PROGRAM MATERIALS
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Up the Ladder Reporting – Counsel's Ethical and Legal Obligations for Addressing Potential Violations by Management

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"Up the Ladder" Reporting:

Counsel's Ethical Obligations for Addressing Potential Misconduct by Executive-Level Managers

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Navigating Legal and Ethical Issues as Company Counsel

- Duties counsel owes to individual executives vs. the Board vs. the Company.
- What to do when an executive is engaged in potentially violative conduct.
- What to do when an executive is unable to perform duties.
- Obligations and options to report misconduct up and out.
- Considerations for counsel as fact witness in internal investigations, especially in the "Yates Memo" era.

ABA Model Rules

- *Model Rules of Professional Conduct* were adopted by the ABA House of Delegates in 1983 and serve as models for the ethics rules of most jurisdictions.
- The Rules of Professional Conduct for an attorney's jurisdiction apply to ***all*** State Bar members
  - Active and inactive
  - Employed as in-house counsel or outside
  - Apply whether acting in a legal or business capacity

Source: https://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/.

(Model) Rules of the Road

- Rule 1.6 Confidentiality of Information
- Rule 1.13 Organization as Client
- Rule 3.3 Candor to the Tribunal and
  4.1 Truthfulness in Statements to Others
- Rule 8.3 Reporting Professional Misconduct

MRPC 1.6: Confidentiality of Information

General Rule:

A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by the Rules of Professional Conduct.

MRPC 1.6(a)

MRPC 1.6: Disclosing Confidential Information

Counsel may disclose confidential client information to the extent reasonably believed necessary to, *inter alia*,

(1) Prevent reasonably certain death or substantial bodily harm;

(2) 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;

(3) Prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services; and,

(4) Comply with the law or court order.

MRPC 1.6(b)

MRPC 1.13: Organization as Client

- If lawyer is employed or retained by a company, the **client is the organization/company.**
- The lawyer represents the organization acting through its duly-authorized constituents (*e.g.*, officers, directors, employees)
  - CEO and management ≠ the client
  - "Other constituents" within the meaning of Comment [1] to MRPC 1.13 means "positions equivalent to officers, directors, employees and shareholders held by persons acting for organizational clients that are not corporations." MRPC 1.13, cmt. [1]
- If the lawyer knows or should know that organization's interests are adverse to the constituent with whom he is dealing, lawyer must explain to that individual that the lawyer represents the company
  - *Upjohn* warning and risks of chilling speech
  - Consider use of outside counsel when such situations are expected

Company Counsel Interactions with Officers and Employees (1)

- Communications between company and its attorneys are protected by attorney-client privilege.
- *Upjohn Co. v. United States*, 449 U.S. 383 (1981) rejected "control group theory" which limited the privilege to communications between high-level employees and counsel.
- *Upjohn* held that when a corporation's managers require its employees to give information to company's attorneys in the course of providing legal advice, those communications are protected.
- Furthers the purpose of the attorney-client privilege, to encourage open communication between attorney and client.

Company Counsel Interactions with Officers and Employees (2)

- In-house counsel may provide advice to constituents **only about company-related issues.**
- Company counsel is presumed to represent only the company; burden is on individual seeking to invoke the privilege to disprove presumption by showing:
  1. Approached company counsel for legal advice.
  2. Made clear to company counsel that sought advice as private individual.
  3. Counsel communicated to individual as such, knowing there could be a conflict.
  4. Conversations with company counsel were confidential.
  5. Substance of conversations did **not** relate to the company or its affairs.

In re: Grand Jury Subpoena, 274 F.3d 563 (1st Cir. 2001); *In re: Grand Jury Proceedings*, 156 F.3d 1038 (10th Cir. 1998).

Multi-Client "Joint" or "Dual" Representations

- Lawyer can serve multiple clients on the same matter if:
  1) All clients consent, and;
  2) No substantial risk that lawyer cannot fulfill duties to both/all.
- Courts will *not* imply multi-client representations lightly.
  - One putative client's expectations or understandings are insufficient.
  - Limited to the legal matter of common interest – not any and all communications between the parties.
- Waiver of privilege requires consent of all clients.
- Terminates when attorney discharged, or respective interests of diverge and become incongruent.

In re: Teleglobe Communications Corp., 493 F.3d 345 (3d Cir. 2007) Restatement (Third) of the Law Governing Lawyers § 19.

Exception to the Privilege in Joint Representations

- Although permitted, joint representations are not without risk.
- For instance, under the so-called adverse-litigation exception to the joint-client privilege, all communications made during the joint representation are discoverable when former joint clients sue one another.

Best Practices for Engaging Jointly Represented (Individual) Clients

- Set forth the following, in plain language, in the engagement agreements:
  - That information learned by counsel from any source will be disclosed to each jointly represented client.
  - That information received by counsel from one joint client will be disclosed to the other(s).
  - That communications between/among jointly represented clients and counsel during the representation may be discoverable (i.e., adverse-litigation exception).
  - That counsel reserves the right to withdraw from the joint representation if he or she concludes that a conflict of interest exists between or among the clients and/or the lawyer.

MRPC 1.13: Reporting "Up"

- If lawyer knows an officer or employee is violating legal obligations to the organization or violating the law that reasonably might be imputed to the organization, he must take steps to bring it to "higher authority" in the organization.
  - Unless lawyer reasonably believes it is not necessary in the best interests of the organization.

- General Counsel/CLO should adopt specific guidelines for what issues should be elevated to General Counsel's attention from other in-house counsel (*e.g.*, associate or deputy general counsel).

MRPC 1.13: Reporting "Out"

- If "highest authority" that can act for the organization acts or fails to act in violation of the law **and** it is likely to result in substantial injury to the organization, lawyer may reveal information relating to the representation to the extent necessary to prevent the injury.
  - Regardless of whether disclosure is permitted by MRPC 1.6.
  - The "highest authority" is typically the board of directors or similar governing body. MRPC 1.13, cmt. [5]
  - Under MPRC 1.13(e), withdrawing lawyer must "assure" that "highest authority" is informed as his/her withdrawal. *See also id*. at cmt. [8]
  - Check your state's rules for requirements to report outside of organization.

SEC Standards of Professional Conduct: Reporting "Up"

- Promulgated under Sarbanes Oxley Act § 307 and applies to attorneys appearing and practicing before the SEC in the representation of an issuer.
- If attorney learns of material violation by issuer or issuer's officer/director/employee/agent, must inform the Chief Legal Officer ("CLO").
  - Exceptions for attorneys retained for internal investigations.
- CLO (or equivalent) must investigate and inform reporting attorney of determination and any action taken in response.
- If reporting attorney is not satisfied, violation must be reported to Audit Committee, Committee of the Board comprised only of outside directors, or (if other options are unavailable) to the Board of Directors.

17 C.F.R. § 205.3(c)

SEC Standards of Professional Conduct: Reporting "Out"

- Attorney may reveal to the SEC, ***without client consent***, confidential information related to the representation to the extent believed to be reasonably necessary to:
  - Prevent the issuer from committing a material violation likely to cause substantial injury to the financial interest or property of the issuer or investors.
  - Prevent the issuer from committing perjury or an act likely to perpetuate a fraud on the SEC.
  - Rectify the consequences of a material violation by the issuer that caused or may cause substantial injury to the financial or property interests of the issuer or investors, where attorney's services were used in furtherance of the violation.

17 C.F.R. § 205.3(d)

Making a Report

- Lawyer must investigate facts and circumstances regarding potential, suspected, or known violations.
- Lawyer should consider:
  - Seriousness of violation and consequences.
  - Responsibility in the organization.
  - Apparent motivation of person(s) involved.
  - Policies and procedures concerning the matter involved.
  - Other relevant circumstances.
- Sometimes counseling against course of conduct is sufficient.
- Lawyer can report to higher authority in organization if believes it is in organization's best interest, even if not required to report.
- Reporting protects counsel and the organization.

MRPC 1.16: Withdrawals Related to Potential Client Misconduct

- Lawyer should not represent a client or shall withdraw from representation if the representation violates Rules of Professional Conduct.

- Lawyer may withdraw if:
  - Client persists in a course of action involving the lawyer's. services that lawyer reasonably believes is criminal or fraudulent.
  - Client has used the lawyer's services to perpetuate a crime or fraud.
  - Other good cause exists.

- Noisy withdrawals under 1.13(e)

MRPC 1.13(c) & (d): Disclosure of Client Confidential Information

- Permit a lawyer to reveal client confidential information outside the organization under limited circumstances if:
  - "The highest authority that can act on behalf of the organization" is engaged in a clear violation of the law and the lawyer reasonably believes that the violation of law is reasonably certain to result in "substantial injury" to the organization.

Internal Investigations
Risks and Considerations for In-House Counsel

- When investigating potential violations or misconduct, in-house counsel may be part of the fact pattern.
  - Importance and role of outside counsel.
  - Outside counsel retained by and reporting to special committee of the Board, Audit Committee, or similar.
  - In-house counsel should not serve as liaison with outside counsel.
- Advice of in-house counsel can serve as organization's reliance defense, used to negate intent.
- Yates Memo considerations:
  - Cooperation credit turns (in part) on identifying those involved in the potential violation.
  - Organization / outside counsel may provide information about in-house counsel to governmental authorities.

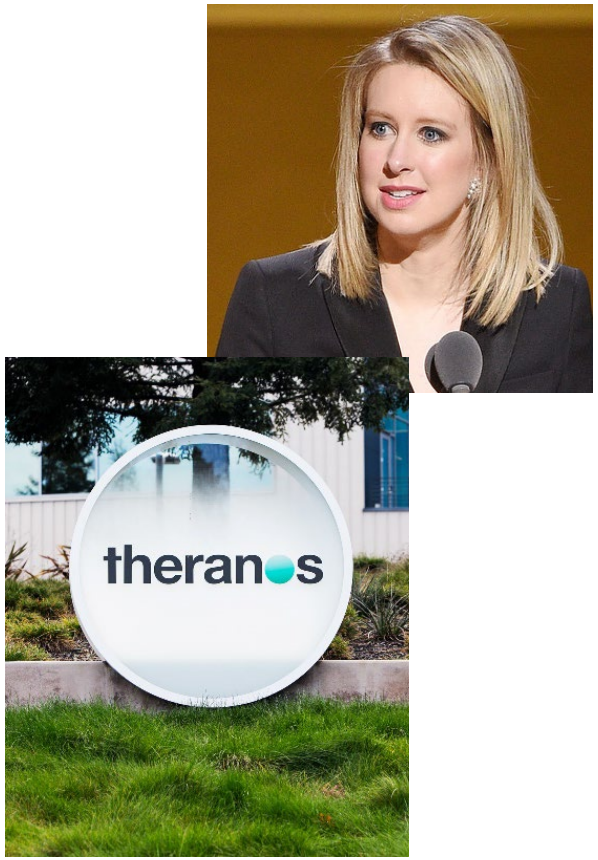
Case Study: Theranos

- Theranos was a Silicon-Valley blood-testing start-up founded in 2003 by Elizabeth Holmes, who was then a 19-year-old freshman at Stanford.
- Holmes claimed that Theranos was developing a blood test that could detect tens of dozens of medical conditions—from high cholesterol to cancer—based on a drop of blood drawn from a pinprick from a finger.
- By September 2017, Theranos—which had raised nearly $1 billion in funding for a valuation estimated at around $9 billion—was in the throes of financial collapse and found itself in the ambit of the SEC, the DOJ, and the FBI.

Case Study: Theranos

- Holmes was eventually charged with 11 criminal felony counts, including wire fraud and conspiracy stemming from allegedly deceiving regulators and investors about the technology and its testing capacity.

Theranos & Holmes: Joint Representation by Outside Counsel



- Outside counsel began jointly representing Holmes ***and*** Theranos in fall 2011 in connection with an IP dispute.
- At the time of this engagement, outside counsel and firm took part of their fee in Theranos stock—around 340,000 shares, then worth about $4.8m.
  - Though this type of fee arrangement is not expressly prohibited under the Model Rules, many firms bar the practice.
  - Joint representations permitted under MRPC 1.13
    - Lawyer representing organization permitted to concurrently represent any of its directors, officers, employees, members, shareholders, or other constituents MRPC 1.13(g), *see also id*. cmt. [12]
    - Advisable to obtain informed consent on behalf of organization from someone other than the individual being represented. *See id*.

Theranos & Holmes: Joint Representation by Outside Counsel

- Joint representations—referred to as "dual representations" in the Model Rules—are principally governed, aside from MRPC 1.13(g), by the standard set forth in *In re Teleglobe Commc'ns Corp.*
  - A joint representation is defined by the "congruence of the clients' interests." *Teleglobe*, 493 F.3d at 363.
- Corporate counsel should also be mindful of the holding in *U.S. v. Graf*, 610 F.3d 1148 (9th Cir. 2011).
  - Governs when a corporate employee who is not a client of outside corporate counsel nevertheless may obtain limited privilege protections for his or her communications with corporate counsel by operation of an implied privileged relationship.

Theranos: Potential "Conflicts" Lurking

- In 2015, outside counsel joined Theranos's Board, thereby owing a fiduciary duty to shareholders while concurrently owing an ethical duty to Holmes and to Theranos.
  - The ABA Ethics Committee has cautioned that there are ethical concerns for lawyers occupying the dual role of director and legal counsel.
  - At the outset, lawyer should ensure that management and other board members understand:
    - The distinct responsibilities of counsel and director;
    - That in some circumstances, mater discussed at board meetings with the lawyer in his or her role as director will not cloaked with the privilege; and,
    - That conflicts could arise requiring the lawyer to recuse as a director or decline representation of the corporation in a matter.

  ABA Formal Opinion 98-410

- Thus, depending on what could have unfolded at Theranos, outside counsel may have been confronted by a situation where they would be forced to protect either the company (as its lawyer), the shareholders (as a director), or Holmes (as her lawyer).

Theranos: Potential "Conflicts" Lurking

- As if outside counsel's joint representation of Holmes and Theranos wasn't thorny enough, around the time the attorney was named to Theranos' Board, Theranos hired one of outside counsel's attorneys as its General Counsel.
  - It was the attorney's first general counsel position after having worked for eight years the firm.
- It was speculated that Holmes installed the General Counsel under the assumption that she would be easily controlled.
- The GC rejoined the law firm after outside counsel ceased its joint representations of Holmes and Theranos in 2016.
- Outside counsel left the Theranos board soon thereafter.

Should Counsel Have Alerted Board about Holmes's Erratic Behavior?

- Under MRPC 1.14(b), when lawyer believes that client has "diminished capacity," lawyer may take steps "necessary for protective action."
  - Including, consulting with individuals or entities that have ability to act to protect client.
  - General Counsel would have a duty to bring a CEO's mental illness to the attention of the Board if business operations are being detrimentally impacted or mental impairment is manifesting itself.
- General Counsel would have a duty to bring a CEO's mental illness to the attention of the board if business operations are being detrimentally impacted or mental impairment is manifesting itself.
- General Counsel should first take issues of such magnitude to the CEO. If ignored or bypassed, then the General Counsel can take it to the Chairperson of the Board, assuming there is a separation of the Chairperson and CEO.
- If not separated, then the General Counsel can take it to the lead independent Director.

Should Counsel Have Alerted Board about Holmes's Erratic Behavior?

- But if all these moves fail, the General Counsel's final option is simply to walk away.
- When a company's leader is in mental crisis, most legal experts agree that the General Counsel has a duty to inform the Board of Directors.

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