliance with its provisions.").

49 Model Rule 1.6, titled "Confidentiality of Information," was promulgated by the American Bar Association. *See* MODEL RULES OF PROF'L CONDUCT r. 1.6 (AM. BAR ASS'N 2018).

50 *Id.* § 1.6(b).

51 *Id.* § 1.6(b)(1).

52 *Id.* §1.6(b)(2).

53 *See infra* note 63 and accompanying text.

54 N.Y. RULES OF PROF'L CONDUCT r. 1.6(b)(5) (N.Y. STATE UNIFIED COURT SYS. 2018).

55 *Id.*

C. *State Professional Conduct Laws*

In many states, ethics rules limit disclosures in instances where Part 205 would in fact permit disclosure to the SEC.[56] Bar associations in these states have addressed the conflicts in various ways. Some state bar associations have advised that attorneys practicing in their respective states may report out in situations where disclosure is prohibited by state law, but permitted by federal law.[57] For example, the North Carolina State Bar held that Part 205.3(d)(2) preempts state law.[58] In its formal ethics opinion, the North Carolina Bar Association noted this would no longer be the case if the Fourth Circuit or United States Supreme Court were to hold that Part 205.3(d)(2) was not validly promulgated.[59]

Other state bar associations have stated that attorneys in their state may not report out to the SEC in circumstances where state law restricts disclosure.[60] For example, the Washington State Bar Association concluded that Washington attorneys may not disclose information that may be permitted by Part 205.3(d)(2) if revealing that information would be contrary to Washington state ethics laws.[61] Following this

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56 For a discussion on state professional conduct laws around the time Part 205 was passed, see Matthew Eslick, *Tension Among Section 307 of the Sarbanes-Oxley Act of 2002, 17 C.F.R. § 205.3(d)(2), and State Rules Governing Disclosure of Confidential Client Information*, 53 DRAKE L. REV. 133, 146–56 (2004).

57 *See, e.g.*, N.C. State Bar Ass'n, Formal Ethics Op. 9 (2006), https://www.ncbar.gov/for-lawyers/ethics/adopted-opinions/2005-formal-ethics-opinion-9/?opinionSearchTerm =confidential%20disclosure [https://perma.cc/5J69-FL8G].

58 *See id.*

59 *Id.* ("It is beyond the capacity of an ethics opinion to determine whether or not the 'reporting out' provision of Rule 205 was validly promulgated. Therefore, unless and until the Fourth Circuit Court of Appeals or the US Supreme Court determines that Rule 205 was not validly promulgated, (a) there will be a presumption that Rule 205 was promulgated by the Commission pursuant to a valid exercise of authority and (b) a North Carolina attorney may, without violating the North Carolina Rules of Professional Conduct, disclose confidential information as permitted by Rule 205 although such disclosure would not otherwise be permitted by the NC Rule.").

60 *See, e.g.*, Wash. State Bar Ass'n, Interim Formal Ethics Opinion Re: The Effect of the SEC's Sarbanes-Oxley Regulations on Washington Attorneys' Obligations Under the RPCs (2003).

61 *Id.* This interim opinion was adopted by the Washington State Bar Association Board of Governors prior to the effective date of Part 205. *See* Roy Simon, *Washington State Bar Takes*

opinion, the SEC's General Counsel issued a public statement finding the opinion incorrect, stating that Part 205 would take precedence over state law.[62]

New York's ethics laws also conflict with the reporting out provision of Part 205.3(d).[63] New York's Rules of Professional Conduct (N.Y. RPC) 1.6(a) provides that an attorney may not reveal a client's confidential information unless there is informed consent, the disclosure is impliedly authorized to further the client's best interests, or the disclosure is permitted under 1.6(b).[64] N.Y. RPC 1.6(b) states that an attorney may reveal confidential information when reasonably necessary in certain circumstances.[65] An attorney may reveal confidential information to prevent reasonably certain death or substantial bodily harm; notably, however, there is no exception for reasonably certain financial injury.[66] Another circumstance in which an attorney may reveal confidential information under New York state law is to prevent the client from committing a crime.[67] Further, N.Y. RPC 1.13[68] states that attorneys representing a corporation may only report out confidential information if permitted under N.Y. RPC 1.6(b).[69] N.Y. RPC 1.7 prevents an attorney from representing a client if "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected" by the attorney's own interests.[70] Additionally, N.Y. RPC 1.9 prevents an attorney from using confidential

on SEC, N.Y. LEGAL ETHICS REP. (Oct. 1, 2003), http://www.newyorklegalethics.com/washington-state-bar-takes-on-sec [https://perma.cc/4PQS-ESGN].

62 *See infra* note 172 and accompanying text.

63 *See, e.g.*, N.Y. RULES OF PROF'L CONDUCT r. 1.6 (N.Y. STATE UNIFIED COURT SYS. 2018).

64 *Id.* at r. 1.6(a).

65 *Id.* at r. 1.6(b).

66 *Id.* at r.1.6(b)(1). Part 205.3(d)(2) dissimilarly allows disclosure for substantial injury of financial interest, which is notably left out of the New York rules. *See* 17 C.F.R. § 205.3(d)(2)(i) (2019).

67 *Compare* N.Y. RULES OF PROF'L CONDUCT r. 1.6(b)(2), *with* 17 C.F.R. § 205. Part 205 allows disclosure to prevent "material violations," which include civil violations, while New York law limits disclosure to the violation of criminal laws.

68 N.Y. RPC 1.13 provides guidelines for attorneys who are representing an organization.

69 *Id.* at r. 1.13(c).

70 *Id.* at r. 1.7(a)(2).

information about their former client to the disadvantage of that former client, except as N.Y. RPC 1.6 would permit.[71]

In response to the conflict with Part 205.3(d)(2), the New York City Law Association Committee issued an opinion that concluded New York attorneys may not participate in whistleblower bounty programs.[72] The opinion stated that Part 205 conflicts with varying New York State ethics rules, including N.Y. RPC 1.6, 1.7, and 1.9.[73] It concluded that New York attorneys may not report out where not permitted by N.Y. RPC 1.6.[74] The opinion noted that that an attorney receiving a monetary reward for blowing the whistle constitutes a conflict of interest prohibited under N.Y. RPC 1.7.[75] While the New York State Bar Association's House of Delegates amended New York's Code of Professional Responsibility in 2009, the Delegates "explicitly rejected" provisions akin to that of Part 205's reporting out provisions.[76]

Similarly, California has more limited reporting out laws than Part 205.3(d)(2). California is the only state that does not follow some version of ABA Model Rule 1.6.[77] California's Business & Professional Code mandates that attorneys preserve their clients' secrets.[78] Rule 3-

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71 *Id.* at r. 1.9(c)(2).

72 N.Y. Cty. Lawyers Ass'n Comm. on Prof'l Ethics, Formal Op. 746, *supra* note 22; *see also Frequently Asked Questions*, *supra* note 20 (noting the SEC Whistleblower Bounty Program provides monetary incentives—a bounty—for individuals to report securities violations).

73 N.Y. Cty. Lawyers Ass'n Comm. on Prof'l Ethics, Formal Op. 746, *supra* note 22.

74 *Id.*

75 *Id.* The New York City Law Association Committee's opinion took the fact that the attorney may collect a bounty into its consideration. However, the opinion did state broadly, "New York lawyers, in matters governed by the [N.Y. RPC], may not disclose confidential information under the Dodd-Frank whistleblower regulations, except to the extent permissible under the [N.Y. RPC]." *Id.* at 15.

76 C. Evan Stewart, *The Pit, the Pendulum, and the Legal Profession: Where Do We Stand After Five Years of Sarbanes-Oxley*, 40 SEC. REG. & L. REP. 247, 250 (2008); *see also* C. Evan Stewart, *The Fork in the Road: The SEC and Preemption; Outside Counsel*, N.Y. L.J. (May 9, 2017) ("[I]n 2009, they did so (1) in full awareness that it's [sic] Rule 1.6 would place materially different disclosure obligations on New York state lawyers than those required by the SEC, and (2) in full awareness of the SEC's position on preemption.")

77 LATHAM & WATKINS LLP, *supra* note 42.

78 CAL. BUS. & PROF. CODE § 6068(e)(1) (West 2019) (attorneys must "maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client.").

100[79] allows an attorney to reveal a client's confidential information if the attorney reasonably believes disclosure is necessary to prevent a crime that is likely to result in death or substantial bodily harm.[80] However, prior to disclosing the confidential information, if the circumstances allow, the attorney must first make an effort to persuade the client to pursue a different course of conduct and inform the client of the attorney's decision to reveal information.[81] Notably absent is any option to disclose client information to prevent financial injury, as provided in Part 205.3(d).[82] The United States District Court for the Northern District of California addressed a conflict between Part 205 and California ethics rules in *Wadler v. Bio-Rad Laboratories.*[83]

II. ANALYSIS

A. *Case Law*

In *United States v. Quest Diagnostics,*[84] the Second Circuit addressed preemption of New York state ethics rules.[85] It looked at the issue of preemption of the False Claims Act[86] versus New York state ethics law.[87] The former in-house counsel for Quest Diagnostics,[88] Mark Bibi, participated in a False Claims Act action against Quest Diagnostics

79 CAL. RULES OF PROF'L CONDUCT r. 3-100 cmt. 8 (CAL. BAR ASS'N 2019) ("Disclosure of confidential information must be no more than is reasonably necessary to prevent the criminal act.").

80 *Id.* at r. 3-100(B).

81 *Id.* at r. 3-100(C).

82 17 C.F.R. § 205.3(d)(2)(i) (2019).

83 212 F. Supp. 3d 829 (N.D. Cal. 2016); *see* discussion *infra* Section II.A.

84 734 F.3d 154 (2d Cir. 2013).

85 *Id.*

86 31 U.S.C. § 3729 (2018). The False Claims Act imposes liability on corporations and individuals who make, present, or cause to be made any fraudulent claim for payment by the government. *See id.*

87 *Quest*, 734 F.3d at 163–65. However, the court looked at preemption of the False Claims Act, rather than any provision of the Sarbanes-Oxley Act directly. *Id.*

88 Quest Diagnostics is a corporation that provides medical testing services for managed care organizations and independent practice association s throughout the United States. Quest acquired Unilab, also a party to this action, which is now a wholly owned subsidiary of Quest. *See id.* at 158–59.

and Unilab Corporation.[89] Quest Diagnostics argued that Bibi violated N.Y. RPC 1.9 by participating in the action.[90] First, Quest Diagnostics argued that Bibi violated N.Y. RPC 1.9(a) by "switching sides" from that of Quest Diagnostics to the side of the government.[91] Second, Quest Diagnostics argued that Bibi violated N.Y. RPC 1.9(c), which prevents a lawyer from disclosing confidential information about a former client to disadvantage that client, unless permitted by N.Y. RPC 1.6.[92]

The Second Circuit ultimately held that the False Claims Act does not preempt state ethical rules governing disclosure of client confidences.[93] The court found that legislative intent to preempt state ethics rules was absent.[94] However, it noted that the goal of the False Claims Act is to encourage individuals to come forward when they are aware of fraud upon the government and, therefore, the court determined the New York rules should be interpreted and applied in a manner that takes federal interests into account.[95] The court found that N.Y. RPC 1.6(b)(2) implicitly takes federal interests into account in the False Claims Act by allowing *necessary* information to be disclosed in order to prevent the commission of a crime.[96] It ultimately decided that Bibi's disclosures went beyond what was necessary in order to prevent the crime.[97] Therefore, he was in violation of N.Y. RPC 1.9(c),[98] and the

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89 *Id.* at 158. The action alleged that Quest Diagnostics violated anti-kickback laws through charging clients unreasonably low prices to clients in order to induce Medicare and Medicaid business, and then billing the government at higher prices. *Id.* at 159.

90 *Id.* at 161–62.

91 *Id.*

92 *Id.* at 162.

93 *Id.* at 163 ("Nothing in the False Claims Act evinces a clear legislative intent to preempt state statutes and rules that regulate an attorney's disclosure of client confidences. As one court recognized, while the [FCA] *permits* any person . . . to bring a *qui tam* suit, it does not authorize that person to violate state laws in the process.") (alterations in original) (internal quotation marks and citations omitted).

94 *Id.*

95 *Id.*

96 *Id.* at 164.

97 *Id.* at 165.

98 N.Y. RPC § 1.9(c)(1) prohibits a lawyer from using confidential information about the former client to disadvantage the client unless permitted under N.Y. RPC 1.6(a). N.Y. RULES OF PROF'L CONDUCT r. 1.9(c)(1), 1.6(a) (N.Y. STATE UNIFIED COURT SYS. 2018). The court noted that since they affirmed the dismissal on the grounds Bibi violated Rule 1.9(c), they did not have to determine if he also violated N.Y. RPC § 1.9(a). *Quest*, 734 F.3d at 165.

case was dismissed.[99] This decision leads many scholars to believe a New York court would come out the same way with regard to the preemptive effect of Part 205.3(d).[100]

In *Wiersum v. U.S. Bank, N.A.*,[101] the Eleventh Circuit looked at the preemption of the National Bank Act versus a Florida whistleblower statute.[102] Marc Wiersum, a former vice president and wealth management consultant for the U.S. Bank of North America, brought a wrongful termination suit against the bank.[103] Wiersum alleged that he saw the bank improperly condition credit in violation of federal law, he objected to this practice, and his employment was subsequently terminated.[104] He alleged that the bank violated the Florida Whistleblower Act (FWA) by firing him.[105] Conversely, the bank argued the National Bank Act, which allows officers of federally chartered banks to be terminated at will, preempted state law and, therefore, the case should be dismissed.[106] The Eleventh Circuit held that the National Bank Act preempted the FWA, thus Wiersum was terminable at will and had no wrongful employment claim against the bank.[107] However, a

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99 *Quest*, 734 F.3d at 168.

100 *See, e.g.*, Stewart, *The Fork in the Road*, *supra* note 76 (noting the *Quest* decision "would seem to provide the answer to the SEC's preemption claim quite definitively, and in the negative"). However, this belief does not consider whether Part 205 was validly promulgated in the first place. This Note argues it was not validly promulgated and, for that reason, it has no preemptive effect against state law. For a discussion on the preemption of Part 205 versus conflicting state law, see *infra* Section II.B.3.

101 785 F.3d 483 (11th Cir. 2015), *cert. denied*, 136 S. Ct. 1655 (2016) (Mem.).

102 *Id.* at 485.

103 *Id.*

104 *Id.*

105 *Id.*

106 *Id.*

107 The Eleventh Circuit noted that determining whether the National Bank Act preempts the FWA in regard to a state employment contract was an issue of first-impression for the court. *Id.* at 496. In its preemption analysis, the court stated that determining preemption primarily involves looking at congressional intent and therefore statutory interpretation is central. *Id.* at 487. In cases where the statute is ambiguous, courts look at legislative history; however, the Eleventh Circuit found that the National Bank Act was unambiguous. *Id.* at 487–88. The National Bank Act explicitly states that bank officers may be dismissed "at pleasure." *See* 12 U.S.C. § 24 (2018) (Fifth) ("To elect or appoint directors, and by its board of directors to appoint a president, vice president, cashier, and other officers, define their duties, require bonds of them and fix the penalty thereof, dismiss such officers or any of them at pleasure, and appoint others to fill their places."). The court found that the two laws were in direct conflict, as

concerned dissenting opinion noted the problematic consequences of the court's decision.[108]

The Northern District of California specifically addressed Part 205 in *Wadler v. Bio-Rad Laboratories*.[109] The court explicitly held that Part 205 preempts state ethics laws.[110] The plaintiff, Sanford Wadler, was the general counsel of Bio-Rad Laboratories for twenty-five years.[111] Wadler alleged that his employment was terminated because he had investigated whether Bio-Rad was acting in violation of the Foreign Corrupt Practices Act[112] (FCPA).[113] Wadler argued that Bio-Rad was violating the FCPA through its work in China, and he reported these concerns to the company's Audit Committee.[114] Wadler's concerns were addressed

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complying with both statutes would be impossible, and therefore it dismissed Wiersum's case. *Wiersum*, 785 F.3d at 490–91.

108 The judge noted that the majority's decision denies bank officers the protections state law affords them. *Wiersum*, 785 F.3d at 491–98 (Martin, J., dissenting) ("The consequences of the majority's ruling are worrying. The majority denies bank officers—of which there are thousands nationwide—the protection of state employment laws. Most obviously, bank officers are no longer protected by anti-retaliation statutes like the Florida law at issue here. But neither will bank officers any longer enjoy the protection of state and local anti-discrimination laws that offer protections the federal anti-discrimination regime does not.") (internal citations omitted).

109 212 F. Supp. 3d 829 (N.D. Cal. 2016). For the sake of clarity, *Wadler* did not address the reporting up provision, Part 205.3(d)(2), specifically. However, it did broadly hold that Part 205 preempts state ethics laws. *See id.*

110 *Id.* at 857 ("Accordingly, the Court finds that to the extent the ethical obligations governing attorneys who practice in California impose stricter limits on the disclosure of privileged and confidential information in this action than are imposed under the Sarbanes-Oxley Act, as reflected in Part 205, the former are preempted.").

111 *Id.* at 833. Bio-Rad Laboratories manufactures and sells laboratory equipment used in scientific and clinical research. *See id.*

112 Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended at 15 U.S.C. § 78dd-1 (2018)). The Foreign Corrupt Practices Act prohibits companies from performing bribery or kickback schemes involving public officials and ensures that companies maintain accurate accounting records, as well as provide compliance mechanisms for preventing these sorts of schemes. *Id.*

113 *Wadler*, 212 F. Supp. 3d at 833 ("Wadler asserts he was terminated because he was investigating potential FCPA violations in China and because he reported his concerns to Bio-Rad's Audit Committee when it became clear that the company was not taking reasonable steps to investigate and remedy FCPA violations.") (internal citation and quotation marks omitted).

114 *Id.* Bio-Rad hired Steptoe & Johnson LLP to investigate potential FCPA violations and Davis Polk & Wardwell LLP to investigate accusations Wadler made to Bio-Rad's Audit Committee. Davis Polk & Wardwell found no evidence of FCPA violations. *See id.* at 833–34.

in SEC and Department of Justice (DOJ) administrative proceedings.[115] He also brought a whistleblower complaint with the Department of Labor.[116]

Bio-Rad argued that it legitimately terminated Wadler's employment, and maintained that its decision was based on his behavior and work performance.[117] Bio-Rad moved to exclude confidential information that Wadler provided in the course of the case.[118] It argued that California's stringent ethics rules—including California RPC 3-100 and California Business & Professional Code section 6068(e)—should govern this conduct.[119] Bio-Rad noted that California's rules are stricter than the ABA Model Rules of Professional Responsibility.[120] Bio-Rad made two primary arguments to support its argument that California state ethics laws preempt Part 205. First, it argued that federal courts look to state rules in areas traditionally regulated by state law, which is the case in attorney ethics and confidentiality rules.[121] Second, it argued that both the Sarbanes-Oxley Act and the Dodd-Frank Act lack congressional intent to preempt state ethics rules about confidentiality.[122]

Wadler made two primary arguments.[123] First, he argued Bio-Rad waived its privilege by disclosing much of the confidential information in the SEC proceeding, DOJ proceedings, and its disclosures in publicly filed documents.[124] Second, he argued the Sarbanes-Oxley Act and Dodd-Frank Acts preempt state ethics law.[125] The SEC filed an amicus

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115 *Id.* at 833.

116 *Id.*

117 *Id.*

118 *Id.* at 837.

119 *Id.*; *see also supra* Section I.C (discussing relevant California ethics laws, including California RPC 3-100 and California Business & Professional Code Section 6068(e)).

120 *Wadler*, 212 F. Supp. 3d at 837; *see also* Section I.B (discussing ABA Model Rule 1.6, which allows for disclosure in situations where California law does not).

121 In making this point, the court cited to *Quest*. *Wadler*, 212 F. Supp. 3d at 837 (citing United States v. Quest Diagnostics Inc. 734 F.3d 154, 163 (2d Cir. 2013)).

122 *Id.* at 837–38.

123 *Id.* at 839.

124 *Id.* Wadler argued, for example, that Davis Polk & Wardwell's summarization of Wadler's FCPA allegation against Bio-Rad, as well Steptoe & Johnson's work, which was presented to the SEC and DOJ, was made public. *See id.*

125 *Id.*

brief supporting his position, arguing the Sarbanes-Oxley Act preempts California's state ethics rules pertaining to attorney-client communication and confidentiality.[126]

Prior to examining California state ethics rules, the court determined that Wadler could introduce certain privileged information as a result of Bio-Rad's "open and aggressive approach" to litigating the matter, in addition to the nature of public disclosures in both the SEC and DOJ administrative hearings.[127] The court next inquired whether Part 205 preempts California ethics laws.[128] It held that Section 307 of the Sarbanes-Oxley Act does in fact preempt the California state ethics laws that Bio-Rad argued prevented Wadler from disclosing confidential information.[129] The court noted that the SEC implemented this section by creating Part 205's reporting up and reporting out provisions.[130] Here, the court cited the Final Rule Implementation, where the SEC stated that Part 205.3(d)(1) corresponded to ABA Model Rule 1.6(b)(3) and self-defense privilege exceptions.[131] The court found that Part 205 appeared to be within the authority granted by Section 307 to the SEC.[132] Finally, the court held that, where Part 205 allowed broader privileged and confidential disclosures than those permitted under California ethics rules and there is therefore a direct conflict between federal and state law, California state rules are preempted.[133] However,

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126 *Id.* at 843.

127 *Id.* at 850. The court held that privilege was waived with regard to the Davis Polk & Wardwell presentation, an Audit Committee memo, and communications pertaining to topics discussed in these documents. The court noted that Bio-Rad conceded that the presentation its attorneys made to the government was not privileged; Davis Polk & Wardwell made the same presentation to the DOJ, following its presentation the SEC. *Id.* at 851–52. The court found that fairness principles allow this waiver of privilege to extend beyond the presentation, as Bio-Rad Labs had repeatedly relied on its attorneys' conclusions "as both a sword and a shield" in arguing that Wadler's allegations involving the FCPA were unjustified. *Id.* at 851.

128 *Id.* at 855.

129 *Id.* at 854.

130 *Id.* at 854–55.

131 *Id.* at 855.

132 *Id.* at 857 ("[S]uch a rule appears to be both within the authority granted under Section 307 and to reflect a reasonable balancing of conflicting policies to the extent it protects attorney whistleblowers from retaliation even as it requires them to report violations.").

133 *Id.* The court stated:

> [T]he rule adopted by the SEC here reflects an unambiguous intent to preempt state ethical rules that prevent attorneys from disclosing privileged information necessary

the court failed to note that it is congressional intent for the agency to create a law that preempts the state law, coupled with the administrative agency's promulgation of the law in a reasonable manner, which governs.[134]

The court denied Bio-Rad's motion to exclude evidence, as the information Wadler provided was permitted under Part 205.[135] Eventually, Wadler was permitted to use the confidential information he obtained as Bio-Rad Lab's general counsel, and was awarded a judgment of $7.29 million in damages for wrongful termination and retaliation under the Sarbanes-Oxley Act and Dodd-Frank Act.[136] Commentators predict that the large damages in *Wadler* will encourage more in-house attorneys to come forward and "blow the whistle" on the corporations they work for.[137] Further, while the specific provision at issue in *Wadler* was the preemption of Part 205.3(d)(1), the court referred to Part 205 generally as preempting California law where California law imposes stricter disclosure limits.[138]

> to comply with Sarbanes-Oxley. To the extent that one of the methods Congress chose for achieving that objective was to afford protection from retaliation to those who comply with these reporting requirements, an ethical rule that deprives an attorney of such protection interferes with the methods by which Sarbanes-Oxley was designed to achieve its objective. In other words, this is a textbook example of obstacle preemption.

Id. (internal citation omitted).

134 *Id.*; *see infra* Section II.B.2.

135 *See Wadler*, 212 F. Supp. 3d at 857–58.

136 *See* Andrew S. Boutros & Craig B. Simonsen, *Federal Whistleblower Laws Collide with the Attorney-Client Privilege: The Bio-Rad Case Study*, SEYFARTH SHAW LLP (Feb. 14, 2017), https://www.linkedin.com/pulse/federal-whistleblower-laws-collide-attorney-client-bio-rad-simonsen [https://perma.cc/S4BW-U53C].

137 *See, e.g.*, Melissa Maleske, *GCs May Increasingly Blow the Whistle After Bio-Rad Verdict*, LAW360 (Feb. 9, 2017, 8:39 AM), https://www.law360.com/articles/890360/gcs-may-increasingly-blow-the-whistle-after-bio-rad-verdict [https://perma.cc/EV63-5WLT].

138 *See Wadler*, 212 F. Supp. 3d at 857.

B. *Doctrine of Federal Preemption*

1. General Preemption Overview

Congressional power to preempt state law is rooted in the Supremacy Clause of the Constitution.[139] Congress has the power to preempt state legislation as long as it is acting within the powers granted to it under the Constitution and not an area reserved to the states.[140] Whether a federal law preempts state law depends on congressional intent, and thus the purpose of federal statutes must be examined.[141] For example, the Supreme Court has noted that, in determining whether a federal act preempts state law, courts will assume that Congress did not intend to preempt the "historic police powers" of the states unless congressional intent is especially clear.[142]

Conflicts between state statutes and federal statutes passed by Congress arise under two circumstances: explicit and implied preemption. Under the doctrine of explicit preemption, courts have determined that Congress may preempt state law by stating it is doing so explicitly within the statute.[143] However, even when congressional intent is not made explicit, congressional intent may be inferred under the doctrine of implied or implicit preemption.[144] In instances of explicit

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139 *See* U.S. CONST. art. VI, cl. 2. The Supremacy Clause states, "[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . [anything] in the Constitution or Laws of any State to the Contrary notwithstanding." *Id.*

140 *Id.* The Tenth Amendment to the Constitution states, "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. CONST. amend. X.

141 *See, e.g.*, Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996) ("[T]he purpose of Congress is the ultimate touchstone in every pre-emption case") (internal quotation marks omitted); Allis-Chalmers Corp. v. Lueck, 471 U.S. 202, 208 (1985); Hawaiian Airlines, Inc. v. Norris, 512 U.S. 246, 252 (1994) (noting the traditional police power of the state).

142 *See, e.g.*, Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230–31 (1947) (finding the United States Warehouse Act contained no express provisions as to the matters in conflict with state law, and therefore state law was not preempted).

143 *See, e.g.*, Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n, 461 U.S. 190, 203 (1983) ("It is well-established that within Constitutional limits Congress may preempt state authority by so stating in express terms.").

144 *See id.* at 203–04. ("Absent explicit preemptive language, Congress' intent to supercede [sic] state law altogether may be found from a scheme of federal regulation so pervasive as to

preemption, language in a statute expressly demonstrates congressional intent to preempt state law.[145] However, statutes do not often contain any express congressional intent to preempt state laws; therefore, the court must inquire into whether congressional intent is implied.[146]

Implied preemption has two sub-categories: field preemption and conflict preemption.[147] Field preemption occurs when, although Congress has not made its intent to preempt state law clear, it legislates in such a comprehensive manner that states are left with no room to legislate in the particular field.[148] Conflict preemption occurs in two different situations.[149] The first is when state and federal law cannot possibly both be complied with, which is often referred to as impossibility preemption or irreconcilable conflict preemption.[150] The second is when state law would upset the purposes and goals of the federal legislation.[151]

While analysis into congressional intent is the main test for preemption of congressional statutes, when an administrative agency creates a regulation pursuant to an act of Congress, there is an extra layer of analysis courts must perform, as courts must determine whether

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make reasonable the inference that Congress left no room to supplement it . . . .") (internal quotation marks omitted).

145 *See id.*

146 *See* Barnett Bank of Marion Cty., N.A. v. Nelson, 517 U.S. 25, 31 (1996) ("More often, explicit pre-emption language does not appear, or does not directly answer the question. In that event, courts must consider whether the federal statute's 'structure and purpose,' or nonspecific statutory language, nonetheless reveal a clear, but implicit, pre-emptive intent.") (internal citations omitted).

147 *See* Stephen Wermiel, *SCOTUS for Law Students: Preemption Again*, SCOTUSBLOG (Mar. 11, 2013, 11:05 AM), http://www.scotusblog.com/2013/03/scotus-for-law-students-sponsored-by-bloomberg-law-preemption-again [https://perma.cc/4KAF-9UQE].

148 *Id.*

149 *Id.*

150 *See* English v. Gen. Elec. Co., 496 U.S. 72, 79 (1990) ("Thus, the Court has found pre-emption where it is impossible for a private party to comply with both state and federal requirements . . . ."); *see also Nelson*, 517 U.S. at 31.

151 *See* Wermiel, *supra* note 147. In *Nelson*, the federal statute and state statute at issue did not "impose directly conflicting duties" on banks. However, the federal statute authorized the national banks to partake in activities prohibited by state law. Therefore, the Court found that the state's prohibition posed an obstacle to the accomplishment of the federal statute's objectives. *See Nelson*, 517 U.S. at 31.

the agency reasonably exercised the authority it was granted by Congress.[152]

2. Preemption of Administrative Regulations

In *City of New York v. FCC*,[153] the Supreme Court noted that a preemption analysis for an administrative regulation is different than one for congressional acts because the inquiry is whether the agency properly exercised its delegated power.[154] The Court inquired whether the Federal Communications Commission (FCC) was legally authorized by Congress to create such a rule, which in effect preempted state and local standards.[155] First, the Court asked whether the regulation promulgated by the federal agency was intended to preempt state law.[156] It found that the intent of the FCC to preempt state technical standards was apparent.[157] Second, the Court asked whether the federal agency

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152 For a discussion on preemption of administrative regulations, see *infra* Section II.B.2. This analysis includes whether the administrative agency purported to preempt state law, and whether the agency exercised its delegated authority reasonably in a manner Congress would have sanctioned.

153 486 U.S. 57 (1988). The case involved cable franchisors seeking judicial review of FCC regulations that establish technical standards governing the quality of cable television signals. The Court looked at legislative history and found the FCC did not exceed its statutory authority, as the ultimate rule was in contemplation of what Congress had intended. It noted, "the House Report which discusses this section of the Act portrays it as nothing more than a straightforward endorsement of current law . . . ." *Id.* at 68 (citing H.R. REP. NO. 98-934, at 70 (1984)).

154 *Id.* at 64 ("[H]ere the inquiry becomes whether the federal agency has properly exercised its own delegated authority rather than simply whether Congress has properly exercised the legislative power.").

155 *Id.* at 66–67. In describing its rationale for performing this analysis, the court stated:

> First, an agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it. Second, the best way of determining whether Congress intended the regulations of an administrative agency to displace state law is to examine the nature and scope of the authority granted by Congress to the agency.

Id. at 66 (quoting Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 374 (1986)).

156 *Id.* at 65.

157 *Id.* The Court pointed to language the FCC provided in adopting the relevant regulations. The FCC noted that technical standards differ between communities, thus causing harm to

was legally authorized to preempt state and local regulations, and found that the FCC was in fact authorized to do so by Congress.[158] The Court noted that the focus is not on whether there was explicit congressional intent to replace state law but, rather, the extent of the agency's authority.[159] Ultimately, the Court in *City of New York v. FCC* made clear that courts should not disturb an agency's undertaking unless the statute itself and legislative history make it clear that Congress would not have authorized the regulation.[160]

One basis on which an agency defends its interpretation of its grant of authority from Congress is by asserting a *Chevron* deference defense.[161] In asserting a *Chevron* defense, the agency argues that, in the case of an ambiguous statute, the court should give deference to an administrative agency's interpretation of its own grant of authority to promulgate a regulation.[162] The *Chevron* Court noted that, in instances where a court is interpreting an administrative rule that was created pursuant to a congressional act, the first question is whether Congress has spoken directly and expressly to the issue at hand.[163] If congressional intent is clear, then the court must give effect to the "unambiguously expressed" congressional intent.[164] However, if a court determines that the congressional statute is silent or ambiguous regarding the specified issue, the court will ask whether the agency's answer is based on a "permissible construction" of the statute.[165]

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consumers and, therefore, they proposed technical standards at the federal level in order to address this problem. *Id.*

158 *Id.* at 66.

159 *Id.* at 64; *see also* United States v. Mead Corp., 533 U.S. 218 (2001). In *Mead*, the Court concluded that Congress had no intention of delegating authority to the United States Customs Service to issue tariff classifications containing the "force of law." *Mead*, 533 U.S. at 219.

160 *City of New York v. FCC*, 486 U.S. at 64.

161 *See* Chevron, U.S.A., Inc. v. Nat'l Res. Def. Council, Inc., 467 U.S. 837 (1984) (finding the Environmental Protection Agency regulation at issue was based on a "permissible construction" of terminology in the Clean Air Act Amendments).

162 *Id.* at 843–44.

163 *Id.* at 842.

164 *Id.* at 842–43 ("If the intent of Congress is clear, that is the end of the matter; for the court . . . .").

165 *Id.* at 843 ("If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the

Ultimately, these cases promulgate a two-pronged test to determine whether preemption of an administrative regulation is appropriate: first, whether the federal agency actually attempted to preempt state law; and second, whether the agency acted with statutorily authorized power, in a permissible manner, in attempting to preempt a state law or regulation. For the federal law to preempt the state law, both prongs must be met.[166]

3. Preemption as Applied to Part 205.3(d)

a. The SEC Purported to Preempt State Law

It is clear the SEC intended Part 205.3(d) to preempt state law. Part 205.1 states explicitly that where state law conflicts, Part 205 shall govern.[167] The SEC's Final Rule Implementation provides that Part 205 shall govern over inconsistent state law.[168] Further, the SEC noted that its rules prevail in situations where state law contains stricter confidentiality requirements, which applies to states such as New York and California.[169]

The SEC's intent is evidenced by its amicus brief filed in *Wadler*, where it argued in favor of preemption of a section of Part 205 over

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agency's answer is based on a permissible construction of the statute.") (internal citations omitted).

166 *See, e.g.*, City of New York v. FCC, 486 U.S. 57, 64 (1988).

167 17 C.F.R. § 205 (2019). Part 205.1 contains the purpose and scope of Part 205. *Id.* § 205.1 ("These standards supplement applicable standards of any jurisdiction where an attorney is admitted or practices and are not intended to limit the ability of any jurisdiction to impose additional obligations on an attorney not inconsistent with the application of this part. Where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with this part, this part shall govern.").

168 *Final Rule Implementation*, *supra* note 8.The Final Rule Implementation stated:

> A number of commenters questioned the Commission's authority to preempt state ethics rules, at least without being explicitly authorized and directed to do so by Congress. . . . The language which we adopt today clarifies that this part does not preempt ethical rules in United States jurisdictions that establish more rigorous obligations than imposed by this part. At the same time, the *Commission reaffirms that its rules shall prevail over any conflicting or inconsistent laws of a state* or other United States jurisdiction in which an attorney is admitted or practices.

Id. (emphasis added) (discussion of Part 205.1).

169 *Id.* For a discussion on New York and California state ethics laws, which impose more restrictive confidentiality requirements, see *supra* Section I.C.

California state law.[170] The SEC's brief points to the language in Part 205 itself and principles of conflict preemption in order to show that the SEC intended for its regulation to preempt state law.[171] Furthermore, in 2003, in responding to the Washington State Bar Association's Proposed Interim Formal Opinion, the SEC's own General Counsel at the time, Giovanni Prezioso, made a public statement that Part 205 takes precedence over state law.[172] In doing so, he noted that the purpose of the SEC's rule would be frustrated if states could bring actions against attorneys who violate their state's ethics laws while complying with the SEC rule.[173]

b. The SEC Did Not Act with Statutorily Authorized Power from Congress in Promulgating a Reporting Out Procedure in Part 205

Section 307 of the Sarbanes-Oxley Act did not explicitly provide for the SEC to create a rule that would preempt state law, or even a law that contained a reporting out provision of any kind.[174] Under *City of New*

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170 Brief of the Securities and Exchange Commission as Amicus Curiae in Support of Plaintiff at 5, Wadler v. Bio-Rad Labs., Inc., 212 F. Supp. 3d 829 (N.D. Cal. 2016) (No. 3:15-cv-2356 JCS) [hereinafter Brief for SEC]. ("The Commission's view is that Section 205.3(d)(1)—without which attorneys complying with their legal obligation to report possible violations would have limited anti-retaliation protection—preempts the California laws on which Bio-Rad relies because those laws would interfere with the effectiveness of Part 205. Accordingly, the Court should deny Bio-Rad's motion.").

171 *See id.*

172 *See* Giovanni P. Prezioso, Public Statement by SEC Official: Letter Regarding Washington State Bar Association's Proposed Opinion on the Effect of the SEC's Attorney Conduct Rules, U.S. SEC. & EXCHANGE COMMISSION (July 23, 2003), https://www.sec.gov/news/speech/spch072303gpp.htm [https://perma.cc/QR4C-U58V]. Giovanni Prezioso stated:

> In opining that the Washington RPC 1.6 bars attorney disclosures permitted by Section 205.3(d)(2) of the Commission's rules, however, the Proposed Interim Formal Opinion is inconsistent with prevailing Supreme Court precedent. . . . Thus, Section 205.3(d)(2) of the Commission's rules will take precedence over any conflicting provision of RPC 1.6.

Id.

173 *See id.* Giovanni Prezioso stated that if the Washington State Bar Association were to bring a disciplinary hearing against an attorney who reported a material violation to the SEC pursuant to Part 205.3(d)(2), the purpose of the SEC's rules would be frustrated. According to Prezioso, even if the attorney was exonerated at the proceeding, it would "thwart the purposes of the Commission's rules" to subject attorneys to proceedings for complying with an SEC rule. *Id.*

174 *See supra* Section I.A.1 (discussing Section 307 of the Sarbanes-Oxley Act of 2002).

York v. FCC, the second step of the inquiry involves determining whether Congress would have sanctioned such a promulgation.[175] Under *Chevron*, the SEC must have reasonably interpreted the authority Congress granted it.[176]

In looking at both the text of Section 307 and the legislative history, there is no indication that Congress would have sanctioned such a broad reporting out provision in conflict with state law without the mention of this broad grant of authority on the legislative floor.[177] In fact, it seems that Congress explicitly had in mind *not* creating the authority to report to the SEC, thus making any interpretation of authority granted under Section 307 to report out impermissible.[178]

In examining the legislative history, it is apparent there was no evidence of anything more than a reporting up provision intended.[179] First, Senator Edwards stated the purpose for Section 307 was to ensure the SEC enforced the up-the-ladder reporting procedures.[180] Second, all discussion of the new regulation was limited to the benefits of reporting up the corporate ladder.[181] For example, Senator Enzi stated that attorneys should have an explicit duty to report violations to primary

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175 486 U.S. 57, 65–66 (1988); *see supra* note 166 and accompanying text.

176 *See* Chevron, U.S.A., Inc. v. Nat'l Res. Def. Council, Inc., 467 U.S. 837 (1984).

177 *See* 148 CONG. REC. S6551–56 (daily ed. July 10, 2002) (Amendment No. 4187) (statement of Sen. Enzi). Prior to voting on an amendment, Senators are able to debate each amendment. For more information on the Senate's amending process see Christopher M. Davis, *The Amending Process in the Senate*, CONG. RES. SERV. (Sept. 16, 2015), https://www.senate.gov/CRSpubs/738b4c8d-66ee-4c11-9b6a-176194c4456a.pdf [https://perma.cc/JXF8-6VXA].

178 *See infra* note 192 and accompanying text.

179 *See* 148 CONG. REC. S6551–56.

180 *Id.* at S6552 (Senator Edwards stated, "[i]n January, a bipartisan group of the top securities lawyers and legal ethics experts in the country wrote a letter to Harvey Pitt telling him it was time for the SEC to enforce the up-the-ladder principle, as in the past. Mr. Pitt's top lawyer said: We are not going to do anything. If Congress wants something done, Congress should act. Then I wrote a letter to Mr. Pitt in essence saying: We are ready to act here. Will you help us in crafting legislation and working out this problem?"). At this time, Harvey Pitt was the Chairman of the SEC. *See SEC Biography: Chairman Harvey L. Pitt*, SEC. & EXCHANGE COMMISSION, https://www.sec.gov/about/commissioner/pitt.htm [https://perma.cc/749J-DZDJ] (last updated Jan. 23, 2009).

181 *See* 148 CONG. REC. S6551–56.

officers and, if necessary, to an audit committee or board of directors.[182] Senator Corzine focused the importance of this amendment on allowing attorneys who are made aware of wrongdoing to report it to their client, without mentioning reporting wrongdoing to anyone else, including the SEC.[183] Senator Corzine called the amendment "simple," and stated the amendment requires attorneys to contact specific management personnel and, if that fails, the attorney must contact the audit committee.[184] These statements focusing on the benefits of reporting up, and not reporting out, reaffirm the notion that the only provisions ever contemplated were those directing an attorney to report up the corporate ladder.[185]

Further comments that Senator Enzi made to the Senate show most strongly the impossibility that Congress imagined, or would have sanctioned, a reporting out procedure.[186] In describing the process this provision provides, Senator Enzi stated that all actions to be taken by the in-house attorney under the new amendment would remain "within the corporation."[187] This statement removes doubt as to whether Congress intended the rule to allow for reporting of conduct to those *outside* the corporation.[188] This statement—in which he ensured the Senators that all disclosures would remain within the corporation—was

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182 148 CONG. REC. S6555 (statement of Senator Enzi) ("When their counsel and advice is sought, attorneys should have an explicit, not just an implied, duty to advise the primary officer and then, if necessary, the auditing committee or the board of directors of any serious legal violation of the law by a corporate agent. Currently, there is no explicit mandate requiring this standard of conduct. It is clearly in the best interest of their client to disclose this kind of information *to the board*, rather than just upper management.") (emphasis added).

183 *Id.* at S6556 (Statement of Senator Corzine) ("That is why Senator Edwards, Senator Enzi, and I have crafted an amendment that will clarify that lawyers who know of wrongdoing by a corporation must report that wrongdoing to the client so it can be corrected.").

184 *Id.* at S6552.

185 *See id.* at S6551–56.

186 *See id.* at S6555.

187 *Id.* Senator Enzi stated:

> If these officers do not promptly take action in response, the Commission is instructed to establish a rule that the attorney then has a duty to take further appropriate action, including notifying the audit committee of the board of directors or the board of directors themselves, of such evidence and the actions of the attorney and others regarding this evidence. *It is all within the corporation.*

Id. (emphasis added).

188 *See id.*

made prior to the Senate's vote on the amendment.[189] Any attempt by the SEC to use Section 307's grant of authority to create a rule in which in-house attorneys may report material violations out to the SEC is thus unreasonable. Therefore, under *City of New York v. FCC* and *Chevron*, in which the agency's reasonable interpretation of its grant of power must be one that would have been sanctioned by Congress, Part 205.3(d)(2) fails to meet the test for preemption of state law.[190]

While Senator Enzi has typically opted for a state solution, he felt a federal solution was necessary in this instance.[191] In doing so, however, he stated explicitly that no breach of attorney-client privilege would occur through this rule, as all discussions were to remain internal.[192] He described concern that the rule promulgated by the SEC would cause a breach of attorney-client privilege as "ludicrous," and explicitly stated that all notifications would be internal.[193] Therefore, it cannot be said that Congress granted the SEC the power to create a reporting out provision. The SEC even noted in its Final Rule Implementation that many commentators found Part 205.3's permissive reporting out provision to be unwarranted and non-delegated authority under Section 307.[194] One such commentator, JPMorgan Chase, appropriately noted that Part 205 went beyond both the language and the legislative history of Section 307.[195]

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189 *See id.*

190 *See supra* Section II.B.2.

191 148 CONG. REC. at S6555 (daily ed. July 10, 2002) (statement of Senator Enzi).

192 *Id.* ("Some argue that the amendment will cause a breach of client/attorney privilege, which is ludicrous. The attorney owes a duty to its client which is the corporation and the shareholders. By reporting a legal violation to management and then the board of directors, *no breach of the privilege occurs, because it is all internal*—within the corporation and not to an outside party, such as the SEC.") (emphasis added).

193 *Id.*

194 *Final Rule Implementation*, *supra* note 8 ("A number of commenters questioned the Commission's authority to preempt state ethics rules, at least without being explicitly authorized and directed to do so by Congress.").

195 *See* Letter from Anthony J. Horan, Corp. Sec'y, JPMorgan Chase, to Sec. & Exch. Comm'n (Dec. 20, 2002), https://www.sec.gov/rules/proposed/s74502/jpmorganchase122002.htm [https://perma.cc/U663-9V7B] ("Even though the standards for these 'over-the-ladder' disclosures or signals are higher than the standards for disclosure within the corporation, we believe that these provisions of the proposed rule are unwarranted by Section 307. They go beyond the express language of the statute and the legislative history.").

III. PROPOSAL

A. *The SEC Exceeded its Authority in Creating Part 205.3(d)(2)*

Congress did not grant the SEC the authority to create Part 205 as it currently stands in its entirety.[196] Therefore, *Wadler* incorrectly held that Part 205 in its entirety should govern over state law.[197] In citing to prior case law, the court noted that federal regulations are not any "less preemptive" than federal statutes.[198] However, there is an added layer in determining the preemptive effect of an administrative regulation versus a direct congressional statute, as inquiry must be made into the reasonableness of the interpretation of Congress's grant of power.[199] The court concluded that Part 205.3(d)(1)[200] was appropriately promulgated by the SEC.[201] While this provision may have been promulgated with appropriate authority,[202] the same cannot be said for all of Part 205,

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196 *See supra* Section II.B.3 (arguing the SEC exceeded congressional authority in promulgating a reporting out procedure in Part 205).

197 Further problems with the *Wadler* decision exist. The court in *Wadler* held that Wadler could use privileged material through ABA Model Rule 1.6. Wadler v. Bio-Rad Labs., Inc., 212 F. Supp. 3d 829, 849 (N.D. Cal. 2016). However, the ABA Model Rules are neither in effect in California, nor any other state. Scholar C. Evan Stewart noted that "the ABA Model Rules are not in effect *anywhere*—and they certainly do *not* constitute federal common law." Stewart, *The Fork in the Road*, *supra* note 76. Also problematic is the emphasis the *Wadler* court puts on the SEC's intent to preempt state law, which is only the first part of a preemption inquiry for administrative regulations and not dispositive on its own. *Wadler*, 212 F. Supp. 3d at 856–58. For a discussion on this inquiry, see *supra* Section II.B.2. The court noted that the SEC's Final Rule Implementation addressed the possibility that some states may have stricter ethics rules and pointed out that the final rule addressed this conflict both in the rule itself and in the comments accompanying the rule. *Wadler*, 212 F. Supp. 3d at 856.

198 *Wadler*, 212 F. Supp. 3d at 856 ("Federal regulations have no less pre-emptive effect than federal statutes.") (citing Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 153 (1982)).

199 For a discussion on the doctrine of federal preemption, see *supra* Section II.B.

200 17 C.F.R. § 205.3(d)(1) (2019). Part 205.3(d)(1) states, "[a]ny report under this section (or the contemporaneous record thereof) or any response thereto (or the contemporaneous record thereof) may be used by an attorney in connection with any investigation, proceeding, or litigation in which the attorney's compliance with this part is in issue." *Id.*

201 *Wadler*, 212 F. Supp. 3d at 856.

202 This Note only questions whether the SEC exceeded authority in creating Part 205.3(d)(2).

specifically Part 205.3(d)(2), and, therefore, it is incorrect for the court to assert that Part 205 broadly preempts California law.[203]

The court in *Wadler* failed to look at whether all of the provisions, including Part 205.3(d)(2), were promulgated by the SEC pursuant to proper authority.[204] Had it done so, and examined the legislative history, perhaps the court would have seen that neither the explicit statutory language nor the legislative history gave the SEC the authority to create Part 205.3(d)(2).[205] Further, some legal scholars have criticized Judge Spero's decision for relying too heavily on the SEC's amicus brief.[206]

B. *Congress Should Not Authorize the SEC to Properly Promulgate a Reporting Out Provision*

First, it should be noted that if Congress does want to allow in-house attorneys to report violations out to the SEC, which would not otherwise be allowed by state law, Congress may do so.[207] The simplest way to do this would be to pass a law specifically requiring the SEC to promulgate this rule. Just as Congress described the required reporting up procedures in detail in Section 307, which were implemented almost verbatim by the SEC, Congress may do the same with a permissive reporting out procedure if it desires.[208] Under the Supremacy Clause and federal preemption law, state law would yield to the federal law.[209] With congressional intent, it would pass a preemption analysis, as it would thus be reasonable for the SEC to promulgate said rule. If this were to occur, state laws that currently do not allow an attorney to

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203 *See Wadler*, 212 F. Supp. 3d at 857.

204 *See id.*

205 *See* discussion *supra* Section II.B.3.

206 *See, e.g.*, Stewart, *The Fork in the Road*, *supra* note 76 (stating that the judge "[l]ift[ed] his ruling almost verbatim from an amicus brief filed by the SEC"); *see also* Brief for SEC, *supra* note 170.

207 For a discussion of the doctrine of federal preemption, including the Supremacy Clause and Tenth Amendment, see *supra* Section II.B.1.

208 See *supra* note 27 for the full text of Section 307.

209 *See* U.S. CONST. art. VI, cl. 2. For a discussion on the preemption of administrative regulations promulgated pursuant to a directive from Congress, see *supra* Section II.B.2.

report out to prevent financial injury, such as those in New York and California, would yield to the new federal law.[210]

Instead, as a result of policy implications, the SEC should amend Part 205.3(d)(2) in order to permit reporting out only when it is allowed by state law. The beginning of 205.3(d)(2) would then read:

> An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, *so long as the state law in which the attorney is practicing allows,* without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary.[211]

This change would take into account the declarations set forth by the congressional testimony regarding the amendment to the Sarbanes-Oxley Act, which were contrary to the ultimate rule the SEC promulgated.[212] Senatorial testimony regarding Section 307, which ultimately contradicts the SEC promulgated rule, including the assertions that: (1) all the action taken by the in-house attorney would remain within the corporation;[213] (2) the amendment would not authorize the SEC to cause attorneys to breach attorney-client privilege;[214] and (3) the idea that a regulation to be implemented would cause a breach of attorney-client privilege, is ludicrous.[215] This amendment would honor the assertions made on the Senate floor and prevent Part 205.3(d)(2) from providing an attorney with the legal right to report violations to the SEC in instances in which they are prohibited under her respective state's laws.[216]

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210 For a discussion on the preemption of federal law versus state law, see *supra* Section II.B.

211 The italicized portion is the content that this Note proposes should be added. While at first glance it may seem as though this would make this provision irrelevant, as reporting out would already be allowed under state law, it would affirm the notion that, where permitted, the SEC does in fact endorse reporting out in instances where state ethics laws provide for it.

212 *See supra* Section II.B.3.

213 *See supra* notes 186–87 and accompanying text.

214 *See* 148 CONG. REC. S6555 (daily ed. July 10, 2002) (Amendment No. 4187) (statement of Sen. Corzine) ("This amendment also does not empower the SEC to cause attorneys to breach their attorney/client privilege. Instead, as is the case now, attorneys and clients can assert this privilege in court.").

215 *See supra* notes 192–93 and accompanying text.

216 *See supra* notes 192–93 and accompanying text.

There are many policy reasons why reporting out should not apply generally in all cases of material violations of securities laws. First, the SEC's new bounty reward program for whistleblowers poses additional ethical obstacles.[217] Corporate officers may be even less likely to discuss problematic conduct with their in-house attorneys if they worry the attorneys may run right to the SEC in order to collect a large payment.[218] One commenter to the SEC's rule proposal noted that this sort of rule could undermine an attorney's ability to have an "open and honest" relationship with their client.[219] This commentator focused on the ways in which an attorney can have a positive impact on a corporate client when she is able to engage in open discussions with the client.[220] The letter further notes that the rule may in fact be counterproductive to the goals of the SEC.[221]

There are additional convincing arguments that have been made against allowing in-house attorneys to report violations of the corporation they are representing to the SEC in order to collect a

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217 For a discussion on the SEC's Whistleblower Bounty Program, see *supra* notes 19–22.

218 There are many examples of large monetary rewards given to those who have blown the whistle on their corporate employer pursuant to the SEC Whistleblower Bounty Program. There was a whistleblower bounty awarded in 2013 for $14 million and an award in 2014 for $30 million. *See* Sundar Narayanan, *Are Whistleblower Reward Programs Really a Good Idea?*, FCPA BLOG (Nov. 30, 2015, 10:08 AM), http://www.fcpablog.com/blog/2015/11/30/are-whistleblower-reward-programs-really-a-good-idea.html [https://perma.cc/CRD7-H6KP].

219 *See* Letter from L.A. Cty. Bar Ass'n, to Sec. & Exch. Comm'n (Dec. 18, 2002), https://www.sec.gov/rules/proposed/s74502/maroni1.htm [https://perma.cc/CH3P-DZ4Z].

220 *See id.*

> These proposed changes appear to be based on misperceptions about the role of a lawyer in the legal system and the nature of the attorney-client relationship. . . . [T]hese proposed changes could undermine a lawyer's ability to develop an open and honest attorney-client relationship that enables the lawyer to learn of and counsel against potential misconduct. Lawyers have a special and unique role in our society: they are vested with the fiduciary duty of confidentiality to enable them to discourage and divert wrongful or illegal client conduct. Because lawyers are presently duty-bound to maintain the confidentiality of client information, we will never know when or how many attorneys successfully change the course of corporate conduct by counseling and advising their clients to perform responsibly.

Id.

221 *See id.* ("Indeed, the proposed rule will likely make clients more reluctant to provide full disclosure to their lawyers, and will impede the ability of lawyers to steer their clients away from unlawful acts. Thus the proposed 'whistle blowing' provision may in fact be counterproductive and increase the problems that the SEC is trying to solve.").

bounty.[222] First, there is concern about where the money comes from.[223] Second, incentivizing whistleblowing through a monetary reward fails to encourage sought-after cultural change within the corporation.[224] Rather than incentivizing corporate officers to converse with their in-house attorneys and address problematic behavior, allowing in-house attorneys to report out to the SEC and collect a large bounty instead incentivizes other in-house attorneys to report out in the future.[225] While many of these concerns have been brought to light in order to question whistleblower bounty programs as a whole, these problems seem especially worrisome in light of in-house attorneys doing the whistleblowing. This is because the attorney is supposed to act in the best interest of her corporate client and, specifically, the corporation as a whole.[226]

Also telling is the response to whistleblower bounty programs from outside of the United States.[227] The Bank of England Prudential Regulation Authority and the United Kingdom Financial Conduct Authority issued a joint report in which they concluded that providing

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222 *See, e.g.*, Narayanan, *supra* note 218.

223 *See id.* The money used to pay the whistleblower comes from the SEC's Investor Protection Fund. The SEC collects the Investor Protection Fund from penalties and disgorgements through its enforcement actions. Therefore, the money paid to whistleblowers was "essentially lost by investors and stakeholders." It has been argued that using the funds from these actions "is arguably inconsistent with the financial interests of the investors and stakeholders." *Id.*

224 *See id.* ("Rewards to individual whistleblowers do not stimulate cultural or behavioral change across organizations.").

225 *See id.*

226 *See, e.g.*, 148 CONG. REC. S6551 (daily ed. July 10, 2002) (Amendment No. 4187) (statement of Sen. Edwards). In-house attorneys are supposed to represent the interest of the corporation as a whole. During the Senate testimony regarding Section 307, Senator Edwards stated:

> If you are a lawyer for a corporation, your client is the corporation and you work for the corporation and you work for the shareholders, the investors in that corporation; that is to whom you owe your responsibility and loyalty. And you have a responsibility to zealously advocate for the shareholders and investors in that corporation.

Id.

227 *See, e.g.*, BANK OF ENG. FIN. CONDUCT AUTH. & PRUDENTIAL REGULATORY AUTH., FINANCIAL INCENTIVES FOR WHISTLEBLOWERS 7 (2014), https://www.fca.org.uk/publication/financial-incentives-for-whistleblowers.pdf [https://perma.cc/A2Y5-ZKVR].

monetary incentives to whistleblowers would not significantly improve the integrity or transparency of financial markets.[228] Prior to issuing this report, the agencies visited the SEC, the Commodities Futures Trading Commission, and the DOJ.[229] Notably, the joint report concluded that none of these agencies have had a significant improvement in the number, or interestingly, the clarity, of whistleblower reports since providing monetary incentives to whistleblowers.[230]

A reporting out provision remains unhelpful to prevent problematic conduct, even when placing the bounty obstacle aside. There has been recent scholarship defending the concept and noting the importance of preserving attorney-client privilege in the corporate setting.[231] Since in-house attorneys represent the corporation as whole,[232] if corporate officers view their attorneys as people who are able to report out to the SEC if they disagree with how a violation has been handled, this may chill important conversations from ever taking place in the first place.[233] Clients should be able to consult with their attorneys regarding the legality of their actions without the fear of it being reported. It is just those instances—where the law may be questionable—where it is pivotal for corporate officers to be able to consult with the company's attorney, in order to discuss how activity

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228 *See id.* ("We consider that providing financial incentives to whistleblowers will not encourage whistleblowing or significantly increase integrity and transparency in financial markets.").

229 *Id.* at 4.

230 *Id.*

231 *See, e.g.*, Katrice Bridges Copeland, *Preserving the Corporate Attorney-Client Privilege*, 78 U. CIN. L. REV. 1199, 1199–1201, 1213 (2010) (defending the preservation of attorney-client privilege in the context of internal investigations); John Cox & Erin Weesner-McKinley, *What is the Attorney-Client Privilege and Why Is it Important?*, GARD (Dec. 13, 2016), http://www.gard.no/web/updates/content/22402644/what-is-the-attorney-client-privilege-and-why-is-it-important [https://perma.cc/7EPY-PN5M] (explaining the importance of attorney-client privilege in the context of defending against criminal matters).

232 *See* Narayanan, *supra* note 218.

233 *See An Overview of the Attorney-Client Privilege When the Client Is a Corporation*, *in* THE ATTORNEY-CLIENT PRIVILEGE IN CIVIL LITIGATION: PROTECTING AND DEFENDING CONFIDENTIALITY 4 (Vincent S. Walkowiak ed., 4th ed. 2008) ("The free flow of uncensored information between an attorney and client is as important within a corporation as it is between the corporation and outside counsel. In-house counsel owes a duty to their client—the corporation. And like outside counsel, in-house counsel can perform that duty only with full knowledge of the information available to the client.").

should proceed or how to rectify past problems.[234] Conversations are less likely to be chilled if the attorney can only report up the ladder, because the officers know the attorney has the corporation's best interests in mind, as that is their ultimate client.

Finally, even the SEC's own stated goals for Part 205 seem to be directly related to the reporting up provision, as there are no specific benefits mentioned that pertain to the reporting out procedure.[235] Ultimately, for the above-mentioned reasons, Congress should not create a rule directing the SEC to create a reporting out procedure for in-house corporate attorneys that would go further than state laws already do.

C. *Possible Objections*

First, it may be argued that Congress did in fact grant the SEC the authority to preempt state law through a reporting provision, as the text of Section 307 does grant the SEC the power to create "minimum standards of professional conduct."[236] The argument would be that Congress granted the SEC the authority to create professional conduct standards and, to do so, they implemented a reporting out procedure. However, there is no indication that Congress intended the "minimum standards" the SEC may implement to conflict with those ethical standards provided for in state laws throughout the country, especially

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234 *See, e.g.*, Letter from Anthony J. Horan, *supra* note 195. JPMorgan Chase, in arguing that reporting out has negative consequences, stated:

> Lawyers are most effective when they are perceived to be working for the good of the corporation. If Rule 205 is adopted as proposed, and lawyers are viewed as having a personal interest in reporting evidence that a violation of securities law or fiduciary duty has occurred or is continuing, even when the lawyer does not have enough evidence to be reasonably certain of a violation, it is likely that lawyers will only be consulted as to proposed future conduct, and then only when the law is clear.

Id.

235 *See Final Rule Implementation*, *supra* note 8. The SEC's Final Rule Implementation lists various purposes and benefits of Part 205, all of which involve the reporting up procedure. Through the mandatory reporting up procedure implemented for attorneys, the SEC aimed to protect investors by increasing their confidence and trust in public companies. Furthermore, they aimed to prevent large instances of public fraud and assure it would be corrected. *See id.*

236 For the full text of Section 307, see *supra* note 27.

when senators testified that all reporting would remain within the corporation.[237] This is evidenced by the clear language on the Senate floor pursuant to the amendment to Section 307.[238]

As many state laws are more restrictive in what they allow to be disclosed when compared to what the SEC's law allows, there are serious federalism concerns at play.[239] As in *Gonzales v. Oregon*, where the Supreme Court noted that principles of federalism oppose the idea that Congress would use an "obscure grant of authority" to regulate those areas traditionally regulated by the state,[240] here too ethics laws governing attorney-client relationships are traditionally provided for by state law.[241] Consequently, if Congress were to grant the SEC the authority to create a law preempting that of many states, it would have done so in a clearer manner.

Second, it may be argued that even if the SEC lacked authority to promulgate Part 205.3(d)(2), Congress should grant the SEC the proper authority to create a reporting out provision, whereby in-house attorneys representing issuers may report evidence of material violations to the SEC. The argument would be that in-house attorneys are in a position in which they are made aware of violations that may impact shareholders of the corporation negatively when the violations come to light. However, as noted above, this would likely chill discussions between attorneys and their clients about actions where legality is unclear, which is exactly when it is most pivotal for an attorney's advice to be sought.[242]

Another possible argument is that in-house attorneys should be encouraged to report violations to the SEC, rather than turn a blind eye to, or even participate in, any violation by the corporation. However, the SEC can bring actions against attorneys who aid and abet securities

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237 *See* 148 CONG. REC. S6551–56 (daily ed. July 10, 2002) (Amendment No. 4187).

238 For a discussion on the legislative history of Section 307, see *supra* Section II.B.3.

239 For a discussion on conflicting state ethics laws, see *supra* Section I.C.

240 Gonzales v. Oregon, 546 U.S. 243, 274 (2006) ("[T]he background principles of our federal system also belie the notion that Congress would use such an obscure grant of authority to regulate areas traditionally supervised by the States' police power.").

241 For a discussion on conflicting state ethics laws, see *supra* Section I.C.

242 See *supra* notes 231–34 and accompanying text for an explanation on why it is important to allow the free flow of information between in-house attorneys and the corporations they are representing.

violations.[243] Actions may be brought against attorneys for turning a blind eye to material violations and therefore failing to follow Part 205's reporting up procedure, preparing materially false information or omitting important information about the corporation they are representing to auditors,[244] and submitting false and misleading forms to the SEC.[245] Thus, there are already enforcement measures in place to prevent attorneys from participating or aiding in the violations of their corporate clients.

CONCLUSION

The New York City Law Association Committee has stated broadly that lawyers in New York may not serve as whistleblowers for a monetary reward under the Dodd-Frank Act, as it violates many New York ethics laws.[246] However, SEC preemption has yet to be specifically addressed and evaluated in a New York court.[247] In *Quest*, the court looked at the issue of preemption; however, it addressed preemption in regard to the False Claims Act, and not the Sarbanes-Oxley Act.[248] Conversely, in California, the district court in *Wadler* explicitly, albeit incorrectly, held that the Sarbanes-Oxley Act and, specifically, the parts reflected in Part 205, preempt California ethics rules.[249] However, the *Wadler* court employed problematic reasoning. Ultimately, nothing in Section 307 of the Sarbanes-Oxley Act or in its legislative history evinces any intent to create a reporting out provision and thus preempt state

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243 15 U.S.C. § 78t (2018).

244 *See, e.g.*, Complaint, Sec. & Exch. Comm'n v. Isselmann, No. 04-cv.-01350 (D. Ore. Sept. 23, 2004), ECF No. 1.

245 *See, e.g.*, Silverstein, Release No. 49676, 2004 WL 1055059 (May 11, 2004).

246 N.Y. Cty. Lawyers Ass'n Comm. on Prof'l Ethics, Formal Op. 746, *supra* note 22, at 15 ("It is the Committee's opinion that New York lawyers who are acting as attorneys on behalf of clients presumptively may not ethically serve as whistleblowers for a bounty against their clients under the Dodd-Frank Wall Street Reform and Consumer Protection Act, because doing so generally gives rise to a conflict between the lawyers' interests and those of their clients.").

247 *See* ROBERT MALIONEK & KEITH CANTRELLE, LATHAM & WATKINS LLP, READ BEFORE WHISTLEBLOWING: WHAT EVERY LAWYER NEEDS TO KNOW (Oct. 23, 2013), https://m.lw.com/thoughtLeadership/lw-newyork-sec-whistleblower-ethics [https://perma.cc/Y2QP-E6X6].

248 United States v. Quest Diagnostics Inc., 734 F.3d 154 (2d Cir. 2013).

249 *See* Wadler v. Bio-Rad Labs., Inc., 212 F. Supp. 3d 829, 857 (N.D. Cal. 2016).

laws.[250] Statements by members of Congress indicated Section 307 only involved reporting internally within a corporation; therefore, Part 205.3(d)(2) was promulgated without a proper grant of authority from Congress.[251] For these reasons, the reasoning in *Wadler*, as well as its holding that Part 205 broadly preempts state law, is incorrect. While Congress may in fact properly authorize the SEC to create a reporting out provision, this Note proposes it should not do so.[252]

250 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, § 307. For a preemption analysis of Part 205.3(d)(2), see *supra* Section II.B.3.

251 *See supra* Section II.B.3.

252 For a discussion on why Congress should not authorize the SEC to create a reporting out provision, including the obstacles that stem from bounty rewards and a chilling effect of conversations between corporate clients and their in-house attorneys, see *supra* Section III.B.