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Ethics Outline (January 1, 2017)

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1. IMPORTANT LEGAL PROFESSION ETHICS SOURCES


- State Codes

- New York adopted the ABA’s Model Rules in April 2009 (with some material differences): New York’s Rules of Professional Conduct (Joint Rules of the Appellate Divisions of the Supreme Court) (the “NY Rules”) are found in Part 1200 of Title 22 of New York Codes, Rules and Regulations. Most states have adopted the ABA Model Rules with some material modifications.

- ABA and Local Bar Association Opinions

- Regulatory Agency Disbarment Rules

- Ethics Rules Apply to Law Firms and In-House Legal Departments; Ethics Rules Apply to Supervisory and Subordinate Lawyers.

- Lawyers may be subject to disciplinary proceedings in their home state, even if the misconduct occurred elsewhere. See, e.g., NY Rule 8.5(a); Illinois Rules of Professional Conduct 2010, Rule 8.5(a); and ABA Model Rule 8.5(a).

- Lawyers confronting an ethics or professional responsibility issue should almost always consult with and seek guidance from their more experienced colleagues or relevant committee at their firm, subject always to client confidentiality duties.

2. IMPORTANT REGULATORY ETHICS PROVISIONS

SEC Rule 102(e)

“The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice and opportunity for hearing in the matter: (i) Not to possess the requisite qualifications to represent others; or (ii) To be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or (iii) To have willfully violated, or willfully aided and
abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.”

**CFTC Rule 14.8 (in addition to Rules 14.4-7)**

“The Commission may … deny, temporarily or permanently, the privilege of appearing and practicing before it to any person who is found by the Commission by a preponderance of the evidence: (a) Not to possess the requisite qualifications to represent others; or (b) To be lacking in character or integrity; or (c) To have engaged in unethical or improper unprofessional conduct in the course of an adjudicatory, investigative, rulemaking or other proceeding before the Commission or otherwise.”

**SEC Disbarment Action**

On November 10, 2010, the SEC disbarred a lawyer under Rule 102(e), finding that the lawyer engaged in unethical and improper professional conduct, in violation of New York bar rules, while representing a prospective witness for the Division of Enforcement (the “Division”) in a Commission administrative proceeding, finding that the lawyer offered to have his client evade the Enforcement Division’s service of a subpoena and/or testify falsely in exchange for financial and other benefits from two respondents in an enforcement proceeding. The SEC concluded that the lawyer’s conduct was fundamentally repugnant to the integrity of the SEC’s processes and warranted permanent denial of the privilege of appearing or practicing before the SEC. The SEC subsequently denied the lawyer’s motion for reconsideration and to stay the original debarment order. *In the Matter of Stephen Altman*, SEC Release No. 63665, Admin. Proc. File No. 3-12944 (SEC, January 6, 2011).

**Other Important Financial Agency Disbarment Rules**

- FDIC, Rule 308.109
- Federal Reserve, Rule 263.91-99
- OCC, 12 C.F.R. Part 19, Subpart K
- IRS, 31 C.F.R. Part 10, Subpart C (Circular No. 230)
3. SHOULD INVESTMENT MANAGEMENT LAWYERS BE DEEMED TO ALSO REPRESENT THE PUBLIC INTEREST?


Are Lawyers “Gatekeepers” to Protect the Public?

Post-Enron, corporate lawyers are viewed by many as “gatekeepers,” called upon to protect the corporation, shareholders and the public. See, e.g., John C. Coffee, Jr., Attorney as Gatekeeper: An Agenda for the SEC, 103 Colum. L. Rev. 1293 (2003).

In a speech at the 2007 Corporate Counsel Institute, former SEC Chairman Cox stated that the SEC expects lawyers and other professionals to act as “gatekeepers” to prevent corporate wrongdoing and as “watchdogs” to report on corporate wrongdoing.

In a speech in 2011, the SEC Enforcement Director warned that unethical or obstructionist conduct by lawyers appearing before the SEC would “increase referrals to state bar associations, and to the Department of Justice where appropriate.” SEC Enforcement Director Robert S. Khuzami; Remarks to the Criminal Law Group of the UJA-Federation of New York (June 1, 2011).

Current SEC Chairman Mary Jo White recently stated that “we also are focusing more on those who play the role of gatekeepers in our financial system. Cases against gatekeepers remind them, and the industry, of the important role that gatekeepers share with us to protect investors … we will not be looking to charge a gatekeeper that did her job by asking the hard questions, demanding answers, looking for red flags and raising her hand.” SEC Chairman Mary Jo White’s remarks at the SEC Enforcement Forum (Oct. 9, 2013), available at http://sec.gov/News/Speech/Detail/Speech/1370539872100.

The SEC’s Agency Financial Report for Fiscal Year 2014 advised at page 19: “[t]he SEC also maintained its focus on holding “gatekeepers,” including attorneys, accountants, and compliance professionals, accountable for the important roles they play in the securities industry.”

SEC Commissioner Kara M. Stein advised that “one gatekeeper that often is absent from the list of cases I see every week are the lawyers…. I think that we should carefully review the role that lawyers play in our markets, with a view towards how they can better

Others do not view corporate lawyers as gatekeepers. In November 2006, the New York City Bar concluded that “to impose general whistle-blowing or gatekeeping duties on lawyers, so contrary to their traditional role as confidential advisors to their clients, would be counterproductive. It probably would result in a chilling of client-lawyer communications, the exclusion of lawyers from some strategic meetings, and generally degrade the ability of lawyers to render well-informed advice to their corporate clients. it might also lead to a defensive advising on the part of lawyers concerned about the possibility of their own liability.” Report of the Task Force on the Lawyer’s Role in Corporate Governance (NY City Bar, November 2006).

Government “Gatekeeper” Actions Against Outside Counsel

Counsel to an IPO of a Derivatives Brokerage House

The head of the derivatives practice group at a large Chicago law firm was the subject of an SEC enforcement action and a criminal indictment. He was charged with aiding and abetting his commodity brokerage house client Refco’s accounting fraud with respect to economically unjustifiable large loans to high-level executives and the hiding of a $1.1 billion debt. The government’s theory of liability was based on the lawyer’s “conscious avoidance” of “red flags” pointing to potential fraud by not adequately investigating the purpose of these transactions. The specific charges were securities fraud, wire fraud and conspiracy. United States v. Collins (SDNY, 07-CR-1170). He was convicted in July 2013. His appeal was denied by the Second Circuit on October 22, 2014. The government’s charges implicated the following ethical issues: (a) “professional responsibility” reporting and disclosure provisions of SEC Rule 205, (b) permissive disclosure provisions of ABA Model Rule 1.6 to prevent substantial injury resulting from a client’s financial fraud, (c) independent professional judgment provisions, and (d) duty not to mislead provisions.
**U.S. Attorney’s announcement of the conviction**

Defendant “used his law license to help orchestrate this massive accounting fraud... ignored his duties as an officer of the court… gave the legal profession a black eye, something that is intolerable… to the vast majority of attorneys who serve their clients and the courts ethically….”

SEC’s announcement of its enforcement action. “Financial and disclosure frauds are often possible only if an attorney, an accountant, or some other outside professional assists. The Commission relies on these professionals to act as gatekeepers to our markets. We will aggressively pursue individuals who ignore their professional obligations and instead assist in their clients’ violation of the federal securities laws.”

**Precious Metals Dealer’s Counsel**

On September 9, 2014, the CFTC brought a federal court enforcement action against a Florida derivatives lawyer alleging that he aided and abetted multiple clients in their operations of illegal retail precious metals investment programs that were not executed on or subject to the rules of a CFTC-regulated trading facility. *CFTC v. Grossman*. Case No. 14-CIV-62061-Bloom/Valle (Sept. 9, 2014 S.D. Fla.). In the CFTC’s press release, the CFTC Enforcement Director said:

“This action shows that the Commission will not hesitate to bring cases against gatekeepers, including attorneys, who are complicit in violating the CEA. Lawyers and accountants have the professional responsibility to avoid participating in unlawful conduct that is perpetrated by their clients.”

On July 22, 2015, without admitting the allegations, lawyer Grossman consented to the payment of a civil monetary penalty and restitution, an injunction against further violations of the CEA and not to appear or practice before the CFTC until reinstated by further order of the Court.

**SEC “Gatekeeper” Actions Against In-House Lawyers**

General counsel alleged to have failed to provide adequate information to the board and its auditors concerning a significant accounting transaction and outside counsel’s relevant legal advice, which actions allegedly allowed the company to hide the fraud. *SEC v. Isselmann*, No. 04-cv 1350 (D. Ore. Sept. 23, 2004).

Government Lawyers: Who Do They Represent?

Lawyers for financial regulatory agencies must also abide by professional responsibility and ethics rules. The two differing views on agency lawyers’ ethics are:

Agency as Client

The government lawyer has one client, his or her agency, which is the lawyer’s organizational client. All of the professional responsibility and ethics considerations that apply to a lawyer representing an organizational client apply to the representation of the agency, e.g., loyalty, zeal, confidentiality.

Public Interest as Client

The government lawyer owes a duty to the public interest beyond his or her duty to the agency. See, e.g., Berger v. United States, 295 U.S. 78, 88 (1935) (criminal prosecutor); Freeport-McMoRan Oil & Gas Co. v. Federal Energy Regulatory Commission, 962 F.2d 45, 47 (D.C. Cir. 1992) (civil agency lawyer).

4. RELEVANCE OF THE “ORGANIZATION RULE”

NY Rule 1.13

“(a) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that (i) is a violation of a legal obligation to the organization or a violation of law that reasonably might be imputed to the organization, and (ii) is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization…. Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such measures may include, among others:

(1) asking reconsideration of the matter;

(2) advising that a separate legal opinion on the matter be sought for presentation to an appropriate authority in the organization; and
(3) **referring the matter to higher authority** in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.

(b) If, despite the lawyer’s efforts in accordance with paragraph (a), the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of law and is reasonably likely to result in substantial injury to the organization, then the lawyer may reveal confidential information only if permitted by Rule 1.6, and may resign in accordance with Rule 1.16.”

NY Rule 1.6(b)(1) permits a lawyer to withdraw when the lawyer “knows or reasonably should know that the representation will result in a violation of these Rules or law.”

**Criticism of General Motors Lawyers for Not Reporting Problems “Up-the-Ladder” Within the GM Organization**

GM’s allegedly defective ignition switches were recalled in 2014 because they allegedly caused numerous deaths and injuries. A publicly disclosed internal report criticized GM’s lawyers for allegedly failing to report up the ladder to their General Counsel their knowledge of the defective switches they learned as early as 2005 from settling lawsuits involving the defects. The Report recommended, among other improvements, that GM “ensure that in-house counsel are aware of the expectation that they will respond appropriately if they become aware of any threatened, ongoing, or past violation of a federal, state or local law or regulation, a breach of fiduciary duty, or violation of GM policy, including the expectation that if they raise such an issue and believe it has not been addressed appropriately, they will bring the situation to the attention of their supervisors, and if they believe their supervisors have not addressed it appropriately, to higher levels including the General Counsel if necessary.” *Report to Board of Directors of General Motors Company Regarding Ignition Switch Recalls* (May 29, 2014), at 265.

5. **DISCOVERY OF WRONGDOING**

**Handling Confidential Client Information**

ABA Model Rule 1.6 provides that a “lawyer shall not reveal information relating to representation of the client unless the client gives informed consent….”
ABA Model Rule 3.3 provides that:

(a) A lawyer shall not knowingly:

(1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer; … or

(2) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer’s client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.

Commodity Exchange Act Section 6(c)(2)

It shall be unlawful for any person to make any false or misleading statement of a material fact to the Commission, including in any registration application or any report filed with the Commission under this Act, or any other information relating to a swap, or a contract of sale of a commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or to omit to state in any such statement any material fact that is necessary to make any statement of a material fact made not misleading in any material respect, if the person knew, or reasonably should have known, the statement to be false or misleading.

Advising the Corporation

NY Rule 1.2(d): “A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is illegal or fraudulent, except that the lawyer may discuss the legal consequences of any proposed course of conduct with a client.”

Disclosing Violative Conduct

ABA Model Rule 1.6(b)(2) permits the disclosure of confidential information:

“to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer’s services;”
NY Rule 1.6(b)(1)(2) and (3):

“A lawyer may reveal or use confidential client information to the extent the lawyer reasonably believes necessary:

(1) to prevent reasonably certain death or substantial bodily harm;
(2) to prevent the client from committing a crime;
(3) to withdraw a written or oral opinion previously given... where the lawyer has discovered that the opinion or representation was based on materially inaccurate information or is being used to further a crime or fraud;”

Financial Crime

New York and the ABA Model Rule allow the disclosure of confidential client information to prevent financial crimes (NY) or financial fraud (ABA). However, a few states ethics codes prohibit a lawyer from disclosing confidential client information except in situations likely to result in death or substantial bodily harm, i.e., disclosure is not permitted in situations involving only financial consequences. See, e.g., California Business & Professional Code 6068(e)(2) and California Rule of Professional Conduct 3-100.

Recent Disclosure of Corporate Client’s False Evidence

In a 2014 case in federal court in Houston, Texas, after the jury awarded the plaintiff a $24 million verdict, the defendant’s counsel filed a motion for sanctions alleging the plaintiff submitted into evidence a fabricated contract and emails from a fictitious domain name created by the plaintiff. Plaintiff’s counsel then spoke to plaintiff and trial witnesses. Reportedly, a trial witness admitted that the evidence was fabricated. After the plaintiff reportedly rejected its law firm’s advice to disclose the information to the court, the law firm filed a motion to withdraw as counsel in which it disclosed the fabrication of this evidence. Rule 3.03(b) of the Texas Disciplinary Rules of Professional Conduct requires an attorney to seek permission from a client to withdraw or correct false evidence and, if the client refuses, to take reasonable remedial measures, including disclosure of the true facts. Would you have disclosed the fact that the evidence was fabricated, or made a general vague disclosure? LBDS Holding Co. LLC v. ISOL Technology Inc., et al., Docket No. 6:11-cv-00428 (E.D. Texas), reported at “Akin Gump Freed From Bogus $25M Trade Secrets Case,” LAW360 (Lexis Nexis), June 5, 2014.
6. COUNSEL TO SEC REGISTRANTS

1992 – Internal Counsel to Securities Registrants

In re Gutfreund, Exchange Act Release No. 34-31554, 1992 WL 362753 (SEC, December 3, 1992). This Section 21A Report addressed an SEC registrant’s alleged violative manipulative and deceitful activity in the U.S. Treasury auction market. The general counsel, upon learning of the activity, advised senior executives to cease the activity and report the wrongdoing to the regulators. The general counsel did not initiate any internal disciplinary action, report the matter to regulators or take appropriate measures to assure that the firm implemented his advice.

The SEC may censure or take certain remedial action against any person associated with a broker or dealer who has supervisory obligations but has failed reasonably to supervise, with a view to preventing violations of the provisions of specified statutes, including the Securities Act of 1933 and the Commodity Exchange Act. With respect to in-house counsel of the SEC registrant in Gutfreund (e.g., a registered investment adviser or a registered broker-dealer), the SEC advised that once such a person has supervisory obligations by virtue of the circumstances of a particular situation, he must either discharge those responsibilities or know that others are taking appropriate action: “These steps may include disclosure of the matter of the entity’s board of directors, resignation from the firm, or disclosure to regulatory authorities.” *** “In the case of an attorney, the applicable Code of Professional Responsibility and the Canons of Ethics may bear upon what course of conduct that individual may properly pursue.”

2012 – SEC Enforcement Decision

The SEC alleged that the general counsel of a broker-dealer ignored or failed to adequately follow up on red flags and failed to supervise in connection with the alleged market manipulation by a registered representative. The ALJ found that although the general counsel did not have any of the traditional powers associated with a person supervising brokers, that he had supervisory authority because his opinions on legal and compliance issues were viewed as authoritative and his recommendations were generally followed by the firm’s business units. However, the ALJ concluded that the general counsel acted reasonably by making numerous attempts to stop the activities and...
terminate the registered representative, and dismissed the complaint. On the enforcement division’s appeal from the ALJ’s decision, the SEC issued an order dismissing the enforcement proceeding against the general counsel. The lesson to be learned is that regulators continue to look to in-house lawyers as “supervisors” of brokers and expects them to act as gatekeepers to prevent fraud. In the Matter of Urban, SEC Administrative Proceeding No. 3-13655, Initial Decision Release No. 402 (September 8, 2010), dismissed Exchange Act Release No. 66259 (January 26, 2012).

2013 – SEC’s FAQ About Liability of Compliance and Legal Personnel at Broker-Dealers (Division of Trading and Markets, September 30, 2013)

Gutfreund was premised on a failure to supervise by a general counsel who was deemed to be a supervisor. In its 2013 FAQ, available at http://www.sec.gov/divisions/marketreg/faq-cco-supervision-093013.htm, the SEC staff advised that compliance and legal personnel do not become “supervisors” solely because they participate in, provide advice to, or consult with a management or other committee. The determination whether a particular person is a supervisor depends on whether, under the facts and circumstances of a particular case, that person has the requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue.

The SEC identified the following 6 non-exclusive factors in determining whether a lawyer or compliance officer is a “supervisor”:

- Has the person clearly been given, or otherwise assumed, supervisory authority or responsibility for particular business activities or situations?
- Do the firm’s policies and procedures, or other documents, identify the person as responsible for supervising, or for overseeing, one or more business persons or activities?
- Did the person have the power to affect another’s conduct? Did the person, for example, have the ability to hire, reward or punish that person?
- Did the person otherwise have authority and responsibility such that he or she could have prevented the violation from continuing, even if he or she did not have the power to fire, demote or reduce the pay of the person in question?
Did the person know that he or she was responsible for the actions of another, and that he or she could have taken effective action to fulfill that responsibility?

Should the person nonetheless reasonably have known in light of all the facts and circumstances that he or she had the authority or responsibility within the administrative structure to exercise control to prevent the underlying violation?

Once a person has supervisory obligations, he or she must reasonably supervise with a view to preventing violations of the federal securities laws, the Commodity Exchange Act, and the rules or regulations under those statutes. That person must reasonably discharge those obligations or know that others are taking appropriate action. The SEC staff advised that it is not reasonable for a person with supervisory obligations to be a mere bystander to events that occurred, or to ignore wrongdoing or “red flags” or other suggestions of irregularity. However, Exchange Act section 15(b)(4)(E) provides an affirmative defense to potential liability for failure to supervise if a firm has established procedures and a system for applying those procedures that would reasonably be expected to prevent and detect, insofar as practicable, a violation, and the supervisor has reasonably discharged his or her duties pursuant to the procedures and system, without reasonable cause to believe that the procedures and system were not being complied with.

7. **SEC RULE 205-ATTORNEY CONDUCT RULE FOR ISSUER’S COUNSEL**

If “an attorney,” in “appearing and practicing” before the SEC “in the representation of an issuer,” becomes aware of “evidence of a material violation” by the issuer or by an officer, director, employee, or agent of the issuer, the attorney is required to “report” that violation internally to the issuer’s CLO (or equivalent) or to both the CLO (or equivalent) and the CEO “forthwith,” or alternatively to the issuer’s QLCC.

**Attorney**

An attorney must be providing legal services to a company within the context of an attorney-client relationship before the attorney will be covered by the Rule.
Appearing and Practicing Before the Commission

- Transacting any business with the SEC, including communications in any form;
- Representing a company in an SEC administrative proceeding or an investigation, inquiry, information request or subpoena;
- Providing advice on U.S. securities laws or SEC rules or regulations regarding any document that the attorney has notice will be filed with, submitted to, or incorporated into, any document filed with, or submitted to, the SEC, including providing that advice in the context of preparing, or participating in the preparation of, such a document;
- Advising a company as to whether information or a statement, opinion, or other writing is required to be filed with, or submitted to, or incorporated into, a document filed with, or submitted to, the SEC; or
- An attorney retained by an issuer to investigate evidence of a “material violation” is deemed to be appearing and practicing before the SEC.

In the Representation of the Issuer

Rule applies only to those providing legal services as an attorney for an issuer, **regardless of whether the attorney is employed or retained by the issuer**.

Rule covers attorneys providing legal services to an issuer who have an attorney-client relationship with the issuer, and who have notice that documents they are preparing or assisting in preparing will be filed with or submitted to the SEC.

Foreign attorneys who are not admitted in the US, and who do not advise clients regarding US law, are not covered by the Rule. Foreign attorneys who provide legal advice regarding US law are covered by the Rule to the extent they are appearing and practicing before the SEC, unless they provide such advice in consultation with US counsel.

**Issuer**

Incorporates the definition contained in the Securities Exchange Act of 1934. Excludes foreign government issuers that are eligible to use Schedule B to the Securities Act of 1933, as amended. Includes any person controlled by an issuer, such as a wholly-owned subsidiary,
where the attorney provides legal services to that person for the benefit of or on behalf of an issuer.

**Material Violation**

“A material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law.”

**Evidence of a Material Violation**

“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.” The SEC has advised that the criteria for evaluating an attorney’s reasonable response are the circumstances existing at the time the attorney determined whether he or she had a reporting obligation, not whether in hindsight the attorney should have drawn an inference of the existence of a material violation.

**Up-the-Ladder Reporting**

Requires an attorney to report evidence of a material violation, determined according to an objective standard, “up-the-ladder” within the issuer to the chief legal counsel or the chief executive officer of the company or the equivalent.

Requires an attorney, if the CLO or the CEO of the company does not respond appropriately to the evidence, or if it would be “futile” to report to the CLO in the first instance, to report the evidence to the audit committee, another committee of independent directors or the full board of directors.

**CLO’s Obligations**

If after receiving a report regarding evidence of a material violation and conducting an appropriate inquiry the CLO determines that no material violation has occurred, is ongoing or is about to occur, the CLO must notify the reporting attorney and advise that attorney of the basis for the CLO’s determination.

If after receiving a report regarding evidence of a material violation and conducting an appropriate inquiry the CLO “reasonably believes” a violation has occurred, is ongoing or is about to occur, the CLO must
“take all reasonable steps to cause the issuer to adopt an appropriate response” and “advise the reporting attorney thereof.”

**QLCC**

Allows an issuer to establish a “qualified legal compliance committee” (“QLCC”) as an alternative procedure for reporting evidence of a material violation. Such a QLCC would consist of at least one member of the issuer’s audit committee, or an equivalent committee of independent directors, and two or more independent board members, and would have the responsibility, among other things, to recommend that an issuer implement an appropriate response to evidence of a material violation. One way in which an attorney could satisfy the rule’s reporting obligation is by reporting evidence of a material violation to a QLCC, bypassing the CLO and CEO.

**Permissive Disclosure to SEC**

Rule 205.3(d)(2) permits (but does not require) an attorney appearing and practicing before the SEC in the representation of an issuer, without the consent of the issuer to reveal confidential information to the SEC related to the representation to the extent the attorney reasonably believes necessary (1) to prevent the issuer from committing a material violation likely to cause substantial financial injury to the financial interests or property of the issuer or investors; (2) to rectify the consequences of such material violation in which the attorney’s services have been used; or (3) to prevent the issuer from committing or suborning perjury in an SEC proceeding. This requirement should not require an attorney to disclose privileged information beyond those circumstances covered by state law. Before making a permissive disclosure to the SEC, an attorney should carefully review applicable state law confidentiality and disclosure rules, notwithstanding the SEC’s position that the Rule preempts conflicting state ethics rules. Committees of the State Bar of California law criticized this disclosure rule “as an ethical conundrum for California attorneys as portions of Rule 205 seemingly conflict with our statutory duty to protect confidential client information.” *Ethics Hotline* (Spring 2004, State Bar of California).

**Supervisory Attorneys**

An attorney supervising or directing another attorney who is appearing and practicing before the SEC in the representation of an issuer is
a supervisory attorney. An issuer’s CLO (or equivalent) and an attorney who is under the direct supervision or direction of the CLO are each supervisory attorneys.

A supervisory attorney must make reasonable efforts to ensure that a subordinate attorney that he or she supervises or directs complies with the Rule. To the extent a subordinate attorney appears and practices before the SEC in the representation of an issuer, his or her supervisory attorneys also appear and practice before the SEC.

A supervisory attorney is responsible for complying with the reporting requirements when a subordinate attorney has reported to the supervisory attorney evidence of a material violation.

Subordinate Attorneys

An attorney who appears and practices before the SEC in the representation of an issuer on a matter under the supervision or direction of another attorney (other than under the direct supervision or direction of the issuer’s chief legal officer (or the equivalent thereof)) is a subordinate attorney.

A subordinate attorney must comply with the reporting requirements even though the subordinate attorney acted at the direction of or under the supervision of another person.

A subordinate attorney is in compliance if the subordinate attorney reports to his or her supervising attorney evidence of a material violation of which the subordinate attorney has become aware in appearing and practicing before the SEC.

A subordinate attorney may comply directly with reporting procedures if the subordinate attorney reasonably believes that a supervisory attorney to whom he or she has reported evidence of a material violation has failed to comply with Rule 205.

Preemption of State Law

Rule 205 governs in the event Rule 205 conflicts with state law, but will not preempt the ability of a state to impose more rigorous obligations on attorneys that are not inconsistent with Rule 205.

No Private Cause of Action, Only SEC Enforcement Action

Rule 205 does not create a private cause of action. The authority to enforce compliance with Rule 205 is vested exclusively with the SEC. This is consistent with case law in the area of derivatives lawyers and professional responsibility. In one decision involving derivatives
lawyers, a court held that “ethical rules of conduct ... do not create corresponding legal duties nor constitute standards for imposition of civil liability on lawyers.” In re Enron Corp. Securities Derivative and ERISA Litigation, 235 F. Supp. 2d 549, 598 (S.D. Tex. 2002).

Noisy Withdrawal

In February 2003, the SEC published for comment a proposed noisy withdrawal rule that has not been adopted. The proposed rule requires an attorney’s withdrawal from further representation of the issuer when the attorney, after reporting substantial evidence of a material violation up-the-ladder within the issuer’s governance structure, reasonably believes the issuer has not made an appropriate response within a reasonable time. The attorney must notify the issuer in writing of such withdrawal and that the withdrawal is based on “professional considerations.” The issuer must report such notice and the related circumstances to the SEC. Failing the issuer’s reporting to the SEC, the attorney may inform the SEC of the attorney’s withdrawal and that the withdrawal was based on “professional considerations.” The public comment period has ended and, as of the date of this outline, the noisy withdrawal rule has not yet been adopted by the SEC.

8. DODD-FRANK ACT: KEY PROFESSIONAL RESPONSIBILITY PROVISIONS CONCERNING “GATEKEEPERS”

Chief Compliance Officers – Sections 731, 732 and 764

Each futures commission merchant, swap dealer, major swap participant, securities-based swap dealer and major securities-based swap participant must designate an individual to serve as a chief compliance officer. Lawyers for derivatives entities will need to interact with CCOs, especially on issues pertaining to regulatory disclosures.

Pursuant to CFTC Rule 3.3, the CCO’s duties are to:

(1) report directly to the board or to the senior officer of the swap dealer or major swap participant;

(2) review the compliance of the swap dealer or major swap participant with respect to the swap dealer and major swap participant requirements described in this section;

(3) in consultation with the board of directors, a body performing a function similar to the board, or the senior officer of the organization, resolve any conflicts of interest that may arise;
(4) be responsible for administering each policy and procedure that is required to be established pursuant to this section;

(5) ensure compliance with Title VII of the Dodd-Frank Act (including regulations) relating to swaps, including each rule prescribed by the Commission under this section;

(6) establish procedures for the remediation of non-compliance issues identified by the chief compliance officer through any –

   (i) compliance office review;
   
   (ii) look-back;
   
   (iii) internal or external audit finding;
   
   (iv) self-reported error; or
   
   (v) validated complaint; and the handling, management response, remediation, retesting, and closing of non-compliance issues.

In accordance with rules prescribed by the Commissions, the CCO must also annually prepare and sign a report that contains a description of:

   (i) a description of the written policies and procedures, including the code of ethics and conflicts of interest policies, of the registrant;
   
   (ii) a review of requirements under the CEA and CFTC regulations applicable to the registrant, the identification and assessment of the written policies and procedures reasonably designed to ensure compliance with each applicable regulatory requirement and discussion of potential areas for improvement;
   
   (iii) a discussion of any material changes to the compliance program of the registrant;
   
   (iv) a description of resources set aside for compliance with the CEA and CFTC regulations, including any material deficiency in such resources; and
   
   (v) a description of any material non-compliance issues identified and the corresponding remediating actions.
CFTC Staff Advisory 14-153

Provides guidance and recommendations to CCOs relating to best practices for the CLO annual reports.

CCO Liability

The CCO is liable for false, incomplete or misleading representations in the reports filed by the CCO.

SEC View on CCO Liability

In a 2014 speech to a group of compliance officers, the SEC Director of Enforcement outlined three instances in which the SEC will seek sanctions against compliance personnel: (i) they actively participated in misconduct, (ii) helped mislead regulators or (iii) they had clear responsibility to implement compliance programs or policies and wholly failed to carry out that responsibility. The speech is available here: http://www.sec.gov/News/Speech/Detail/Speech/1370541872207.

National Futures Association Case

On July 24, 2013, the NFA settled a member enforcement action against the CCO of a registered foreign exchange dealer, alleging that the CCO violated NFA Compliance Rule 2-36(e) by failing to adequately supervise the dealer’s operations, including its anti-money laundering program. The case was settled with the payment of a fine without the CCO admitting or denying the allegations. In the Matter of FX Direct Dealer LLC, et al. (NFA Case Nos. 12-BCC-021 and -030, July 24, 2013).

CCOs as Deputies of the Government

Rule 38a-1(c) under the Investment Company Act of 1940 (the “ICA”) prohibits an officer, director, or employee of a fund, or its investment adviser, from, directly or indirectly, taking any action to coerce, manipulate, mislead, or fraudulently influence the fund’s CCO in the performance of his or her duties under the ICA. Pursuant to Rule 38a-1(c) of the ICA, the SEC recently sanctioned a portfolio manager for a registered investment adviser for forging documents and misleading the firm’s CCO in an attempt to conceal his personal trades in securities that the funds he managed were buying or selling. In the Matter of Carl D. Johns, Release IA 3655, Admin. Proc. File No. 3-15440 (SEC, August 17, 2013).
Whistleblowers – Section 748 and CFTC Rules Part 165; Section 922 and SEC Rule 21F

New Whistleblower Rules Present Challenges for Lawyers

The enforcement arsenals of the SEC and CFTC were strengthened by the Dodd-Frank Act by authorizing the agencies to implement whistleblower programs. Section 922 of the Dodd-Frank Act adds new Section 21F to the Securities Exchange Act of 1934, authorizing the SEC to award natural person whistleblowers a percent of any monetary recovery (including penalties, restitution and disgorgement) for voluntarily providing the SEC with original information that leads to the successful prosecution of an SEC enforcement action or related actions, if the monetary sanctions imposed on the violator exceed $1 million. Section 748 of the Dodd-Frank Act adds new Section 23 to the Commodity Exchange Act containing analogous whistleblower bounty provisions concerning CFTC enforcement actions and related actions. The whistleblowing programs present new professional responsibility challenges for lawyers, including (i) creating internal whistleblower reporting procedures and incentives that do not force an employee to internally report to the exclusion of reporting to the regulator, (ii) creating internal systems to track internal reports of wrongdoing, (iii) responding to a whistleblower’s report, (iv) creating anti-retaliation procedures, and (v) understanding situations in which lawyers may themselves report wrongdoing to regulatory authorities.

Sarbanes-Oxley Act

The Supreme Court has held that employees of a private investment manager to a registered investment company (a public company) are covered by the anti-retaliation provisions of the Sarbanes-Oxley Act whistleblower provisions even though these persons are not employees of a public company, but as employees of private contractors who contract with a public company (the registered investment company), they are protected as whistleblowers under the relevant provisions of the Sarbanes-Oxley Act. *Lawson et al. v. FMR LLC, et al.*, 2014 U.S. Lexis 1783, 82 U.S.L.W. 4144 (Sup. Ct. March 4, 2014).

SEC View on Retaliation

Rule 21F-17 of the Securities Exchange Act of 1934 provides, in part: “No person may take any action to impede an individual from
communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement … with respect to such communications.”

The SEC has published an interpretation under Rule 21F-2(b)(1) that employees can be afforded whistleblower anti-retaliation protection even if they do not report information to the SEC as contemplated by Section 21F of the Securities Exchange Act of 1934, but instead only report internally to the employer and suffer employment retaliation. The SEC’s view is that Rule 21F-2(b)(1), which controls the reporting methods that qualify an employee as a whistleblower for anti-retaliation purposes, does not require reporting to the SEC, as opposed to qualifying for a whistleblower’s monetary award under Rule 21F-2(a). SEC Release No. 34-75592, published at 80 FR 47829 (SEC, August 10, 2015). See also, Wiggins v. ING U.S. Inc., 2015 WL 3771646 (D. Conn. June 17, 2015).

The Chief of the SEC’s Whistleblower Office advised that his office is going to examine confidentiality agreements, separation agreements and employee agreements to see if they contain conditions that disincentivize employees from being whistleblowers. He said: “And if we find that kind of language, not only are we going to go to the companies, we are going to go after the lawyers who drafted it.” SEC Whistleblower Director Sean McKessy, remarks at the Georgetown University Law Center Corporate Counsel Institute, March 13, 2014, reported at LAW360 (Lexis Nexis), March 14, 2014.

The SEC settled a whistleblower anti-retaliation enforcement action against a hedge fund advisory firm that demoted its head trader to “compliance assistant” and marginalized him in retaliation for his reporting unlawful principal trades to the SEC. In the Matter of Paradigm Capital Management, Inc., SEC Administrative Proceeding No. 3-15930 (June 16, 2014).

On April 1, 2015, the SEC commenced and settled an administrative enforcement action, alleging that a company that required its employees to sign confidentiality agreements that imposed pre-notification requirements before contacting the SEC violated SEC Rule 21F-17, because the agreement silenced potential whistleblowers. In the Matter of KBR Inc., SEC Release No. 714619, Admin. Proc. File No. 3-16466 (SEC, April 1, 2015).

On September 28, 2016, the SEC settled with penalties an enforcement case against a Belgian company whose ADRs traded on the NYSE, for entering into separation agreement that impeded its Indian subsidiary’s employee from continuing to voluntarily cooperate with
the SEC about potential FCPA violations due to a liquidated damages payment that would be imposed on the employee for violating non-disclosure provisions in the separation agreement. **In the Matter of Anheuser-Busch IN/BEV SA/NV, SEC Administrative No. 3-17586 (Sept. 28, 2016).**

On September 28, 2016, the SEC settled with penalties an enforcement case against a public casino-gaming company for first removing an employee from significant work assignments and then firing him because he reported to senior management and the SEC that the company’s financial statements might be distorted. The employee was not involved in the company’s accounting functions and the company had determined that its reported financial statements contained no misrepresentations. **In the Matter of International Game Technology, SEC Administrative Proceeding No. 3-17596 (Sept. 29, 2016).**

On October 24, 2016, the SEC staff issued an Alert entitled “Examining Whistleblower Rule Compliance” summarizing that confidentiality provisions in employment agreements and severance agreements that contain language that impedes employees and former employees from communicating with the SEC concerning securities law violations may be in violation of SEC Rule 21F-7. The SEC Alert is available here: https://www.sec.gov/ocie/announcement/ocie-2016-risk-alert-examining-whistleblower-rule-compliance.pdf

**FINRA View on Retaliation**

On October 9, 2014, FINRA issued Regulatory Notice 14-40 warning that it is a violation of FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) if regulated entities enter into confidentiality agreements, arbitration settlements or other documents that ban customers or former employees from reporting wrongdoing to FINRA or the SEC. FINRA advised that documents should be written in a way that expressly and unconditionally authorizes such reporting or responding to regulatory inquiries.

**Court Views on Retaliation**

There is a split among the federal circuits concerning whether an individual who reports wrongdoing internally is protected by the SEC’s whistleblower anti-retaliation rules. The Fifth Circuit dismissed an anti-retaliation claim where the employee reported wrongdoing internally to his employer, concluding that the employee was not a whistleblower because he did not report to the SEC. **Asadi v. G.E.**
Energy (USA), LLC (5th Cir. July 17, 2013). A recent decision in the Second Circuit allowed a whistleblower award for an accountant who was allegedly fired after he internally reported suspected accounting fraud. Berman v. Neo@Ogilvy LLC (Case No. 14-4626, 2nd Cir., September 10, 2015). In Berman, the Court reasoned that accountants and lawyers cannot first report to the SEC, because they have special obligations to first report wrongdoing to their employer, and therefore the anti-retaliation provisions apply to their internal reporting.

CFTC View on Retaliation

Section 23(h)(i)(B) of the CEA provides that a whistleblower who has been retaliated against by his or her employer may bring a lawsuit against the employer in federal court. The court may award a prevailing whistleblower reinstatement, back pay, litigation costs, expert witness fees and attorney’s fees. See CFTC Rule 165.2(p)(2) and Appendix A to Part 165 of the CFTC’s rules. The CFTC’s rules currently do not explicitly provide that retaliation is a violation that subjects the violator to a CFTC enforcement remedy. However, on August 30, 2016, the CFTC proposed anti-retaliation enforcement rules that generally adopt the SEC’s enforcement approach. 81 Federal Register 59551. A full description of the CFTC Whistleblower Program is described on the CFTC’s website: https://www.whistleblower.gov/protections/.

May Lawyers be Whistleblowers?

The SEC adopted new Rule 21F on May 25, 2011 to implement Section 922 of the Dodd-Frank Act. The CFTC adopted new Part 165 of its rules on August 4, 2011 to implement Section 748 of the Dodd-Frank Act. Both the SEC’s and the CFTC’s rules provide exclusions from the whistleblower award for original information submitted by persons with legal, compliance, audit, supervising or governance responsibilities.

CFTC Rules 165.2(g)(2) and (3) exclude an attorney who provides information covered by an attorney-client privilege or in connection with the legal representation of a client, from acting as a whistleblower and being paid a bounty, unless the disclosure is permitted under either applicable federal rules or state attorney conduct rules. NY Rule 1.6 (b)(2) permits the disclosure of confidential information to the extent the lawyer reasonably believes is necessary to prevent the client from committing a crime. SEC Rule 240.21F-4(b)(4) also permits disclosure if permissible under SEC rules or state attorney conduct rules or
“otherwise.” SEC Rule 205.3(d)(2) permits an issuer’s counsel to disclose confidential information to the SEC to prevent substantial financial injury to the issuer or investors.

In the highly unlikely event that a lawyer decides to be a whistleblower concerning a client, the lawyer needs to consider many ethical issues, including NY Rule 1.7(a)(2), that provides that a lawyer cannot represent a client if a reasonable lawyer would conclude that there is a significant risk that the lawyer’s professional judgment on behalf of a client will be adversely affected by the lawyer’s own financial interests, i.e., the potential bounty.

One New York court has held that an associate at a law firm who wanted the firm to report to the appropriate authorities professional misconduct allegedly committed by a fellow associate but was instead discharged, was permitted to maintain a tort action against the law firm for wrongful discharge. Wieder v. Scala, 80 N.Y. 2d 628, 1593 NYS 2d 752 (1992); but see, Ausman v. Arthur Anderson, LLP, 80 N.E. 2d 566 (Ill. 1st Dist. 2004).

Organized Bar’s View on Lawyers as Whistleblowers

According to the New York County Lawyers Association, New York lawyers who are acting as attorneys of clients presumptively may not ethically collect whistleblower bounties in exchange for disclosing confidential information about their clients under the Dodd-Frank Act’s whistleblower provisions because doing so generally gives rise to a conflict between the lawyers’ interests and the interests of their clients. New York lawyers may not disclose confidential information relating to current or past clients, under the Dodd-Frank Act’s whistleblower regulations, even if such disclosure is in compliance with SEC Rule 205, if that disclosure does not fit within an exception under NY Rule 1.6 or is not necessary to correct a fraud, crime or false evidence within the meaning of NY Rule 3.3. This opinion is limited to New York lawyers who are acting as attorneys on behalf of clients. Committee on Professional Ethics, New York County Lawyers Association, Formal Opinion 746 (October 7, 2013).

Compliance Officers as Whistleblowers

Compliance and audit personnel are required to first report wrongdoing internally and only become whistleblowers if their employer does not respond appropriately. On August 29, 2014, the SEC announced its first whistleblower award to a compliance and audit officer. The
SEC’s Whistleblower Chief said: “Individuals who perform internal audit, compliance, and legal functions . . . may be eligible for an SEC whistleblower award if their companies fail to take appropriate, timely action on information they first reported internally.” SEC Press Release 2014-180 (Aug. 29, 2014).

**SEC Whistleblower Bounties**

On August 30, 2016, the SEC announced that its awards to whistleblowers surpassed $100 million, with its second-largest award of more than $22 million.

**CFTC Whistleblower War Chest**

Pursuant to Section 23(g) of the CEA, the CFTC’s whistleblower war chest is funded by the civil penalties collected by the CFTC’s Enforcement Division. As of September 30, 2015, the CFTC’s whistleblower fund was in excess of $267 million. *Annual Report in the Whistleblower Program* (CFTC, October 30, 2105) available at https://www.whistleblower.gov/files/Reports/wb_fy2015reporttocongress.pdf.

**Recent CFTC Whistleblower Award**

On April 4, 2016, the CFTC announced a March 28, 2016 award of $10 million to a whistleblower who provided key original information that led to a successful CFTC enforcement action. This was the CFTC’s third whistleblower award and the largest. *CFTC Whistleblower Award Order No. 16-WB-06.*

**Hypothetical**

Sally is the new in-house general counsel to Wall Street FCM/BD, LLC (“WSLLC”). WSLLC is reorganizing its “high-speed derivatives transactions” department. As part of a severance package for a trader who is being let go, Sally is reviewing a written agreement that conditions the severance payment on the trader’s “agreeing to notify WSLLC before discussing WSLLC’s high-speed transactions with any regulator or exchange.” How might the SEC or CFTC view this provision?
9. DODD-FRANK ACT: CFTC’S ANTI-EVASION RULE CREATES NEW ISSUES FOR LAWYERS

The CFTC’s anti-evasion rules will impact the way lawyers furnish advice to derivatives clients in respect of structuring derivatives transactions, entities and arrangements, including whether the anti-evasion rules should be addressed when issuing opinion letters. In 2012, the CFTC adopted its initial anti-evasion rules in a joint release with the SEC entitled “Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement; Mixed Swaps; Security-Based Swap Agreement Recordkeeping.” 77 Federal Register 39626 (CFTC and SEC, July 5, 2012). The SEC did not feel that it was necessary to implement Section 761(b)(3), because security-based swaps are securities as to which the SEC’s existing antifraud and anti-manipulation regulations already apply.

Statutory Authority

Section 722(d) of the Dodd-Frank Act, which added Section 2(i) to the CEA, to address extraterritorial anti-evasion. Pursuant to Section 721(c) of the Dodd-Frank Act, the CFTC has adopted rules to define “swap,” “swap dealer,” “major swap participant” and “eligible contract participant” in order to include transactions and entities that have been structured to evade Subtitle A of Title VII.

CFTC Anti-Evasion Provisions

CFTC Rule 1.3(xxx)(6)(i) – Any agreement, contract, or transaction that is willfully structured to evade any provision of Subtitle A of Dodd-Frank shall be deemed a swap.

CFTC Rule 1.3(xxx)(6)(ii) – An interest rate swap or currency swap that is willfully structured as a foreign exchange forward or foreign exchange swap to evade any provision of Subtitle A of Dodd-Frank shall be deemed a swap.

CFTC Rule 1.3(xxx)(6)(iii) – An agreement, contract, or transaction of a bank that is not under the jurisdiction of an appropriate federal banking agency and that is willfully structured as an identified banking product to evade the provisions of the CEA, shall be deemed a swap.
CFTC Rule 1.3(xxx)(6)(v) – An agreement, contract, or transaction that has been willfully structured to evade as provided in Rules 1.3 (xxx)(6)(i)-(iii) of this section shall be considered in determining whether a person that so willfully structured to evade is a swap dealer or major swap participant.

CFTC Rules 1.3(xxx)(6)(vi)and 1.6 (d) – . . . no agreement, contract or transaction structured as a security (including a security-based swap) under the securities laws . . . shall be deemed a swap. Note: These provisions do not include a “structured to evade” condition.

CFTC RULE 1.6 (a) and (c) – Section 2(i) of the CEA provides that the provisions of the CEA relating to swaps that were enacted by the Dodd-Frank Act (including any rule prescribed or regulation promulgated thereunder), shall not apply to activities outside the United States unless those activities – (1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations as the CFTC may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of the CEA that was enacted by the Dodd-Frank Act. Rule 1.6(a) and (c) makes it unlawful to conduct activities outside the United States, including entering into transactions and structuring entities, to willfully evade or attempt to evade any provision of the CEA as enacted under Title VII or the rules and regulations promulgated thereunder and makes such activity subject to Subtitle A of Title VII.

CFTC Rule 50.10 – It shall be unlawful for any person to knowingly or recklessly evade or facilitate an evasion of the mandatory clearing requirements of the CEA or any CFTC rule or regulation promulgated thereunder.

It shall be unlawful for any person to abuse the exception or exemption to the clearing requirement as provided under section 2(h)(7) of the CEA, including any other exemption or exception as the CFTC may provide by regulation.

CFTC Rule 75.21 –

(a) Any banking entity that engages in an activity or makes an investment in violation of section 13 of the BHC Act or Part 75 of the Commission’s rules entitled “Proprietary Trading and Certain Interests In and Relationships With Covered Funds”, or acts in a manner that functions as an evasion of the requirements of section 13 of the BHC Act or Part 75 of the Commission’s rules
entitled “Proprietary Trading and Certain Interests In and Relationships With Covered Funds”, including through an abuse of any activity or investment permitted under subparts B or C of Part 75, or otherwise violates the restrictions and requirements of section 13 of the BHC Act or Part 75 of the Commission’s rules entitled “Proprietary Trading and Certain Interests In and Relationships With Covered Funds”, shall, upon discovery, promptly terminate the activity and, as relevant, dispose of the investment.

(b) Whenever the Commission finds reasonable cause to believe any banking entity has engaged in an activity or made an investment in violation of section 13 of the BHC Act or Part 75 of the Commission’s rules entitled “Proprietary Trading and Certain Interests In and Relationships With Covered Funds”, or engaged in any activity or made any investment that functions as an evasion of the requirements of section 13 of the BHC Act or Part 75 of the Commission’s rules entitled “Proprietary Trading and Certain Interests In and Relationships With Covered Funds”, the Commission may take any action permitted by law to enforce compliance with section 13 of the BHC Act and Part 75 of the Commission’s rules entitled “Proprietary Trading and Certain Interests In and Relationships With Covered Funds”, including directing the banking entity to restrict, limit, or terminate any or all activities under this part and dispose of any investment.

**CEA Section 6(e)** – Any designated derivatives clearing organization, swap dealer, or major swap participant, that knowingly or recklessly evades or facilitates an evasion of the clearing requirements shall be liable for a civil money penalty. This anti-evasion is not dependent upon the promulgation of a special anti-evasion rule under Section 721(c) of Dodd-Frank.

**Extraterritoriality** – Section 722(d) of the Dodd-Frank Act and CEA section 2(i) provide that the provisions of the CEA relating to swaps shall not apply to activities outside the United States unless those activities, among other things, contravene such rules or regulations as the CFTC may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of the CEA that was enacted by the Title VII. Rule 1.6(a) makes it unlawful to conduct activities outside the United States, including entering into transactions and structuring entities, to willfully evade or attempt to evade any provision of the CEA as enacted under Title VII or the rules and regulations promulgated thereunder.
CFTC Anti-Evasion Guidance

No Bright-Line Test

The CFTC believes a “principles-based” approach to its anti-evasion rules is appropriate. The CFTC has not adopted an alternative approach, whereby it would provide a bright-line test of non-evasive conduct. The CFTC believes that such an approach may provide potential wrongdoers with a roadmap for structuring evasive transactions.

Being “Lawful” is Not a Test

The CFTC has not adopted an alternative “lawful” standard for evasion because it believes that to adopt this standard would blur the distinction between whether a transaction or entity is lawful and whether it is structured in a way to evade the Dodd-Frank Act and the CEA. The CFTC does not believe it is appropriate to limit the enforcement of its anti-evasion authority only to unlawful transactions.

Willfulness

Rule 1.3(xxx)(6)(i) under the CEA generally defines as swaps those transactions that are “willfully structured” to evade the provisions of Title VII governing the regulation of swaps. The CFTC will interpret “willful” consistent with how the CFTC has interpreted the term in the past, that a person acts “willfully” when they act either intentionally or with reckless disregard. Rule 1.3(xxx)(6)(ii) applies to currency and interest rate swaps that are “willfully structured” as foreign exchange forwards or foreign exchange swaps to evade the new regulatory regime for swaps enacted in Title VII. Rule 1.3(xxx)(6)(iii) applies to transactions of a bank that are not under the regulatory jurisdiction of an appropriate Federal banking agency and where the transaction is “willfully structured” as an identified banking product to evade the new regulatory regime for swaps enacted in Title VII. Rule 1.3(xxx)(6)(v) further provides that transactions, other than transactions structured as securities, “willfully structured” to evade (as provided in rules 1.3(xxx)(6)(i) through (iii)) will be considered in determining whether a person is a swap dealer or major swap participant.
Clever Draftsmanship

Lawyers are the draftsmen of many of the derivatives documents and the opinions that support the transactions. Rule 1.3(xxx)(6)(iv) provides that in determining whether a transaction has been willfully structured to evade rules 1.3(xxx)(6)(i) through (iii), the CFTC will not consider the form, label, or written documentation dispositive. This approach is intended to prevent evasion through clever draftsmanship of a form, label, or other written documentation. The CFTC advised that the structuring of instruments, transactions, or entities to evade the requirements of the Dodd-Frank Act may be “limited only by the ingenuity of man.” Therefore, the CFTC will look beyond the manner in which an instrument, transaction, or entity is documented to examine its actual substance and purpose to prevent any evasion through clever draftsmanship—an approach consistent with the CFTC’s case law in the context of determining whether a contract is a futures contract. The documentation of an instrument, transaction, or entity (like its form or label) is a relevant, but not dispositive, factor in determining whether evasion has occurred.

Swap Execution Facilities

Concerning the applicability of the anti-evasion rules to transactions executed on a SEF, the CFTC clarified that a transaction that has been self-certified by a SEF or a Designated Contract Market pursuant to Party 40 of the CFTC’s rules, or that has received prior approval from the CFTC, will not be considered evasive.

Business Purpose Test

The CFTC recognized that transactions may be structured, and entities may be formed, in particular ways for legitimate business purposes, without any intention of circumventing the requirements of the Dodd-Frank Act with respect to swaps. Thus, in evaluating whether a person is evading or attempting to evade the swap requirements with respect to a particular instrument, entity, or transaction, the CFTC will consider the extent to which the person has a legitimate business purpose for structuring the instrument or entity or entering into the transaction in that particular manner. Although different means of structuring a transaction or entity may have differing regulatory implications and attendant requirements, absent other indicia of evasion, the CFTC will not consider transactions, entities, or instruments structured in a manner solely motivated by a legitimate business
purpose to constitute evasion. However, to the extent “a purpose” in structuring an entity or instrument or entering into a transaction is to evade the requirements of Title VII with respect to swaps, the structuring of such instrument, entity, or transaction may be found to constitute willful evasion. The CFTC clarified that a person’s specific consideration of regulatory burdens, including the avoidance thereof, is not dispositive that the person is acting without a legitimate business purpose in a particular case. The CFTC will view legitimate business purpose considerations on a case-by-case basis in conjunction with all other relevant facts and circumstances.

**Legitimate Business Practices**

The CFTC recognized that it is possible that a person intending to willfully evade Dodd-Frank may attempt to justify its actions by claiming that they are legitimate business practices in its industry. The CFTC will retain the flexibility, via an analysis of all relevant facts and circumstances, to confirm not only the legitimacy of the business purpose of those actions but whether the actions could still be determined to be willfully evasive. Because transactions and instruments are regularly structured, and entities regularly formed, in a particular way for various, and often times multiple, reasons, it is essential that all relevant facts and circumstances be considered. Where a transaction, instrument, or entity is structured solely for legitimate business purposes, it is not willfully evasive. By contrast, where a consideration of all relevant facts and circumstances reveals the presence of a purpose that is not a legitimate business purpose, evasion may exist.

**Fraud, Deceit or Unlawful Activity**

When determining whether a particular activity constitutes willful evasion of the CEA or the Dodd-Frank Act, the CFTC will consider the extent to which the activity involves deceit, deception, or other unlawful or illegitimate activity. Persons that craft derivatives transactions, structure entities, or conduct themselves in a deceptive or other illegitimate manner in order to avoid regulatory requirements should not be permitted to enjoy the fruits of their deceptive or illegitimate conduct. However, although fraud, deceit, or unlawful activity will be present where willful evasion has occurred, the CFTC does not believe that these factors are prerequisites to an evasion finding. The presence or absence of fraud, deceit, or unlawful activity is simply one fact
or circumstance) the CFTC will consider when evaluating a person’s activity.

**Innocent Counterparty to an Evasive Transaction**

With respect to the treatment of evasive transactions after they are discovered, the CFTC clarified that in instances where one party willfully structures a transaction to evade but the counterparty does not, the transaction, which meets the swap definition under rule 1.3 (xxx)(6), or is subject to the provisions of Subtitle A of Title VII pursuant to rule 1.6, will be subject to all CEA provisions and the regulations thereunder (as applied to the party who willfully structures a transaction to evade). In rare situations where there is a true “innocent party,” the CFTC concluded that it will likely be due to fraud or misrepresentation by the evading party and the business consequences and remedies will be the same as for any such victim. The CFTC will impose appropriate sanctions only on the willful evader for violations of the relevant provisions of the CEA and CFTC regulations since the individual agreement, contract or transaction was (and always should have been) subject to them. Further, on a prospective basis for future transactions or instruments similar to those of the particular evasive swap, the CFTC will consider these transactions or instruments to be swaps within the meaning of the Dodd-Frank Act (as applied to both the party who willfully structures a transaction to evade and the “innocent party”).

**Consequences of Evasion**

Evasive transactions will count toward determining whether each evading party with the requisite intent is a registrable swap dealer or major swap participant. The evasive transaction would count toward the relevant thresholds (e.g., *de minimis* (with respect to determining swap dealer status, if the evasive transaction constituted dealing activity) and substantial position (with respect to determining major swap participant status)). Further, in determining whether such a transaction is a swap, the CFTC will consider whether the transaction meets the definition of the term “swap” as defined by statute and as it is further defined in this rulemaking. For example, the CFTC advised that if a person, “in seeking to evade Title VII,” structures a product that is a privilege on a certificate of deposit, the CFTC’s anti-evasion rules would not be implicated because CEA section 1a(47)(B)(iii) excludes such a product from the swap definition. Note that the CFTC
conceded this issue even though the intent of the person is to “evade” rather than “avoid” Title VII.

**End-User Clearing Exemption**

Section 9(a)(6) of the Commodity Exchange Act, added by the Dodd-Frank Act, makes it a felony punishable by a $1 million fine or 10 years imprisonment for any person to “abuse” the end-user clearing exemption under section 2(h)(4), as determined by the CFTC. How will this affect a lawyer’s professional obligations when representing end-users, *e.g.*, opinion letters, structuring transactions?

10. **MULTIPLE CLIENTS; WAIVERS**

**Divided Loyalties**

NY Rule 1.7(a):

“Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that either:

1. the representation will involve the lawyer in representing differing interests; or
2. there is a significant risk that the lawyer’s professional judgment on behalf of a client will be adversely affected by the lawyer’s own financial, business, property or other personal interests.”

NY Rule 1.7(b):

“Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

1. the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
2. the representation is not prohibited by law;
3. the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
4. *each affected client gives informed consent, confirmed in writing.*”

**Forex Fraud Conflicts-of-Interest Decision**

A Florida lawyer was suspended from the practice of law for 3 years based on his ethics violations, including failure to disclose a conflict-of-interest and making misrepresentations to his new client, who he represented as a potential shareholder in a new forex brokerage venture founded by his existing client. Notwithstanding that the
lawyer represented to the new client that the existing client was an “honest man,” he failed to disclose that he represented the existing client in federal court to unfreeze the existing client’s forex brokerage firm’s assets that were frozen in a CFTC enforcement action alleging forex fraud and other violations. Unaware of the existing client’s background, the new client relied upon his lawyer’s representations in deciding to become a shareholder and lender in the existing client’s new forex brokerage company. The new client first learned about the existing client’s fraud problems when, because he could not contact the existing client, he went to the new forex brokerage and encountered law enforcement officers raiding the new forex brokerage of which the new client was now a shareholder and lender. The new client was an unwitting investor in the new forex business operated by the existing client. The court found that the lawyer’s conflicts were so serious that they were unwaivable by the new client and that the lawyer violated Florida’s lawyers’ ethics code, including the conflicts-of-interest provisions and provisions prohibiting a lawyer from making a false statement of a material fact to a third person in the course of representing a client. *The Florida Bar v. William Sumner Scott*, No. SCO5-1145 (Fla. S. Ct. June 10, 2010).

**Guidances**

*ABA Model Rule 1.7, Comment 34*

“A lawyer who represents a corporation does not, by virtue of that representation, necessarily represent any constituent or affiliated organization, such as a parent or subsidiary.”

*ABA Model Rule 1.7, Comment 31*

“As to the duty of confidentiality, continued common representation will almost certainly be inadequate if one client asks the lawyer not to disclose to the other client information relevant to the common representation.”

*NY Ethical Consideration 5-16*

“In those instances in which a lawyer is justified in representing two or more clients having differing interests, it is nevertheless essential that each client be given the opportunity to evaluate the need for representation free of any potential conflict and to obtain
other counsel if the client so desires. Thus before a lawyer may represent multiple clients, the lawyer should explain fully to each client the implications of the common representation and otherwise provide to each client information reasonably sufficient, giving due regard to the sophistication of the client, to permit the client to appreciate the significance of the potential conflict, and should accept or continue employment only if each client consents, preferably in writing. If there are present other circumstances that might cause any of the multiple clients to question the undivided loyalty of the lawyer, the lawyer should also advise all of the clients of those circumstances.

If a disinterested lawyer would conclude that any of the affected clients should not agree to the representation under the circumstances, the lawyer involved should not ask for such agreement or provide representation on the basis of the client’s consent. In addition, there may be circumstances in which it is impossible to make the disclosure necessary to obtain consent, such as when the lawyer represents different clients in related matters and one of the clients refuses to consent to the disclosure necessary to permit the other client to make an informed decision. In all cases in which the fact, validity or propriety of client consent is called into question, the lawyer must bear the burden of establishing that consent was properly obtained and relied upon by the lawyer.”

Joint Representation of the Corporation and a Constituent

NY City Bar Opinion 2004-02

This opinion addresses the circumstances under which a lawyer may represent both the corporation and one or more of its constituents (employees, officers, directors, agents) in a government investigation, but the opinion is also generally applicable to joint representations in the transactional context. Opinion 2004-02 concludes that representing a corporation and one or more constituents can be ethically permissible provided a disinterested lawyer would believe that multiple representation is in the best interest of both the corporate and employee client. The lawyer must also obtain the knowledgeable and informed consent of both clients after full disclosure of the potential conflicts that may arise. The lawyer must be alert to changes in circumstances that would render the continuation of the multiple representation impermissible, and must take steps to
minimize potential adverse consequences should a conflict arise between the corporation and the constituent.

**Simultaneous Dual Corporate Representations**

**NY City Bar Opinion 2001-02**

A lawyer may represent one client in a transaction with a concurrent client in another matter, with disclosure and informed consent, so long as a “disinterested lawyer” would believe that the lawyer can competently represent the interests of each. Determinative factors are:

(i) the nature of the conflict of interest, *i.e.*, is it direct and contentious,

(ii) the likelihood that client confidences or secrets in one matter will be relevant to the other representation,

(iii) the ability of the lawyer or law firm to ensure that confidential information of each of the clients will be preserved,

(iv) the ability of the lawyer to explain, and the clients’ ability to understand, the reasonably foreseeable risks of the conflict in order to give an “informed consent” to waive the conflict, and

(v) the lawyer’s relationship with the clients, *i.e.*, the ability to vigorously represent each client.

**New York City Bar Opinion 2001-03**

The scope of a lawyer’s representation of a client may be limited in order to avoid a conflict that might otherwise result with a present or former client, provided that the client whose engagement is limited consents to the limitation after full disclosure and the limitation on the representation does not render the lawyer’s counsel inadequate or diminish the zeal of the representation. An attorney whose representation has been limited, however, must be mindful of the duty of loyalty to both clients.

**Corporate-Family Conflicts**

The issue is whether a current corporate client’s affiliate has *de facto* become a client of the law firm, preventing the law firm from accepting a representation that is adverse to the affiliate without first receiving an informed consent from the affiliate and the adverse party.
ABA Opinion 95-390

Criteria that may be used for identifying when representation of a corporation will be deemed a representation of its affiliates and may prohibit representing a party adverse to an affiliate of the corporation are:

1. two members of a corporate family are alter egos, e.g., there is a general disregard of corporate separateness or common management; or

2. in representing one entity, a lawyer acquires relevant confidential information about its affiliate; or

3. legal matters for all corporate family members are handled by a single in-house legal department, e.g., the outside lawyer reports to in-house counsel who represents both the corporation and the affiliate.

NY City Bar Opinion 2007-3

The law firm should consider whether the affiliate has de facto become a client of the law firm. The relevant considerations include the nature of the law firm’s relationship and dealings with the affiliate during its representation of the corporate client, as well as the presence of significantly overlapping personnel and infrastructures between the corporate client and its affiliate. The law firm should consider:

1. the presence of any material limitations on the law firm’s responsibilities to either the current corporate client or the adverse client if the law firm were to accept the adverse representation; and

2. whether the law firm learned confidences and secrets during the representation of the corporate client that would be so material to the adverse representation as to preclude the law firm from proceeding.

Informed Consents

NY Rule 1.7(b)(4) requires that each affected client gives informed consent, confirmed in writing.

In potential conflicts circumstances, the lawyer should first obtain an informed written consent from each party. If the conflict is capable of being waived, the waiver may be given orally but must be followed
by a written or electronic (email) confirmation of the waiver. Where confidences of one party that are relevant to the transaction will be divulged to the lawyer, the informed consent should permit the sharing of the otherwise confidential information with the other party to the transaction. See ABA Model Rule 1.7.

**NY City Bar Opinion 2005-02**

The fact that a lawyer possesses confidences or secrets that might be relevant to a matter the lawyer is handling for another client but the lawyer cannot use or disclose does not, without more, create a conflict of interest barring the dual representation. The critical question is whether the representation of either client would be impaired. The lawyer has a conflict if the lawyer cannot avoid using the embargoed information in the representation of the second client or the possession of the embargoed information might reasonably affect the lawyer’s independent professional judgment in the representation of that client. Whether that is the case depends on the facts and circumstances, including in particular the materiality of the information to the second representation and whether the information can be effectively segregated from the work on the second representation. Whether the conflict can be waived depends on whether the lawyer can disclose sufficient information to the affected client to obtain informed consent and whether a disinterested lawyer would believe that the lawyer’s professional judgment would not in fact be affected by possession of the information. If the lawyer is required to withdraw from the representation, the lawyer may not reveal the information giving rise to the conflict.

**Advance Waivers**

**NY City Bar Opinion 2006-1**

A law firm may request a client to waive future conflicts if (a) the law firm makes appropriate disclosure of, and the client is in a position to understand, the relevant implications, advantages and risks, so that the client may make an informed decision whether to consent, and (b) a disinterested lawyer would believe that the law firm can competently represent the interests of all affected clients. Advance waivers, and advance waivers that permit the law firm to act adversely to the client on matters substantially related to the law firm’s representation of the client, should be limited to sophisticated
clients, and be conditioned on meeting the tests articulated in ABCNY Formal Opinion 2001-2, including (a) the waiver be limited to transactional matters that are not starkly disputed and (b) client confidences and secrets be safeguarded. See, e.g., NY Rule 1.7(b).

**ABA Formal Opinion 05-436**

General and open-ended consent is more likely to be effective when given by a client that is an experienced user of legal services, particularly if, for example, the client is independently represented by other counsel in giving consent and the consent is limited to future conflicts unrelated to the subject of the representation.

**Decision Rejecting an Advance Waiver**

In *Celgene Corporation v. KV Pharmaceutical Company*, 2008 U.S. Dist. Lexis 58735 (D.N.J. 2008), the court declined to enforce an advance waiver that included “litigation” contained in a retention agreement signed by plaintiff’s in-house counsel in the context of a motion to disqualify defendant’s counsel in pending intellectual property litigation. The court focused on whether the law firm had complied with New Jersey Rule 1.7, which permits a firm to be directly adverse to a client only if it has obtained the client’s “informed consent, confirmed in writing, after full disclosure and consultation ....” The court defined informed consent “to be consent that an attorney obtained after a consultation with the client in which the attorney proposed a course of conduct using adequate information, explained the material risks of this course of conduct, and stated reasonably available alternatives to the proposed course of conduct.” At the time of the waiver, the intellectual property issue that became the subject of the pending litigation probably could not reasonably have been anticipated. The court concluded that neither the terms of the engagement letter nor the evidence concerning the engagement letter showed that the law firm had obtained the “truly informed consent” of Celgene. The lessons are that advance waivers should be as specific as possible and disclose as many potential adverse consequences as possible.

**Decisions Enforcing an Advance Waiver**

A U.S. federal district court recently enforced a general, open-ended written waiver of future conflicts of interest and therefore refused to disqualify a law firm from appearing opposite a current
client in litigation. *Galderma Laboratories, L.P. v. Actavis Mid Atlantic LLC*, No. 3:12-cv-2038-K, 2013 U.S. Dist. LEXIS 24171 (N.D. Tex. February 21, 2013) In enforcing the advance written waiver against Galderma, the court relied on the following: Galderma was a sophisticated business organization; it was a regular user of legal services (including using several other law firms to which it had also given similar broad advance waivers); it was represented in connection with the waiver by a senior in-house counsel; the potential consequence of the waiver – adverse representation, including possibly in litigation – was disclosed; and the alternative of not hiring the firm was also disclosed.

In *Macy’s Inc. v. J.C. Penny Corp.*, 107 A.D. 3d 616, 968 N.Y.S. 2d 2013 NY Slip Op 04891 (App Div 1st Dept 2013 [2013 BL 170689]), a New York court allowed a law firm to represent Macy’s in a contract dispute against its former client J.C. Penny. The law firm was retained in 2008 to represent J.C. Penny in a trademark litigation matter in Asia. The engagement letter expressly informed J.C. Penny about the possibility that the law firm’s present or future clients “may be direct competitors of [J.C. Penny] or otherwise may have business interests that are contrary to [J.C. Penny]’s interests,” and “may seek to engage [the law firm] in connection with an actual or potential transaction or pending or potential litigation or other dispute resolution proceeding in which such client’s interests are or potentially may become adverse to [J.C. Penny]’s interests.” The court found that the new representation of Macy’s did not conflict with the 2008 J.C. Penny Asian trademark matter and that this language constituted an enforceable advance waiver.

**Advance Waivers in Regulatory Proceedings**

Advance waivers may be used to allow corporate counsel to also represent an employee and continue the corporate representation even if a conflict develops. See ABA Opinion 2004-02. Most regulators have sequestration rules that should be consulted prior to taking on a dual representation in an agency enforcement matter. See, e.g., CFTC Rule 11.8(b) and Rule 7(b) of the SEC’s Rules Relating to Investigations. Generally, an agency must prove that the multiple-representation would obstruct and impede the investigation. See, e.g., *SEC v. Csapo*, 533 F. 2d 7, 11 (D.C. Cir. 1976); *SEC v. Tang*, No. C-09-05196 (N.D. Cal. Nov. 28, 2011).
Counsel must also provide the employee with an appropriate explanation of the implications of a lawyer’s representation of both the employee and the corporation. See, e.g., *Upjohn v. United States*, 449 U.S. 383 (1991).

**Law Firm Procedures**

A law firm’s internal policies and procedures must be adhered to when considering obtaining an advance waiver. The partner who represented the original client should be consulted.

When you are drafting an engagement letter, you should consider whether that are any types of future conflicts that could be anticipated and addressed in the advance waiver provision, so that it is an informed consent. An advance waiver that addresses potential specific categories of future conflicts is more likely to be enforceable.

**Former Government Lawyers**

NY Rule 1.11(a) generally prohibits a former government lawyer from representing a client in connection with a matter in which the lawyer participated personally and substantially as a government lawyer without the agency’s consent. NY Rule 1.9(c) requires the former government lawyer to preserve confidential information learned while in the government. D.C. Rule of Professional Conduct 1.11(1) and other jurisdictions have similar provisions.

The D.C. Court of Appeals disbarred a former CFTC enforcement lawyer who left the CFTC to become the general counsel of a scrap-metal dealer. He was the principal CFTC lawyer in the 1998 investigation and settlement with the Sumitomo Corporation involving alleged copper manipulation. As the general counsel to the scrap-metal dealer, the lawyer handled the dealer’s lawsuit against Sumitomo alleging copper market manipulation, allegedly using confidential information he learned as a CFTC enforcement lawyer. In a D.C. disciplinary proceeding alleging ethics violations, the lawyer consented to the disbarment without admitting engaging in ethical violations. *In re Dennis O’Keefe* (D.C. Court of Appeals, November 3, 2005).

**11. DIRECT COMMUNICATIONS WITH THE OTHER PARTY, NOT THROUGH ITS LAWYER**

NY Rule 4.2(a) provides: “In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer...
knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.”

NY Rule 4.2(b) allows a direct communication if the lawyer gives reasonable advance notice to the represented person’s counsel that such communication will take place.

Comment 7 to ABA Model Rule 4.2 advises that in the case of a represented organization, communications are prohibited with a constituent of the organization who supervises, directs or regularly consults with the organization’s lawyer concerning the matter or has authority to obligate the organization with respect to the matter or whose act or omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability.

### Directing Your Client to Communicate with a Represented Party

**NY City Bar Opinion 2002-03**

Where the client conceives the idea to communicate with a represented party, the client’s lawyer is not precluded from advising the client concerning the substance of the communication. The lawyer may not assist the client inappropriately to seek confidential information or invite the non-client to take action without the advice of counsel.

### Contacting In-House Counsel

**NY City Bar Opinion 2007-1**

A lawyer is not prohibited from communicating with an in-house counsel of an organizational party represented by outside counsel as long as the communicating lawyer has a reasonable, good faith belief based on objective evidence that the in-house lawyer is acting as a lawyer for the represented organization “though not necessarily with respect to the subject matter of the communication as issue….”

**ABA Formal Opinion 06-443**

ABA Model Rule 4.2 prevents a lawyer from contacting a represented party without the consent of the opposing lawyer.
ABA Formal Opinion 06-443 advises that Rule 4.2 generally does not prohibit a lawyer who represents a client in a matter involving an organization from communicating with the organization’s inside counsel about the subject of the representation without obtaining the prior consent of the entity’s outside counsel “unless the lawyer is in fact a party in the matter and represented by the same counsel as the organization.”

**Contacting Former Employees of the Other Party**

Some decisions have found that directly contacting the other side’s former employees is not prohibited. See, e.g., *Muriel Siebert & Co. v. Intuit Inc.*, 8 N.Y.3d 506, 836 N.Y.S. 2d 527 (2007).

**Hypothetical**

You are in-house counsel for an investment bank. The head of your underwriting department calls you and asks if you can come to Conference Room 23 to meet with the top executives of a company that is considering an IPO, to discuss some preliminary business and legal issues. When you get to the meeting, the company’s VP said their GC was supposed to be at the meeting but had a medical emergency and would not be there. Should you participate in the meeting or say that you cannot participate without the company’s GC being present or giving his permission? Can you ever meet with a corporation’s business people without their legal department being present?

12. **EMAIL ISSUES**

**Expectations of Confidentiality**

*ABA Formal Opinion 99-413*

Email containing confidential and privileged client information does not violate ABA Model Rule 1.6(a), because there is a reasonable expectation of privacy in its use.

*NY City Bar Opinion 1998-2*

Email is a reasonably secure means of communication and is in most instances an acceptable form of conveying client confidences even where the lawyer does not obtain specific client consent. “It would be advisable for Law Firms to advise their clients and
prospective clients that the security of communications over the Internet is not equal to that of other forms of communications that are generally accepted as secure. Different levels of security on the Internet would seem to be appropriate for matters of differing sensitivity.”

**ABA Formal Opinion 11-459**

Lawyer should warn his client of the consequences of using an electronic communications system to communicate with the lawyer that is susceptible to interception by third parties (the client’s employer’s electronic system).

**Opening Emails Mistakenly Sent to You**

A Florida court recently denied a request to disqualify defendant’s law firm, which received an email from plaintiff’s law firm that accidentally attached a confidential mediation statement instead of the intended summary judgment motion in a dispute over a family estate. Defendant’s counsel read the confidential attachment that was not marked as confidential, and initially thought that it was intentionally sent to her in an attempt to resolve the dispute. When defendant’s lawyer emailed plaintiff’s counsel about the mediation statement, plaintiff’s counsel responded in an email pointing out the mistake, but after counsel had read the attachment. Defendant’s counsel then destroyed the document. Plaintiff sought to disqualify defendant’s law firm, alleging that the reading of the confidential attachment gave them an unfair advantage and that they violated Florida rules of professional conduct by not immediately notifying plaintiff’s law firm of their receipt of a confidential document inadvertently sent to them (Florida Rule 4-4.4(b)). The court determined that there was no unfair advantage and that the defendant’s firm acted ethically upon being advised of the mistake. This case is also important because it stands for the proposition that a lawyer will not be automatically disqualified solely based on inadvertently being furnished with the other side’s confidential material. *Sara Moriber v. Michael Paul Dreiling et al.*, Case 3D12-300 (Florida, Third Dist. Ct. of App., August 22, 2012).

**Metadata**

Metadata is electronically stored embedded information about the drafting and history of the electronically transmitted document, e.g., lawyers’ comments about prior drafts, changes that were made to the
There are software systems to delete (“scrub”) Metadata, but sometimes senders neglect to use the deletion system.

**Relevant Organized Bar Guidances**

*New York County Lawyers Association, Committee on Professional Ethics, Formal Opinion 738*

A lawyer who receives electronic documents that appear to contain inadvertently produced Metadata is ethically obligated to avoid searching Metadata in those documents. While attorneys are advised to take due care in sending documents by scrubbing the documents to ensure that they are free of Metadata, a recipient may not ethically take advantage of a breach in the attorney’s care by intentionally searching for Metadata. Searching Metadata for opposing counsel’s work product or client confidences is unethical. Without a prior understanding to the contrary, there is a presumption that disclosure of Metadata is inadvertent and would be unethical to view.

If a lawyer sends material clearly showing tracked changes, the recipient will have to determine from the circumstances whether the sender intended to send a document showing changes or whether it appeared to be a mistake and the document is likely to contain privileged material. If the receiving lawyer reasonably believes that the disclosure was intentional because, for example, the lawyers were using tracked changes to show one another the changes that each was making, it is not unethical for the receiving lawyer to review the Metadata. Without such a prior understanding or course of conduct to the contrary, however, there is a presumption that disclosure of Metadata is inadvertent and would be unethical to view.

*City Bar of New York, Committee on Professional Ethics, Formal Opinion 2012-1 (2012)*

Rule 4.4(b) provides that a “lawyer who received a document relating to the representation of the lawyer’s client and knows or reasonably should know that the document was inadvertently sent shall promptly notify the sender.” The term “document” includes email and other electronically stored information subject to being read or put into readable form. A lawyer who received a letter, fax, email or other communication that the lawyer knows or reasonably
should know was transmitted by mistake must promptly notify the sender, pursuant to NY Rule 4.4(b), and follow any other applicable law.

**New York State Bar Association Opinion 749, affirmed by Opinion 782**

Lawyers may not intentionally use computer technology to surreptitiously obtain an opposing party’s privileged or confidential information, to discover the history of the drafting of the documentation, or to trace emails. The opinion notes that New York Disciplinary Rule 4-101 prohibits lawyers from knowingly revealing a client’s confidences or secrets except pursuant to an enumerated exception. A lawyer has a duty under 4-101 to use reasonable care when transmitting documents by email to prevent the disclosure of Metadata.

**ABA Formal Opinion 06-442**

The ABA Model Rules, including Rule 4.4(b) which relates to a lawyer’s receipt of inadvertently sent information, do not explicitly prohibit the accessing of Metadata. The lawyer sending the document has a duty to scrub the Metadata to avoid disclosing client confidences. The opinion notes that ABA Model Rule 4.4(b) requires that a lawyer who receives a document and knows or should know that the document was inadvertently sent should promptly notify the sender, but the opinion does not address the receiving lawyer’s use of the Metadata.

**Email Exchanges of Transactional Understandings May Not Prove the Final Agreement**

In a credit default swap decision, Bank A’s counterclaim for $245 million it lost on a credit default swap was rejected by the court. Bank A alleged that the executed CDS should be “reformed” based on “mutual mistake” because it did not reflect an understanding in email exchanges by lawyers and business personnel during the negotiations leading up to the CDS confirmation, in which Bank B’s negotiator responded “OK” to Bank A’s negotiator’s understanding that Bank A would be contacted before any sale of the CDS collateral. The email exchange was not reflected in the executed CDS. In rejecting Bank A’s argument that the executed CDS confirmation should be “reformed” based on the email exchanges and also not finding “mutual
mistake,” the court found that (a) both parties were sophisticated banks, (b) the “OK” email was not the type of clear and convincing evidence required to reform the executed CDS, and (c) the parties had agreed in the executed CDS confirmation that only the terms set forth in the final executed CDS would be binding on the parties. *Citibank N.A. v. Morgan Stanley & Co. International*, 2011 WL 2078211 (S.D.N.Y. May 25, 2011).

Some courts have found that some email chains form binding agreements. Lawyer should consider adding a disclaimer on emails as to whether the email is or is not intended to conduct the transaction electronically or create a binding agreement. In *Williamson v. Bank of New York Mellon*, No. 3:12 – CV-N, 2013 WL 2359577 (N. D. Tex. May 16, 2013), based on the ongoing email negotiations and the specific content of the emails, a court found that the parties implicitly consented to the use of electronic means (the emails) to conduct their transactions and to form binding agreements between the parties. In conducting negotiations by email, lawyers should consider whether a court would conclude that the chain of emails creates a binding agreement between the parties and whether a disclaimer should appear on the emails. See, e.g., *Forcelli v. Gelco Corp.*, 972 N.Y.S.2d 570 (N.Y. App. Div. 2013).

13. **ENFORCEMENT OF ETHICS PROVISIONS**

- Lawyer Disciplinary Actions
- Lawsuits by Former Clients
- Lawsuits by Aggrieved Persons
- Disqualification and Contempt
- Regulatory Agency Sequestration or Debarment
- SEC Enforcement Action Under Rule 205
- Dodd-Frank Anti-Evasion Remedies
- Dodd-Frank End-user Exemption Criminal Remedies
- Other Remedies