# MUTINY FOR A BOUNTY

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*Experience teaches that attorneys may violate duties of confidentiality and trust to pursue personal gain. Multiple insider trading, embezzlement, and fraud prosecutions prove the point. The Dodd-Frank Act of 2010 establishes a bounty regime whereby certain whistleblowers are eligible for awards of 10%–30% of Securities and Exchange Commission ("SEC") enforcement recoveries exceeding $1 million. Since its inception, this program has paid at least 207 whistleblowers more than $1 billion. The Commission's bounty program thus may be a meaningful inducement to breach privilege.*

*The SEC asserts that its whistleblower authority preempts state law and that it can accept attorney–client privileged information. However, it simultaneously operates filter teams designed to sequester potentially privileged information from enforcement attorneys who might work on the matter, suggesting that it may be skeptical of its own preemption claim. This skepticism is warranted. The SEC's purported preemption is unsupported by the statutory text and legislative history. The Commission should, therefore, rescind its views regarding preemption but continue to operate its filter teams.*

*The Commission would also be wise to modify its current filter team procedures and improve its communications regarding the receipt of potentially privileged information. Specifically, the Commission should reform and publicize its filter team procedures. It should also loudly warn whistleblowers that it will neither accept privileged information nor reward those who breach privilege. Finally, filter teams should adopt more aggressive techniques to ensure that they are not inadvertently receiving privileged information.*

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## INTRODUCTION

Attorneys today may face significant and rapidly expanding incentives to violate privilege by disclosing confidential information to the SEC, which offers bounties that can run up to many millions of dollars. Attorneys may breach promises of confidentiality for financial gain; insider trading prosecutions of members of the

bar illustrate this point. Similar challenges may arise regarding physician–patient, clergy, and other forms of privilege.

But SEC policies governing the receipt of privileged whistleblower information are susceptible to profound critique. The SEC asserts that its whistleblower authority preempts state privilege laws.[1] By the Commission's logic, attorneys can provide privileged information to the SEC with no fear of reprisal, and the SEC can receive that information with no concern that its investigations will be impaired. Nonetheless, as part of the whistleblower intake process, the Commission may operate filter teams responsible for identifying potentially privileged information and sheltering line enforcement attorneys from that information.[2]

If SEC whistleblower authority preempts state law privilege, then filter teams are largely unnecessary. Their existence, however, suggests that the Commission is not entirely secure in concluding that its whistleblower authority preempts state law. In this Article, we argue that such skepticism is warranted because there is serious doubt that Congress authorized the SEC, expressly or implicitly, to preempt state privilege rules. This is because authorization for such preemption does not appear in the text of Sarbanes-Oxley, preemption displaces traditional regulation by the states, and it is not consistent with the legislative history. Accordingly, we urge that the Commission recede from its historic position. While the SEC does not purport to preempt other privileges and confidentiality rules, such as attorney–client privilege in foreign jurisdictions, physician–patient or priest–penitent privileges, the SEC's robust interpretation of its own preemption authority leaves open the possibility that it might also accept and pay for tips covered by these privileges, and we therefore address them as well.

We also suggest that the Commission's filter team process can and should be improved. Several courts have raised significant constitutional and pragmatic concerns regarding the use and operation of filter teams.[3] The Department of Justice ("DOJ") has responded by reforming the operation of its privilege teams, composing them of dedicated attorneys who, arguably, have a greater incentive to be objective in making privilege determinations. In contrast, the Commission appears to staff its filter teams with a rotating cast drawn from Enforcement Division attorneys and has no publicly disclosed process that would support the use of third parties. The Commission's protocols are thus highly vulnerable to judicial critique. As an initial matter, the Commission should consider adopting procedures at least as sensitive to judicial concern as those adopted by the DOJ.

The Commission should also be more transparent in explaining the operation of its filter teams. The procedures governing the operation of SEC filter teams are not well-defined in the public domain. The SEC Enforcement Manual should include a clear statement of when these teams are employed, how they are staffed, and how counsel and respondents can challenge filter team determinations. Much about the whistleblower program is secret by design, but recent scholarly work suggests that the SEC "does not adequately track and maintain records

1. 17 C.F.R. § 205.

2. SEC.& EXCH.COMM'N, COMPLIANCE AND ENFORCEMENT ANSWER BOOK 22-40 to 22-41 (2021).

3. *See, e.g.*, United States v. Under Seal, 942 F.3d 159, 164 (4th Cir. 2019).

regarding its whistleblower program."[4] There are also accusations that "the SEC has abused [the] justification [of] 'whistleblower anonymity' as a *carte blanche* to shield from disclosure all sorts of information."[5] These critiques should give observers pause regarding the SEC's handling of potentially privileged tips. Neither the Commission's nor the public's interest is served by a lack of transparency regarding the Commission's handling of this information.

Equally important, the Commission should loudly warn whistleblowers that it will neither accept privileged information nor reward persons who provide privileged information. Such an announcement, though it should reduce the overall volume of privileged tips submitted, might induce some whistleblowers to try to circumvent screening procedures by disguising privileged information as nonprivileged or submitting their tips through informal channels. To forestall this possibility, the Commission should also adopt enhanced procedures designed to detect and deter whistleblowers who conceal the privileged nature of the information they offer to the Commission.

This Article proceeds as follows. Part I provides background on the SEC's purported preemption of attorney confidentiality rules, the SEC's whistleblower provisions, and a capsule summary of attorney–client and other forms of privilege. Part II lays out confidant incentives to violate confidentiality rules for financial gain. Part III argues that the SEC lacks authority to preempt state laws governing attorney confidentiality and other state and foreign privilege rules. Part IV discusses filter team practice and critiques of it. Part V lays out our recommendations to the SEC, and a brief conclusion follows.

## I. BACKGROUND: THE SEC WHISTLEBLOWER PROVISIONS AND A CAPSULE SUMMARY OF ATTORNEY–CLIENT AND OTHER FORMS OF PRIVILEGE

The SEC's purported ability to preempt state privilege laws is enshrined in Part 205,[6] the final SEC rule that establishes "standards of professional conduct for attorneys who appear and practice before the Commission." The relevant text reads: "Where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with this part, this part shall govern."[7] Based on this language, the SEC has declared that "an attorney who complies in good faith with the provisions of this part shall not be subject to discipline or otherwise liable under

4. Alexander I. Platt, *The Whistleblower Industrial Complex*, 40 YALE J. ON REGUL. 688, 754 (2023).

5. Alexander I. Platt, *Going Dark(er): The SEC Whistleblower's FY 2022 Report is the Least Transparent in Agency History*, 2023 U. ILL. L. REV. ONLINE 66, 66 (May 18, 2023).

6. 17 C.F.R. § 205.

7. SEC. EXCH. COMM'N, IMPLEMENTATION OF STANDARDS OF PROFESSIONAL CONDUCT FOR ATTORNEYS (2003) [hereinafter FINAL PART 205 RULE RELEASE], https://www.federalregister.gov/documents/2003/02/06/03-2480/implementation-of-standards-of-professional-conduct-for-attorneys [https://perma.cc/N73C-69W7].

inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices."[8] We argue that this position is incorrect.

Section A examines the background of these provisions and demonstrates how subsequent regulation essentially gives lawyers permission to violate the confidentiality and privilege rules of their jurisdictions in exchange for a bounty. Section B illustrates the heterogeneity of state laws that may be implicated, demonstrating that the SEC's position may produce untenable conflicts. Finally, Section B also examines other privileges that could be breached in exchange for a whistleblower bounty.

### *A. The History of Part 205 and the Dodd-Frank Whistleblower Provisions*

The genesis of the whistleblower bounty program was the devastating financial crisis of 2008 and subsequent passage of the Dodd-Frank Act. Section 922 of the Act directs the SEC to "pay awards to eligible whistleblowers who voluntarily provide[] the SEC with original information that leads to a successful enforcement action yielding monetary sanctions of over $1 million."[9] The amount of the reward required by the Act is between 10%–30% of the total monetary sanctions collected.[10] The rationale for introducing such a requirement was that "[w]histleblowers provide a vital early warning system to detect and expose fraud in the financial system. With the right protections, whistleblowers can help root out the kinds of massive Wall Street fraud that contributed to the current financial crisis."[11]

The SEC approved final rules implementing the whistleblower program in 2011. In publicizing its new rules, the SEC acknowledged some of the potential problems inherent in providing bounties for information obtained from attorneys in violation of privilege and generally excluded information reported by lawyers in violation of privilege from the definition of "original information" for which a bounty could be paid.[12] The Commission noted:

> [We] recognized the prominent role that attorneys play in all aspects of practice before the Commission and the special duties they owe to clients. We observed that compliance with the Federal securities laws is promoted when individuals, corporate officers, and others consult with counsel about possible violations, and the attorney–client privilege furthers such consultation. This important benefit could be undermined if the whistleblower award program created monetary incentives for counsel to disclose information about possible

8. 17 C.F.R. § 205.6(c).

9. *Dodd-Frank Act Rulemaking: Whistleblower Program*, SEC (Aug. 12, 2011), https://www.sec.gov/spotlight/dodd-frank/whistleblower.shtml [https://perma.cc/G9C5-ZQDV].

10. *Id.*

11. 156 CONG. REC. S4066 (daily ed. May 20, 2010) (statement of Sen. Kaufman).

12. *See* LATHAM & WATKINS LLP, ATTORNEYS AS SEC WHISTLEBLOWERS: CAN AN ATTORNEY BLOW THE WHISTLE ON A CLIENT AND GET A MONETARY AWARD? 3 (May 8, 2013) [hereinafter ATTORNEYS AS WHISTLEBLOWERS], https://www.lexology.com/library/detail.aspx?g=26debb8b-fccc-4cfb-9463-5961dd1b6de2 [https://perma.cc/WJK7-7EMX].

> securities violations in violation of their ethical duties to maintain client confidentiality.[13]

However, this was not the end of the story. The SEC included in its rules several carve-outs allowing attorneys to collect bounties in exchange for the disclosure of client information without the client's consent. Specifically, attorneys may receive bounties for client information disclosed to the SEC if "such disclosure would otherwise be permitted under the SEC's attorney conduct rules, the applicable state attorney conduct rules, or 'otherwise.'"[14]

The SEC's attorney conduct rules date from another crisis: the Enron scandal. In light of the perceived collapse of attorneys' gatekeeping role,[15] Congress, as part of the Sarbanes-Oxley Act, mandated that the SEC prescribe minimum standards of conduct for attorneys practicing before the Commission.[16] The rules implementing this mandate are known as "Part 205"[17] and apply to lawyers "appearing and practicing" before the SEC in the context of providing legal services for an "issuer."[18] The legislative history of Sarbanes-Oxley demonstrates that the main purpose of these rules was to "make sure [that] lawyers . . . don't violate the law, and in fact, more importantly, ensure that the law is being followed":

> If you [a lawyer] find out that the managers are breaking the law, you must tell them to stop. If they won't stop, you go to the board of directors, which represents the shareholders, and tell them what is going on. If they won't act responsibly and in compliance with the law, then you go to the board and say something has to be done; here is a violation of the law occurring. It is basically going up the ladder, up the chain of command.[19]

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13. SEC. & EXCH. COMM'N, IMPLEMENTATION OF THE WHISTLEBLOWER PROVISIONS OF SECTION 21F OF THE SECURITIES EXCHANGE ACT OF 1934, at 56 (2011), https://www.sec.gov/files/rules/final/2011/34-64545.pdf [https://perma.cc/7FLM-H2W9]. We note in passing that the SEC's interpretation of attorney–client confidentiality obligations writ large has sometimes been the subject of profound disagreement. *See, e.g.*, Alison Frankel, *The SEC's Subpoena Fight with Covington – A 'Perilous New Course'?*, REUTERS (Jan. 12, 2023), https://www.reuters.com /legal/government/secs-subpoena-fight-with-covington-perilous-new-course-2023-01-12/ [https://perma.cc/8HDK-BTRK] (discussing the SEC's recent lawsuit attempting to force Covington & Burling to cough up the names of clients affected by a recent hack).

14. ATTORNEYS AS WHISTLEBLOWERS, *supra* note 12, at 5.

15. 148 CONG. REC. S6552 (daily ed. July 10, 2022) ("With Enron and WorldCom, and all the other corporate misconduct we have seen, it is again clear that corporate lawyers should not be left to regulate themselves no more than accountants should be left to regulate themselves. There has been a lot of debate, rhetoric, and discussion—rightfully so—about the necessity about not 'letting the fox guard the chicken coop.' The same is true with lawyers. This has become clear through various acts of misconduct. The lawyers have involvement and responsibility, and they also cannot be left to regulate themselves.").

16. *Id.*

17. *See generally* FINAL PART 205 RULE RELEASE, *supra* note 7.

18. 17 C.F.R. § 205.2(a).

19. 148 CONG. REC. S2673 (daily ed. July 10, 2002).

Part 205, accordingly, deals mainly with the obligation of attorneys to report violations "up the ladder" within the issuer company if the attorney knows of a "material violation" of the securities laws.[20]

But although Part 205 mandates only "up the ladder" reporting, it also permits lawyers to "report evidence of material violations to the Commission"—that is, disclose confidential information obtained in the course of representing an issuer to the SEC.[21] Attorneys may do this if they believe it reasonably necessary to

> prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors; . . . . [t]o prevent the issuer, in a Commission investigation or administrative proceeding from committing [or suborning] perjury . . . or committing any act . . . that is likely to perpetrate a fraud upon the Commission; or . . . to rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.[22]

The SEC will pay a bounty for confidential information disclosed by lawyers under Part 205 *or* the applicable state attorney conduct rules—but these rules may be in conflict. That is, many states prohibit such disclosures under conditions where Part 205 permits them. Part 205 furnishes a trump card by which the SEC purports to alleviate this bind, stating "*[w]here the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with this part, this part shall govern.*"[23]

### *B. Attorney–Client and Other Forms of Privilege*

The rules most obviously implicated by the preemption provision of Part 205 are those governing attorney–client privilege and the duty of confidentiality lawyers owe to their clients. Accordingly, we lay out the contours of various confidentiality rules governing attorneys and illustrate the heterogeneity among states and internationally. We also outline other forms of privilege that unscrupulous confidants might breach to secure a lucrative bounty, including physician–patient, priest–penitent, and spousal privileges.

#### *1. Attorney–Client Privilege Laws and Confidentiality Rules and their Heterogeneity*

The preemption provision of Part 205 implicates two distinct, though related, bodies governing attorney conduct. The first is composed of the laws of attorney–client privilege, which are rules of evidence. In federal court for federal questions (such as those arising under the federal securities laws), these rules are the Federal Rules of Evidence, and the federal common law of attorney–client privilege

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20. ATTORNEYS AS WHISTLEBLOWERS, *supra* note 12, at 5.
21. 17 C.F.R. § 205.3(d)(2)(i)-(iii).
22. *Id.*
23. 17 C.F.R. § 205.1 (emphasis added).

governs.[24] In state courts or federal courts applying state law in diversity cases, state rules of evidence, and thus state attorney–client privilege rules, govern.[25] The other body is composed of the rules governing attorneys' conduct, specifically the duty of attorneys to maintain the confidentiality of their clients' information. The basis of these rules are the ethical requirements of state bars, often codified into statute.[26]

The rationale behind both sets of rules is similar; both are "intended to encourage 'full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of the law and administration of justice.'"[27] The attorney–client privilege is one of the "oldest recognized privileges for confidential communication."[28] Attorney–client privilege in the federal courts is typically narrowly construed,[29] protecting only confidential communications between clients and their counsel (or specified third parties) made for the purpose of obtaining or rendering legal advice.[30] Most state attorney confidentiality rules are broader, and in at least several significant cases, this breadth carries over into the attorney–client privilege rules of those states.[31]

For the SEC's purposes, restrictions on information that may be produced or the subject of testimony in a lawsuit are likely important but not front-and-center

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24. Thomas E. Spahn, *Attorney-Client Privilege: Overview (Federal)*, THOMSON REUTERS, https://content.next.westlaw.com/practicallaw/document/Ia6d0cddc2d7b11eaadfea82903531a62/Attorney-Client-Privilege-Overview-Federal?viewType=FullText&contextData=%28sc.Default%29&transitionType=Default [https://perma.cc/3MS8-2P3D] (last visited Feb. 25, 2024).

25. *Id.*

26. For a discussion of the differences between privilege and confidentiality rules, see Fred C. Zacharias, *Harmonizing Privilege and Confidentiality*, 41 S. TEX. L. REV. 69, 73–74 (1999).

27. Swidler & Berlin v. United States, 524 U.S. 399, 403 (1998) (citing Upjohn Co. v. United States, 449 U.S. 383, 389 (1981)).

28. *Id.*

29. Spahn, *supra* note 24.

30. Zacharias, *supra* note 26, at 74 ("[J]udges tend to interpret attorney-client privilege narrowly. It covers only specified types of communications, not other information that might come to a lawyer's attention."). Even now, however, the Supreme Court may be in the process of expanding the scope of the privilege. *See In re* Grand Jury, 13 F.4th 710 (9th Cir. 2021) (testing whether the "predominant purpose" of a communication must be legal advice for the communication to be privileged or whether it is sufficient for legal advice merely to have been a "significant purpose" of the communication). Notably, one of the most recent opinions on this topic was authored by now-Supreme Court Justice Brett Kavanaugh when he sat on the D.C. Circuit. *See In re* Kellogg Brown & Root, Inc., 756 F.3d 754, 760 (D.C. Cir. 2014) (holding that courts should evaluate "whether obtaining or providing legal advice was one of the significant purposes of the attorney-client communication" when deciding if the communication is privileged).

31. *See, e.g.*, CAL. EVID. CODE § 954 (defining privileged communications as "confidential communication[s] between a client and a lawyer" without further restriction); N.Y. C.P.L.R. § 4503 (McKinney 2019) ("Unless the client waives the privilege, an attorney or his or her employee, or any person who obtains without the knowledge of the client evidence of a confidential communication made between the attorney or his or her employee and the *client in the course of professional employment*, shall not disclose, or be allowed to disclose such communication[.]") (emphasis added).

for the purposes of procuring tips. The federal definition of attorney-client privilege, and its attendant narrow construction, is likely to apply in most judicial enforcement actions brought by the SEC, which are brought in federal court under federal statutes;[32] accordingly, state confidentiality rules may not always prevent the actual use in court of tips falling outside the federal common law definition of the attorney-client privilege. The stickier problem is likely to be inducing attorneys in jurisdictions where confidentiality obligations are broader to share such information in the first place. The preemption provision of Part 205 appears calculated to address this problem, purporting to free lawyers from worries about compliance with more rigid state-imposed confidentiality obligations so long as their tips are usable under the federal rubric.

**a. Variation Among States**

The SEC's rules in Part 205 do not universally conflict with state laws governing attorney–client privilege and confidentiality. But several jurisdictions do contain mandates more restrictive than those that the SEC prescribes. This conflict is important not only for conceptual reasons governing the preemption framework but also because some of these jurisdictions are the home of many large public firms and substantial securities activities governed by the SEC.

Two prime examples are California and New York.[33] California is home to the tech giants of Silicon Valley, and the Ninth Circuit, in which it sits, is widely considered to be one of the jurisdictions most expert in the application of federal securities law because of the frequency with which these large firms are sued in its courts.[34] California is also home to one of the most ironclad interpretations of attorney–client confidentiality. Recall that the rules of Part 205 permit an attorney practicing before the SEC to report confidential client information to the SEC—without client consent—where they believe it reasonably necessary to "prevent the issuer from committing a *material violation* that is likely to cause substantial injury to the *financial interest or property* of the *issuer or investors*."[35] Rule 1.6 of the California attorney conduct rules allows such disclosure only to "the extent that the lawyer reasonably believes the disclosure is necessary to prevent a *criminal* act that the lawyer reasonably believes is likely to result in the *death of, or substantial bodily harm to, an individual*."[36] Similarly, the rules governing the New York state bar allow disclosure to prevent "reasonably certain death or substantial bodily harm" or "to prevent the client from committing a crime,"[37] and such disclosures must be

32. Spahn, *supra* note 24.

33. *See, e.g.*, Kevin LaCroix, *Securities Suit Filings Up in Year's First Half*, D & O DIARY (July 4, 2023), https://www.dandodiary.com/2023/07/articles/securities-litigation/securities-suit-filings-up-slightly-in-years-first-half [https://perma.cc/N8TS-9K5U] (noting that 48% of the securities lawsuits in the first half of 2023 were filed in California and New York).

34. *Id.*

35. 17 C.F.R. §§ 205.3(d)(2)(i)-(iii) (emphasis added).

36. CAL. CODE PRO. CONDUCT r. 1.6(b) (STATE BAR OF CAL. 2018) (emphasis added), https://www.calbar.ca.gov/Portals/0/documents/rules/Rule_1.6-Exec_Summary-Redline.pdf [https://perma.cc/NQ66-9C5P].

37. N.Y. RULES OF PRO. CONDUCT r. 1.6(b)(1)-(2), https://nysba.org/app/uploads/

limited to "reasonably necessary information."[38] As New York is the virtually undisputed financial center of the world, drawing many securities lawsuits,[39] conflicts with the SEC rules are of serious pragmatic import.

A similar divergence exists for an attorney's disclosure of past acts. There is no exception under California law for the disclosure of a client's past criminal acts,[40] creating an irreconcilable conflict with the Part 205 rule that attorneys may disclose confidential information to "rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used."[41] New York lawyers are permitted to reveal past misconduct only insofar as they may "withdraw a written or oral opinion or representation previously given by the lawyer and reasonably believed by the lawyer still to be relied upon by a third person, 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."[42]

The potential seriousness of these divergences between Part 205 and the rules governing the conduct of California and New York lawyers prompted the state bar associations of both jurisdictions to publish open letters to their constituents warning them that discipline could result from disclosure of client information under the SEC rules.[43] The California opinion states in a summary paragraph: "Do the provisions of the Part 205 Rules permitting disclosure of client confidences to the SEC conflict with California law requiring attorneys to maintain client confidences?

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2024/02/20240226-Rules-of-Professional-Conduct-as-amended-6.10.2022.pdf [https://perma.cc/W6GA-NG56].

38. *See, e.g.*, NYSBA Comm. on Pro. Ethics, Op. 837 (2010) (lawyer must take reasonable remedial measures under RPC 3.3 to correct client perjury but may only reveal client confidences to the extent reasonably necessary: "Therefore if there are any reasonable remedial measures short of disclosure, that course must be taken.").

39. *See* Morrison v. Nat'l Austl. Bank, 561 U.S. 247, 275–76 (2010) (Stevens, J., concurring in judgment) (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975)) (calling the Second Circuit the "Mother Court" for securities lawsuits).

40. CAL. CODE PRO. CONDUCT r. 1.6(b) cmt., at 2 (STATE BAR OF CAL. 2018) (emphasis added), https://www.calbar.ca.gov/Portals/0/documents/rules/Rule_1.6-Exec_Summary-Redline.pdf [https://perma.cc/NQ66-9C5P] ("Although a lawyer is not permitted to reveal [protected information] concerning a client's past, completed criminal acts, the policy favoring the preservation of human life that underlies this exception to the duty of confidentiality and the evidentiary privilege permits disclosure to prevent a future or ongoing criminal act.").

41. 17 C.F.R. §§ 205.3(d)(2)(i)-(iii) (emphasis added).

42. N.Y. BAR RULE 1.6, *supra* note 37, at r. 1.6(b)(3).

43. *See* STATE BAR OF CAL. ETHICS HOTLINE, ETHICS ALERT: THE NEW SEC ATTORNEY CONDUCT RULES V. CALIFORNIA'S DUTY OF CONFIDENTIALITY 1 (2004) [hereinafter ETHICS ALERT], https://www.calbar.ca.gov/Portals/0/documents/ethics/Publications/EthicsHotliner/Ethics_Hotliner-SEC_Ethics_Alert-Spring_04.pdf [https://perma.cc/MFH6-ABWD]; N.Y. Cnty. Laws. Ass'n Comm. on Pro. Ethics Formal Op. 746 (Oct. 7, 2013), http://www.nycla.org/siteFiles/Publications/Publications1647_0.pdf [https://perma.cc/C365-9ZGE].

The answer appears to be 'yes.'"[44] Similarly, the New York committee concluded that "[u]nder the SEC rules discussed above, an attorney may collect a bounty in exchange for disclosure of confidential information in situations not permitted under the New York Rules."[45] The committee further explained that "disclosure of confidential information in order to collect a whistleblower bounty is unlikely, in most instances, to be ethically justifiable. This is because, under most circumstances, such disclosure is not reasonably necessary, and does not fit within the enumerated exceptions of [the New York rules]."[46] The committee also opined that in most situations, the "large sums of money [potentially paid out as a bounty] would tend to cloud lawyers' professional judgment, influencing lawyers to report out a violation regardless of their clients' interests," thus violating professional conduct rules against conflicts of interest.[47]

To be sure, not all state privilege laws are in conflict with the dictates of Part 205, and some state bar associations have even published opinions to that effect.[48] Nonetheless, the broad diversity of state rules governing attorney–client confidentiality—and the complete lack of any consideration for this heterogeneity in the legislative process leading to the passage of Sarbanes-Oxley[49]—suggest that Congress never intended for the diversity of state privilege laws to be preempted, especially in exchange for a bounty.

**b. International Variation**

In a world where enormous multinational companies trade on American exchanges and are subject to the SEC's jurisdiction, foreign whistleblowers now furnish a significant percentage of the SEC's tips. This potentially implicates foreign privilege laws, which are as diverse, if not more so, as those of the states. Of the 99 countries that furnished whistleblower tips in 2021, the top jurisdictions were Canada (248 tips), China (152 tips), the United Kingdom (132 tips), Colombia (85 tips), and India (81 tips).[50] Many of these jurisdictions appear to include exceptions

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44. ETHICS ALERT, *supra* note 43, at 4–5 ("Given the apparent conflict between the provisions of the Part 205 Rules permitting disclosure of client confidences to the SEC and the fiduciary duty of California attorneys to maintain client secrets and confidences, it may be safer for California attorneys not to accept the SEC's invitation to disclose client confidences to the SEC, at least until such time as the preemption and good faith issues have been decided by a court of competent jurisdiction.").

45. N.Y. Cnty. Laws. Ass'n Comm. on Pro. Ethics Formal Op. 746, *supra* note 43, at 9.

46. *Id.*

47. *Id.* We note here that the Bar Association of Washington also published an ethics opinion stating that the disclosure permissions of Part 205 were inconsistent with Washington confidentiality rules. *See* Giovanni Prezioso, *Public Statement by SEC Official: Letter Regarding Washington State Bar Association's Proposed Opinion on the Effect of the SEC's Attorney Conduct Rules*, SEC (July 23, 2003), https://www.sec.gov/news/speech/spch072303gpp.htm [https://perma.cc/NS43-L64P].

48. *See, e.g.*, N.C. State Bar, Formal Op. 9 (2005).

49. *But see* Comment to File No. S7-45-02 (April 7, 2003), https://www.sec.gov/rules/proposed/s74502/abcny040703.htm [https://perma.cc/F8KW-UH3J].

50. SEC, 2021 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 38–39 (2021), https://www.sec.gov/files/owb-2021-annual-report.pdf [https://perma.cc/9ZNY-5AKZ].

to the attorney–client privilege narrower than those listed in Part 205. For instance, in the United Kingdom, the crime–fraud or "iniquity" exception applies only if "the communications between lawyer and client are, whether or not the lawyer knows this, in fact conducted with the intention of pursuing a fraudulent purpose."[51] Canadian privilege rules contain a similar exception where "communications between solicitor and client are criminal communications or are for the purpose of obtaining legal advice to facilitate the commission of a crime."[52] This exception is virtually identical to the American crime–fraud exception to the privilege, which provides that communications to a lawyer "made in furtherance of a crime or fraud" are not privileged.[53] Both of these exceptions, however, are narrower than the Part 205 exception, which permits the disclosure without client consent of information concerning a future "violation," irrespective of whether the communications with the lawyer were used in furtherance of the violation or whether the violation amounts to a crime or fraud.[54]

Canada also has exceptions permitting disclosure where "the safety of members of the public is at risk and a breach of the solicitor–client privilege will prevent harm" and where "national security is at stake."[55] China, though it has no official privilege laws as such, does require lawyers to keep confidential information their clients are unwilling to disclose, and exceptions to this rule exist only for "criminal facts and information that endanger national security, public security, or seriously endanger the personal safety of others."[56] Again, the circumstances permitting disclosure under these rules are narrower than those permitted under Part 205, which allows for disclosure where a past or future violation could result in losses by the issuer or investors.[57] Even more permissive jurisdictions, such as India[58] and Colombia,[59] may not allow for disclosure under all the circumstances allowed by Part 205.

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51. *See* Andrew Wanambwa, *Privilege Disapplied: the "Iniquity" Exception*, LEWIS SILKIN (Aug. 6, 2019), https://www.lewissilkin.com/en/insights/privilege-disapplied-the-iniquity-exception [https://perma.cc/85WK-ZBVP].

52. STEVEN GARLAND ET AL., PRIVILEGE AND PROFESSIONAL CONFIDENCES: AN INTERNATIONAL REVIEW 3 (2020).

53. PAUL F. ROTHSTEIN ET AL., *The Crime-Fraud Exception*, *in* FEDERAL TESTIMONIAL PRIVILEGES § 2:37 (2022–2023 ed.).

54. *See supra* Section I.A.

55. *See* GARLAND ET AL., *supra* note 52.

56. AUGUST ZHANG & TIM JACKSON, *China*, *in* PRIVILEGE AND PROFESSIONAL CONFIDENCES: AN INTERNATIONAL REVIEW 2 (2020).

57. *See supra* Section I.A.

58. India's attorney–client privilege allows for disclosure of communications made to further an illegal purpose. *See* Manavendra Mishra et al., *Legal Privilege in Attorney-Client Communications: India*, KHAITAN & CO, at 84, https://www.khaitanco.com/sites/default/files/2024-02/TheLegalPrivilegeUncovered.pdf [https://perma.cc/EJ6N-2VTC] (last visited Feb. 29, 2024) ("Any communications made in furtherance of an illegal purpose or any fact coming to the knowledge of the attorney since the commencement of his employment showing that any crime or fraud has been committed are not protected.").

59. Colombian privilege rules appear to allow for disclosure on a case-by-case basis, where the limitation on the privilege is "(1) directed to the achievement of a

*2. Other Privileges: Physician/Psychiatrist–Patient Privilege, Priest–Penitent Privilege, and the Marital Communications Privilege*

Though not explicitly addressed in Part 205 or any component of the SEC's whistleblower regime, it is far from implausible that confidants other than lawyers might disclose privileged or confidential information in the hope of reaping a bounty, and as we discuss in Part II, the breach of such privileges for pecuniary gain has made headlines for years. Other disclosures protected by confidentiality rules include, broadly, those made in the physician– or psychiatrist–patient relationship and the even more venerable priest–penitent relationship. Though facially dissimilar, the rationales for these privileges, at least in part, overlap. The privilege protecting communications with clergy "recognizes the human need to disclose to a spiritual counselor, in total and absolute confidence, what are believed to be flawed acts or thoughts and to receive priestly consolation and guidance in return."[60] The privilege "respond[s] to the urgent need of people to confide in, without fear of reprisal, those entrusted with the pressing task of offering spiritual guidance so that harmony with one's self and others can be realized."[61] Reasoning behind the privilege protecting communications with psychotherapists and other counselors is largely analogous:

> Effective psychotherapy . . . depends upon an atmosphere of confidence and trust in which the patient is willing to make a frank and complete disclosure of facts, emotions, memories, and fears . . . . The psychotherapist privilege serves the public interest by facilitating the provision of appropriate treatment for individuals suffering the effects of a mental or emotional problem. The mental health of our citizenry, no less than its physical health, is a public good of transcendent importance.[62]

Broader privileges between physicians and patients have been embraced more reluctantly, likely because "[t]reatment by a physician for physical ailments can often proceed successfully on the basis of a physical examination, objective information supplied by the patient, and the results of diagnostic tests,"[63] making the confidence of communications less imperative to effective treatment. Nonetheless, many states respect more general privileges of communications between physicians and patients on the basis that some communications helpful to treatment might be otherwise withheld and for the general protection of patients' privacy.[64]

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constitutionally legitimate purpose, (2) it should be relevant for achieving such a purpose, and (3) there must be no other less onerous means to achieve the articulated purpose, in terms of the loss of privacy or other fundamental rights." CRISTÓBAL PORZIO, *South America*, *in* PRIVILEGE AND PROFESSIONAL CONFIDENCES: AN INTERNATIONAL REVIEW 16-5 (2020).

60. Trammel v. United States, 445 U.S. 40, 51 (1980).
61. Keenan v. Gigante, 390 N.E.2d 1151, 1154 (1979).
62. Jaffee v. Redmond, 518 U.S. 1, 10–11 (1996).
63. *Id.* at 10.
64. DAVID M. GREENWALD ET AL., 2 TESTIMONIAL PRIVILEGES § 7:2 (3d ed. 2023).

The privilege over communications with clergy varies by state, and the strength of the privilege fluctuates based in part on who holds it.[65] There is similarly broad variation across the states with respect to the existence and coverage of various medical privileges, although in general, these privileges are uniformly agreed to belong to the patient.[66] Virtually all states have a privilege for mental health professionals of various stripes, and in many jurisdictions, the privilege extends much more broadly to cover medical professionals of all kinds.[67] We note that the disclosures protected by the clergy communication privilege and the therapist–patient privilege are more likely to produce information useful for the purposes of SEC enforcement than most communications protected by other physician–patient privileges for the same reasons that led to these communications being protected in the first place. And while we do not know of any instances in which a priest or a psychiatrist blew the whistle on a church member or a patient for a bounty, there are, as we discuss, examples of such confidants trading on securities information that they received in professional confidence.

Another category of communication protected from disclosure is communication among spouses. The marital communications privilege generally prevents "information privately disclosed between [spouses] in the confidence of the marital relationship—once described by [the] Court as 'the best solace of human

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65. In four states, both the clergy and the penitent hold the privilege, meaning that either can waive it. Caroline Incledon, *The Constitutionality of Broadening Clergy Penitent Privilege Statutes*, 53 AM. CRIM. L. REV. 515, 516–17 (2016). In nine states, a clergy may refuse to disclose confidences, but the decision to do so lies with the clergy. These states are Georgia, Illinois, Indiana, Mississippi, New Jersey, Vermont, Virginia, and Wyoming. *See id.* at 516. In 37 states, the communicant's consent is controlling, and among these states, those with broad definitions as to who qualifies as "clergy," such as New York, appear to have the least latitude for disclosure. *See id.* at 517.

66. GREENWALD ET AL., *supra* note 64, § 7:9. ("The general rule is that the privilege is a right belonging exclusively to the patient.").

67. Georgia and West Virginia's privileges, for example, are relatively weak; Georgia's covers only drug abuse treatment facilities and psychologists, and West Virginia's covers only social workers, professional counselors, and information obtained in the course of treatment or evaluation at mental health facilities. *See* GA. CODE ANN. § 26-5-17; GA. CODE ANN. § 43-39-16; W. VA. CODE § 27-3-1; W. VA. CODE § 30-30-24; W. VA. CODE § 30-31-16; *see also* GREENWALD, *supra* note 64, at app.7: 1. By contrast, other states' privilege rules sweep much more broadly. California protects communications with physicians, psychotherapists, clinical social workers, school psychologists, marriage, family and child counselors, psychological assistants and interns, associate clinical social workers, trainees, registered psychiatric nurses, sexual assault victim counselors, domestic violence victim counselors, human trafficking caseworkers, and other persons rendering mental health treatment or counseling services. CAL. EVID. CODE §§ 990–1007; CAL. EVID. CODE §§ 1010–27. Rhode Island's protections are similarly broad, applying to communications with physicians, hospitals, intermediate care facilities or other health care facilities, dentists, nurses, optometrists, podiatrists, physical therapists, social workers, pharmacists, psychologists, any person licensed to provide health care services, and officers, employees and agents of such providers, mental health counselors and marriage and family therapists, licensed chemical dependency professionals, and licensed chemical dependency clinical supervisors. *See* R.I. GEN. LAWS §§ 5-37.3-1–5-37.3-4; R.I. GEN. LAWS § 5-39.1-4; R.I. GEN. LAWS § 5-63.2-18; R.I. GEN. LAWS § 5-69-4.

existence'"—from being entered into evidence.[68] In federal courts and many states, either spouse can refuse to disclose such communications and prevent the other spouse from disclosing them.[69] The rationale for the privilege "is the protection of marital confidences, regarded as so essential to the preservation of the marriage relationship as to outweigh the disadvantages to the administration of justice which the privilege entails."[70]

## II. BOUNTIES GENERATE SIGNIFICANT AND EXPANDING INCENTIVES TO VIOLATE PRIVILEGE AND CONFIDENTIALITY RULES

The SEC's claim to preempt state privilege and confidentiality rules began before the advent of whistleblower bounties, but it is difficult to dispute that such pecuniary incentives are likely to weigh heavily on the mind of any confidant—whether a lawyer, therapist, or pastor—considering passing along confidential tips to the SEC. While the SEC's confidentiality rules prevent us from examining this in the whistleblower context directly, we analogize this by investigating the rich history of confidants who have engaged in insider trading or other fraud using confidential information for pecuniary gain. We also evaluate other factors specific to the SEC's whistleblower bounty program—namely, the increasing frequency and value of bounties and the decreasing likelihood of being caught—that could make whistleblowing based on privileged information particularly appealing.

### *A. Attorneys and Others Violate Privilege for Financial Gain*

The information to which parties bound by confidentiality rules may be privy can be highly lucrative. This is especially true of lawyers, many of whose bread and butter consists of shepherding transactions worth billions of dollars. The incentive to profit off such information is strong; indeed, the news features a regular drumbeat of lawyers accused of insider trading based on information they learn in the course of their work. Famous historical examples include Ilan K. Reich, a Wachtell partner who resigned when he came under investigation for assisting Dennis K. Levine,[71] the investment banker whose prosecution for insider trading ultimately brought down the likes of Ivan Boesky and Michael Milken in the notorious Wall Street shakedown of the mid-1980s.[72] More recent cameos include

68. Trammel v. United States, 445 U.S. 40, 51 (1980).

69. GREENWALD ET AL., *supra* note 64, § 5:9.

70. Wolfle v. United States, 291 U.S. 7, 14 (1934). We note that the Federal Rules of Evidence and many states also recognize spousal testimonial immunity, which allows one spouse to refuse to testify against the other or allows a party to refuse to allow their spouse to testify against them. *See* GREENWALD ET AL., *supra* note 64, § 5:2; *see also* Hawkins v. United States, 358 U.S. 74, 78–79 (1958); *Trammel*, 445 U.S. at 51. Both privileges are likely more relevant where an SEC action against one spouse actually reaches trial.

71. Peter Behr, *Lawyer Resigns as Levine Probe Spreads in N.Y.*, WASH. POST, (July 16, 1986), https://www.washingtonpost.com/archive/business/1986/07/16/lawyer-resigns-as-levine-probe-spreads-in-ny/781cb7f9-6524-4ec1-8885-96b74ea675a0/ [https://perma.cc/D8JQ-MVG3].

72. Steven Perlstein, *The Inside Trader Comes Out*, WASH. POST (Sept. 9, 1991), https://www.washingtonpost.com/archive/lifestyle/1991/09/09/the-inside-trader-comes-out/b87c143b-5095-41b7-876a-412f611d74c5/ [https://perma.cc/2U52-6S63].

Gene Levoff, Apple's former director of corporate law, who in 2022 pleaded guilty to six counts of securities fraud based on trading on earnings information in the company's draft SEC disclosures before they were released.[73] Levoff had previously been responsible for enforcing Apple's ban on insider trading.[74] Earlier in 2022, lawyer Rinat Gazit, head of mergers and acquisitions at Ormat Technologies, tipped a friend regarding the Company's merger with Geothermal Inc. using WhatsApp messages coded as "Peter Pan and Beauty and the Beast."[75] The friend bought up nearly 5% of Geothermal's shares.[76] Lawyers have often been charged with insider trading based on information they learned through their firms even when they did not personally represent the company,[77] and state bars may suspend attorneys for failing to disclose to clients that they traded on the clients' information.[78]

The incentive to betray professional obligations for financial gain is not limited to lawyers. While there are occasional recent reports of pastors dabbling in securities violations,[79] one of the most famous illustrations is the downfall of the empire of televangelists Jim and Tammy Faye Bakker in the 1980s. Jim Bakker was sentenced to 45 years in prison (though he ultimately served only 8)[80] for defrauding

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73. Chris Dolmsetch, *Apple Ex-Corporate Law Chief Admits Years of Insider Trading*, BLOOMBERG L. (June 30, 2022), https://news.bloomberglaw.com/securities-law/apples-former-top-corporate-lawyer-admits-insider-trading [https://perma.cc/UA6Q-2TYV].

74. *Id.*

75. Jennifer Bennett, *Coded Tip Aided Lawyer's $1.2 million in Insider Trades*, BLOOMBERG L. (Apr. 20, 2022), https://news.bloomberglaw.com/securities-law/coded-tip-aided-lawyers-1-2-million-in-inside-trades-sec-says?context=search&index=1 [https://perma.cc/V69M-C4QQ].

76. *Id.*

77. *See, e.g.*, Andrew Ramonas, *SEC Charges Ex-Foley Lardner Partner with Insider Trading*, BLOOMBERG L. (May 12, 2017), https://news.bloomberglaw.com/securities-law/former-fox-rothschild-attorney-gets-six-months/ [https://perma.cc/J4JG-CNYC] (lawyer traded on 11 announcements and passed information to a neighbor based on looking at the files of clients he did not represent); Richard Hill, *Former Fox Rothschild Attorney Gets Six Months*, BLOOMBERG L. (July 25, 2016) (lawyer defendant learned the information about the merger he traded on by overhearing a conversation between another attorney and a legal assistant).

78. *See* Jennifer Bennet, *High Court Won't Hear Case Over Insider Trading Lawyer's Penalty*, BLOOMBERG L. (Oct. 1, 2018), https://news.bloomberglaw.com/securities-law/high-court-wont-hear-case-over-insider-trading-lawyers-penalty (Supreme Court declined to consider whether state bar's suspension of attorney for failure to disclose insider trades violated lawyer's Fifth Amendment rights).

79. *See, e.g.*, Jonathan Stempel, *Pastor Convicted of Hacking, Insider Trading, Gets Five Years in Prison: NY Judge*, REUTERS (Mar. 21, 2019), https://www.reuters.com/article/us-usa-crime-insidertrading-cyber/pastor-convicted-of-hacking-insider-trading-gets-five-years-prison-ny-judge-idUSKCN1R22CW [https://perma.cc/Y55A-XS26]. We note that the pastor at issue in this case had been an investment banker earlier in life, and it is not clear that his questionable trading activities were based on information received from his flock.

80. *Televangelist Jim Bakker is Indicted on Federal Charges*, HIST. (Oct. 4, 1988), https://www.history.com/this-day-in-history/jim-bakker-is-indicted-on-federal-charges [https://perma.cc/B2TR-L8ZE].

donors and congregants out of roughly $158 million to fund a lavish lifestyle[81] that included "several homes, a private jet, two Rolls Royces, a Mercedes Benz, expensive clothes and an air-conditioned doghouse."[82]

There is also a particularly colorful history of insider trading prosecutions against psychotherapists. In one particularly notorious instance from the 1980s, Dr. Robert Willis, a psychiatrist, made profitable stock trades by buying Shearson Loeb Rhoades shares ahead of its merger with American Express and BankAmerica shares ahead of an announcement that American Express would invest $1 billion in BankAmerica.[83] Dr. Willis knew of these transactions because he was a therapist to the wife of Sanford I. Weill, who was attempting to become head of BankAmerica by inducing Shearson Loeb Rhoades, his former firm, to make the investment. This endeavor apparently put significant stress on his family life, and his wife ultimately shared information about the potential merger in the course of her therapy.[84] Major transactions and their deleterious effect on marriages featured in another episode a few years later where Dr. Mervyn Cooper, a licensed social worker who provided marriage counseling to an executive of Lockheed Corporation, pleaded guilty to insider trading for buying shares in Lockheed ahead of the defense titan's merger with Martin Marietta based on information provided over the course of his patient's counseling.[85] More recently, in 2017, Seattle therapist Kenneth Peer, one of whose patients was a Zulily employee who shared information about an impending transaction in the course of therapy, settled insider trading charges with the SEC for purchasing Zulily shares immediately before the announcement that the Company would be acquired by Liberty Interactive Corp.[86]

Finally, it is far from implausible that an irate ex-spouse might choose to blow the whistle, and indeed, it seems like only a matter of time until such an

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81. David Treadwell, *Bakker Charged with Bilking PTL Followers: Indictment Accuses Evangelist, Aide of Fraud in Selling 'Partnerships' for Vacations at Hotel*, L.A. TIMES (Dec. 6, 1988), https://www.latimes.com/archives/la-xpm-1988-12-06-mn-857-story.html [https://perma.cc/N865-S2PA].

82. Lauren Efron et al., *The Scandals That Brought Down the Bakkers, Once Among the US's Most Famous Televangelists*, ABC NEWS (Dec. 20, 2019), https://abcnews.go.com/US/scandals-brought-bakkers-uss-famous-televangelists/story?id=60389342 [https://perma.cc/8Z4K-9D22].

83. *Financier's Wife Sues Former Psychiatrist in Insider Case*, AP NEWS (Dec. 9, 1991), https://apnews.com/article/b44b8a2488bcb8fbbf6d85e2f786c619 [https://perma.cc/4PKM-4R7V]; *Broker Fined in Insider Case*, N.Y. TIMES (July 2, 1993), https://www.nytimes.com/1993/07/02/business/broker-fined-in-insider-case.html [https://perma.cc/6HKS-29LF].

84. *Id.*

85. Martha M. Hamilton, *Therapist Pleads Guilty to Using Patient to Profit*, WASH. POST (Dec. 14, 1995), https://www.washingtonpost.com/archive/business/1995/12/14/therapist-pleads-guilty-to-using-patient-to-profit/b8e1a73c-5f63-4b7b-bbbd-3e9003b56367/ [https://perma.cc/GA93-FLEB].

86. *See* Matt Levine, *Mental Health Doesn't Improve from Passing Insider Trading Tips*, BLOOMBERG L. (Dec. 17, 2017), https://www.bloomberg.com/opinion/articles/2017-12-17/mental-health-doesn-t-improve-from-passing-insider-trading-tips [https://perma.cc/M9H7-ZBKK].

incident is exposed.[87] Estranged or enraged spouses might possess information valuable to SEC enforcers, and the privileges governing such information vary widely by state.

Clearly, it is not unusual for people in positions of trust to betray confidence for financial gain. And if those bound by confidentiality rules are willing to compromise their professional obligations by trading based on client confidences, what prevents them from turning over similar information to the SEC in exchange for a bounty? While this temptation will almost certainly prove fruitful for prosecutorial efforts, it undermines the purposes for which these privileges exist, and although those efforts might be worthwhile, without explicit instructions from Congress, safeguards should be in place to curb it.

### *B. Bounty Payments are Large and Increasing*

Insider trading anecdotes suggest that there are ample pecuniary incentives to breach confidentiality obligations, and in some respects, turning over confidential information in exchange for a bounty is even more appealing; while insider trading may result in liability or even a jail sentence, whistleblowing likely results in a "warm glow" in addition to a potential award.[88] These incentives have been amplified in recent years by a veritable explosion in whistleblower rewards. The whistleblower program has paid out "more than $1 billion in awards to 207 whistleblowers, including over $500 million in fiscal year 2021 alone."[89] The largest award by a long shot, $279 million, was paid out very recently.[90] Such awards can obviously be life-altering. And if a lawyer wouldn't think of violating a confidence

87. *See* Kelly McLean, *The Divorcée Whistleblower: A Gold Digger's Guide to Exposing Your Ex and His Company*, WHISTLEBLOWER NEWS REV. (Jan. 11, 2022), https://www.whistleblowergov.org/editorial.php?article=divorcee-whistleblower-a-gold-diggers-guide-to-exposing-your-ex_12 [https://perma.cc/4DH2-FWHN] ("[W]here's the whistleblowing divorcée hero the media is waiting to devour? . . . I can only imagine that some of the same white-collar criminals ripping off America are also sleeping with their secretaries . . . I can't help but think some Wall Street wives and medical mogul's soon-to-be exes are missing out here. Why not collect $200 before passing Go? Or, for that matter, $200 million.").

88. Yuval Feldman & Orly Lobel, *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties, and Protections for Reporting Illegality*, 88 TEX. L. REV. 1151, 1192 (2010) (finding that "[a]s is expected intuitively, the more outraged respondents feel about the illegal behavior, the more likely they are to report and to predict reporting by others").

89. SEC, *SEC Surpasses $1 Billion in Awards to Whistleblowers with Two Awards Totaling $114 Million* (Sept. 15, 2021), https://www.sec.gov/news/press-release/2021-177 [https://perma.cc/VGH9-A84F].

90. *See Tipster on Ericsson Won SEC's Largest-Ever Whistleblower Award of $279 Million, Wall Street Journal Reports*, REUTERS (May 26, 2023), https://www.reuters.com/business/media-telecom/tipster-ericsson-won-secs-largest-ever-whistleblower-award-279-mln-wsj-2023-05-26/ [https://perma.cc/92KX-EAL7]. The second and third largest awards, for $114 million and $110, respectively, are also recent and were paid out in 2020 and 2021.

for a few thousand dollars, what about a few million dollars? Tens of millions? The question is no longer hypothetical.[91]

### *C. The Probability of Detection is Decreasing*

As the incentives to blow the whistle using confidential information multiply, the likelihood of getting caught remains in many instances, particularly for lawyers working outside the firm, quite small. As explored below, this is largely because of the prominent role of internal investigation in financial enforcement and the structure of the law firms that typically conduct such investigations.

#### *1. The Industrial Organization of Internal Investigations*

The problems posed by the bounties that attorney-whistleblowers may collect are particularly acute in light of the primacy of internal investigation as part of the modern corporate governance structure. The financial and political scandals of the 1970s were the genesis of programs by the SEC aimed at encouraging firms to voluntarily self-disclose violations by providing leniency.[92] The rise of the internal investigation accelerated in the 1980s with the DOJ's revision of its organizational sentencing guidelines to reduce the "culpability score" of companies that had an "effective program to prevent and detect violations of the law" or through "self-reporting, cooperation, and acceptance of responsibility."[93] Agencies investigating companies—the SEC among them—thus extended their reach and preserved scarce enforcement resources by shifting the burden of investigating misconduct primarily to the companies themselves.

That this investigative work is done by lawyers is now practically self-evident. When under investigation, firms, unlike people, do not benefit from the Fifth Amendment protection against self-incrimination, and accordingly, they *must* turn over virtually any evidence that is subpoenaed from them.[94] The main bulwark against this vulnerability consists of the confidentiality rules imposed by the attorney–client privilege and the attorney work product doctrine.[95] Accordingly, internal investigations are almost universally conducted by lawyers. Lawyers do not operate without staff, however, and the communications of non-lawyers involved in internal investigations are also covered by the attorney–client privilege, where they are explicitly acting on the directions of an attorney.[96] Firms under investigation may hire multiple law firms to investigate and represent not only themselves but

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91. Feldman & Lobel, *supra* note 88, at 1198 (finding the size of a reward to be "influential" in the decision to report, although the presence and size of a reward interacted with many other factors in such a decision).

92. Sarah Helene Duggin, *Internal Corporate Investigations: Legal Ethics, Professionalism and the Employee Interview*, 2003 COLUM. BUS. L. REV. 859, 872–73 (2003).

93. *Id.* at 876; *See also* U.S. SENT'G COMM'N, GUIDELINES MANUAL § 8C2.5(f–g) (2023).

94. Katrice Bridges Copeland, *The Yates Memo: Looking for "Individual Accountability" in All the Wrong Places*, 102 IOWA L. REV. 1897, 1902 (2017).

95. *Id.*

96. O'MELVENY & MYERS, IN-HOUSE COUNSEL'S GUIDE TO CONDUCTING INTERNAL INVESTIGATIONS 14 (2020), https://archive.omm.com/omm_distribution/white_collar_defense/guide%20_to_conducting_internal_investigations_jan_2020.pdf [https://perma.cc/LH2E-P4PU].

also various employees who may find themselves of interest to regulators.[97] Moreover, misconduct in large multinational corporations may occur across multiple jurisdictions. Under those circumstances, it is considered good practice to engage local counsel or a firm with offices in that jurisdiction to minimize travel, cultural and language barriers, and to benefit from expertise on local compliance requirements.[98] An investigation thus may be scattered across multiple teams in multiple countries, potentially implicating a diverse array of privilege rules. Both authors of this Article have been part of internal investigations and can personally attest to the sprawling extent of some of the largest, which may involve lawyers and non-lawyers in multiple offices of diverse law firms. The information the lawyers conducting these investigations could provide to the SEC is rich and varied; the structure, reach, and prevalence of the modern internal investigation provide plenty of opportunity for a motivated attorney to blow the whistle on a client. While firms may be able to trace a tip leaked from a relatively short list of in-house lawyers, once information about the investigation leaves the company to arrive on the desks of investigating law firms, many more people may have access to it, and tracing a leak may become more difficult.

*2. The Race to the Commission*

The opportunity to blow the whistle based on privileged information is compounded by the urgency with which attorneys must do so if they hope to receive a bounty. Bounties are only awarded for the receipt of "original information." The SEC defines "original information" as "information derived from your independent knowledge (facts known to you that are not derived from publicly available sources) or independent analysis (evaluation of information that may be publicly available but which reveals information that is not generally known) *that is not already known by us*."[99] That only the first whistleblower disclosing an informational nugget will receive a reward incentivizes those inclined to disclose to do so as quickly as possible, thus creating a race to the SEC. This race may compound the difficulty of identifying attorneys and others who breach privilege.

*3. An International Dimension*

The SEC "actively seeks information on securities violations from individuals across the globe";[100] indeed, whistleblower reports may be even more important for SEC enforcement of transnational violations because they are otherwise difficult to detect.[101] The largest whistleblower bounty paid to a foreign whistleblower occurred in 2014 to the tune of $30 million.[102] In 2021, the SEC

97. *Id.*

98. *Id.* at 19.

99. *Office of the Whistleblower: Frequently Asked Questions* SEC. & EXCH. COMM'N, (Apr. 6, 2023), https://www.sec.gov/whistleblower/frequently-asked-questions#faq-12 [https://perma.cc/2RE3-7JLN].

100. *Foreign SEC Whistleblower Tips by Country*, KOHN, KOHN, & COLAPINTO LLP (Nov. 2021), https://kkc.com/foreign-sec-whistleblower-tips-country/ [https://perma.cc/2RE3-7JLN].

101. *Id.*

102. *Id.*

received tips from 99 foreign countries.[103] 2021 was a record year for bounties, both in dollar amount ($564 million) and number of awards (108);[104] 20% of these bounties were paid to foreign whistleblowers.[105] Almost 20% of tips overall in 2021 came from foreign whistleblowers, meaning that these tips actually appear to have a proportionally higher chance of leading to a successful enforcement action—and thus a bounty—than domestic tips.[106] From outside the SEC, it is impossible to know if or how many of these tips contain privileged information. But as the importance of foreign whistleblowers continues to accelerate, the odds that a foreign lawyer with access to valuable information may be tempted by a multi-million-dollar bounty are likely to increase as well.

## III. THE SEC LACKS AUTHORITY TO PREEMPT STATE PRIVILEGE LAWS

The SEC's purported preemption of state attorney confidentiality rules prompted significant controversy when the SEC solicited comments on Part 205,[107] with multiple commenters arguing emphatically that "such preemption was not expressly granted by Congress in the Sarbanes-Oxley Act and cannot be inferred where neither the text nor the legislative history support preemption in this area."[108] This Part lays out the arguments undermining preemption.

### *A. Statutory Text*

The SEC lacks authority to preempt state privilege laws first for the basic reason that there is no mention of such preemption anywhere in the Statute. An embarrassment of statutory canons illustrates the proposition that the "language of the statute must control the interpretation of the rule."[109] Specifically, "[n]othing is to be added to what the text states or reasonably implies"; [110] in a more colorful articulation, Congress does not "hide elephants in mouseholes."[111]

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103. Jason Zuckerman & Matthew Stock, *SEC Whistleblower Program Attracts Record Number of Tips and Pays Awards in FY 2021*, NAT'L L. REV. (Nov. 16, 2021), https://www.natlawreview.com/article/sec-whistleblower-program-attracts-record-number-tips-and-pays-record-awards-fy-2021 [https://perma.cc/2V3M-TA9E].

104. *Id.*

105. *Id.*

106. SEC, 2021 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM, *supra* note 50, at 24.

107. *See Comments on Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys*, SEC (Apr. 22, 2004), https://www.sec.gov/rules/proposed/s74502.shtml [https://perma.cc/W9XG-94AP].

108. Joseph A. Grundfest et al., Comment Letter on Proposed Rule to Implement Standards of Professional Conduct for Attorneys (Dec. 23, 2002), https://www.sec.gov/rules/proposed/s74502/jagrundfest1.htm [https://perma.cc/8UES-8464].

109. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 472 (1977). *See also* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring) ("The starting point in every case involving the construction of a statute is the language itself.").

110. ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 93 (2012).

111. Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 468 (2001).

Section 307 of Sarbanes-Oxley contains Congress's instruction to the SEC to establish professional conduct rules for those attorneys practicing before it. The statutory text reads as follows:

> Not later than 180 days after July 30, 2002, the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule—
>
> (1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and
>
> (2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.[112]

The statute specifically provides that the SEC should promulgate rules requiring attorneys to report up the corporate ladder, culminating at the board level.[113] Such reporting would not violate the confidentiality owed by an attorney to a corporate client.[114] The instruction to issue rules "setting forth minimum standards of professional conduct for attorneys" should be interpreted consistently with the more specific mandates that follow,[115] instructing lawyers to report up the ladder *within the company*[116]—which notably do not implicate any circumvention of confidentiality rules.

That there is no mention of privilege laws or confidentiality rules in the text of the Statute is not the only reason to conclude that the SEC should not preempt them. In general, "[a] federal statute is presumed to supplement rather than displace state law,"[117] and courts generally require a clear statement before finding that a federal statute "alter[s] the federal-state balance."[118] Rules governing the confidentiality of attorney–client communications are traditionally the province of

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112. 15 U.S.C. § 7245.

113. 7 C.F.R. § 205.3(b).

114. Communications within the company remain confidential for the purposes of asserting privilege so long as "the communications are disclosed to employees who need to know them." JOHN GERGACZ, ATTORNEY-CORPORATE CLIENT PRIVILEGE § 5:48 (Spring 2024 ed.).

115. Multiple canons of construction counsel that broad terms in a statute should be interpreted in harmony with specific ones. *See, e.g.*, SCALIA & GARNER, *supra* note 110, at 183, 195, 199 (describing the broad/specific canon, *noscitur a sociis*, and *ejusdem generis*).

116. *See* 15 U.S.C. § 7245.

117. SCALIA & GARNER, *supra* note 110, at 290.

118. ESKRIDGE ET AL., CASES AND MATERIALS ON LEGISLATION AND REGULATION 1205 (5th ed. 2014); SCALIA & GARNER, *supra* note 110, at 290; Bond v. United States, 572 U.S. 844, 858 (2014).

the states.[119] Further, "[w]hen a statute covers an issue previously governed by the common law, [courts] must presume that Congress intended to retain the substance of the common law."[120] The Supreme Court has hewed to this rule with respect to privilege specifically, stating that "[a] 'no harm in one more exception' rationale could contribute to the general erosion of the privilege, without reference to common law principles or 'reason and experience.'"[121]

Commentators arguing that Congress delegated the SEC authority to preempt confidentiality rules in Sarbanes-Oxley often do so on the ground that the congressional instruction to establish "minimum standards of professional conduct for attorneys appearing and practicing before the Commission" is an arguably broad directive.[122] But there is no reason to suppose that this directive should involve tinkering with the application of privilege and confidentiality laws that extend far beyond practitioners who find themselves involved with the SEC. It would be more rational to suppose that such "minimum standards for professional conduct" should involve issues specific to securities lawyers; indeed, in a recent speech about the reinvigoration of Sarbanes-Oxley's command to promulgate such rules, one SEC commissioner proposed several such specific standards.[123] Some ideas included "offer[ing] greater detail regarding a lawyer's obligation to a corporate client, including more specifically how their advice must reflect the interests of the corporation and its shareholders rather than the executives who hire them"; "[a]dvice on materiality . . . to ensure sufficiently independent and rigorous analysis"; "requirements of competence and expertise" in securities law; "independence in rendering legal advice" to issuers; "the obligation to investigate red flags and insure an accurate factual predicate for legal opinions" expressed in disclosures; and "the retention of sufficient contemporaneous records to support the reasonableness of any legal advice, including whether appropriate expertise was brought to bear."[124] All of these are eminently commonsensical suggestions specific to securities lawyers, on

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119. *See supra* notes 33–34 and accompanying text.

120. VALERIE C. BRANNON, CONG. RSCH. SERV., R45153, STATUTORY INTERPRETATION: THEORIES, TOOLS, AND TRENDS 63 (2018) (first alteration in original) (quoting Kirtsaeng v. John Wiley & Sons, Inc., 568 U.S. 519, 538 (2013)). *See also* ESKRIDGE ET AL., *supra* note 118, at 1208 ("Presumption in favor of following common law usage and rules where Congress has employed words or concepts with well-settled common law traditions."); SCALIA & GARNER, *supra* note 110, at 318 ("A statute will be construed to alter the common law only when that disposition is clear."); *id.* at 320 ("A statute that uses a common-law term, without defining it, adopts its common-law meaning."). *See also, e.g.*, Evans v. United States, 504 U.S. 255, 259 (1992) ("[A] statutory term is generally presumed to have its common-law meaning." (quoting Taylor v. United States, 495 U.S. 575, 592 (1990) (internal quotation mark omitted)).

121. Swidler & Berlin v. United States, 524 U.S. 399, 410 (1998).

122. *See, e.g.*, Jennifer M. Pacella, *Conflicted Counselors: Retaliation Protections for Attorney-Whistleblowers in an Inconsistent Regulatory Regime*, 33 YALE J. ON REGUL. 491, 530 (2016); Kathleen Clark & Nancy J. Moore, *Financial Rewards for Whistleblowing Lawyers*, 56 B.C. L. REV. 1697, 1760 (2015).

123. Allison Herren Lee, Comm'r, *SEC Remarks at PLI's Corporate Governance – A Master Class 2022: Send Lawyers, Guns and Money: (Over-) Zealous Representation by Corporate Lawyers* (March 4, 2022), https://www.sec.gov/news/speech/lee-remarks-pli-corporate-governance-030422 [https://perma.cc/SS9V-YQUG].

124. *Id.*

matters within the purview of the SEC, which do not affect state law.[125] Moreover, as other commentators have noted, the SEC has so far failed to find any violation of the existing up-the-ladder reporting requirement that was specifically mandated by Congress.[126] Attention to the professional conduct of attorneys practicing before the Commission should begin with enforcement of the mechanism actually authorized in the text of the statute.

Furthermore, even if Congress had authorized the SEC to preempt state privilege laws in Sarbanes-Oxley, it certainly never manifested any intent for the SEC to preempt those rules to allow lawyers to "disclose client information to the SEC for the purpose of obtaining a whistleblower award."[127] Section 922 of Dodd-Frank, which authorizes the SEC whistleblower program, is completely devoid of any language evincing such intent. While some state laws permit disclosures of the kind that Part 205 allows, no state allows for such disclosures in exchange for a bounty.[128] The SEC's rule, therefore, purports to displace not only the rules of some states, but the consensus among all states.

The text of the Sarbanes-Oxley Act and Dodd-Frank Act do not support an interpretation allowing the SEC to preempt state privilege law, particularly in exchange for a bounty—indeed, the applicable canons of construction militate against such an interpretation.

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125. That no privilege-related rules were suggested in this recent list suggests again that the SEC understands its preemption of state privilege law to rest on shaky ground.

126. *See* John C. Coffee, Jr., *The Political Economy of Dodd-Fran: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019, 1044 (2012) ("Total silence on the enforcement front has followed the SEC's aspirational Standards of Professional Conduct. Despite numerous instances in which lawyers were clearly aware of executive misconduct—and both the stock-option backdating scandal and the mutual-fund-market timing scandal followed the adoption of these standards and presented instances in which misconduct involving violations of the federal securities laws deeply implicated attorneys—the SEC appears to date never to have charged an attorney representing a public corporation with violating this rule."); Marc I. Steinberg, *Ethical and Practical Lawyering with Vanishing Gatekeeper Liability*, 88 FORDHAM L. REV. 1575, 1583–84 (2020) ("Perhaps most telling is that, since the adoption in 2003 of its standards of professional conduct, mandated by the Sarbanes-Oxley Act of 2002, the SEC has not instituted a single proceeding against an attorney based on an alleged violation of these standards. Hence, for several years, the SEC has refused to invoke statutory and regulatory mechanisms that clearly come within the ambit of its authority."); Lee, *supra* note 123 ("[W]hile an entirely new regime for oversight of the accounting profession has grown and evolved, and thousands of executives have certified SEC filings under Section 302, some having their salaries clawed back under Section 304, we have never brought a single case finding a violation of the up-the-ladder rule under Section 307, a glaring fact of which market observers are well aware.").

127. William McLucas et al., *Attorneys Caught in the Ethical Crosshairs: Secret-Keepers as Bounty Hunters Under the SEC's Whistleblower Rules*, 46 SEC. REGUL. L. REP. (BNA) 1, 7 (2014).

128. *Id.* at 2.

Other scholars have argued that statutory authorization for the SEC's preemption of state privilege law is implied, rather than express.[129] Courts may find implied authorization where "compliance with both federal and state regulations is a physical impossibility";[130] such reasoning is inapplicable to the SEC's preemption of privilege rules because attorneys could simply decline to report to the SEC. An argument that preemption is implied based on the dominance of federal regulation in the field[131] of attorney conduct is similarly inapplicable. The last possibility is that Part 205's preemption is statutorily authorized because state privilege rules "stand[] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[132] Congress's objective in charging the SEC with creating attorney conduct rules was, however, to prevent lawyers from standing by silently when they knew of corporate misconduct, and instead encourage them to report it to the company.[133] This goal is served by the requirement that attorneys report misconduct up within the organization, potentially all the way to the board. Sarbanes-Oxley and exchange rules put extra teeth into corporate boards, such as beefing up independence requirements[134] and audit committees,[135] to make sure such misconduct was dealt with seriously. With such requirements in place, lawyers need not report out to the SEC to bring bad corporate actors to heel. Indeed, this conclusion is strengthened by the fact that Part 205's "reporting out" rule is permissive, not mandatory.[136] Finally, Congress had ample opportunity to create an express preemption provision if it had thought one necessary: "If Congress thought state [laws] posed an obstacle to its objectives, it surely would have enacted an express pre-emption provision at some point . . . ."[137] Accordingly, leaving state privilege laws intact does not "stand as an obstacle" to Congress's objectives in Sarbanes-Oxley.

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129. Arizona v. United States, 567 U.S. 387, 399 (2012) (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)); *see* Pacella, *supra* note 122, at 531.

130. Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142–43 (1963).

131. *See* Hillsborough County, Fla. v. Automated Medical Laboratories, Inc., 471 U.S. 707, 713 (1985) (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)) (Field preemption exists "where the scheme of federal regulation is sufficiently comprehensive to make reasonable the inference that Congress 'left no room' for supplementary state regulation").

132. Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n, 461 U.S. 190, 220 (1983) ("It is well established that state law is preempted if it 'stands as an obstacle to the accomplishment of the full purposes and objectives of Congress.'").

133. *See* 148 CONG. REC. S6552 (daily ed. July 10, 1992).

134. N.Y. Stock Exch., Inc., Listed Company Manual § 303A.01 (2003), available at https://nyse.wolterskluwer.cloud/listed-company-manual/09013e2c8503fca9 [https://perma.cc/X698-M7Z3]; NASDAQ Stock Market, Inc., Marketplace Rules, R. 4350(c) (2004), https://www.sec.gov/files/rules/other/nasdaqllcf1a4_5/nasdaqllcamendrules4000.pdf [https://perma.cc/E4JJ-7ZS8].

135. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204 § 301, 116 Stat 745.

136. 17 C.F.R. § 205.3(d)(2).

137. Wyeth v. Levine, 555 U.S. 555, 574 (2009) (finding that Congress's "silence on the issue, coupled with its certain awareness of the prevalence of state tort litigation, is powerful evidence that Congress did not intend FDA oversight to be the exclusive means of ensuring drug safety and effectiveness").

### *B. Legislative History*

The texts of Sarbanes-Oxley and Dodd-Frank do not instruct the SEC to preempt state privilege law because Congress had no intent that it should do so. Rather, the aim of § 307, as reflected in the text, was to ensure that lawyers could not turn a blind eye to corporate misconduct, but instead had an obligation to report it up the corporate ladder. Many references from the legislative history reflect that intent.[138] In writing statutes, Congress understands that "a 'prior' legal rule should be retained if no one in legislative deliberation even mentioned the rule or discussed any changes in the rule."[139] In passing Sarbanes-Oxley, Congress did not understand itself to be giving the SEC the power to override state confidentiality rules.

In drafting the bill, Congress was aware of concerns that rules promulgated by the SEC could present privilege issues. The American Bar Association ("ABA"), in a singularly self-interested missive, expressed to Senator Sarbanes its deep concerns about § 307 of Sarbanes-Oxley and its opinion that *no* power should be delegated to the SEC to regulate attorneys.[140] The letter argued that lawyers are already subject to rigorous professional standards and discipline by the states and state bars and that "superimpos[ing] a new set of national ethical rules on the well-established state court rules will likely cause unnecessary confusion regarding the duties and obligations of lawyers who represent accounting firms or who practice before the SEC."[141] More specifically, the ABA expressed concerns that

> granting the oversight board and the SEC the power to overturn existing state ethical rules could interfere with the attorney-client

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138. *See, e.g.*, 148 CONG. REC. S6552 (daily ed. July 10, 1992), https://www.congress.gov/congressional-record/volume-148/issue-92/senate-section/article/S6524-2 [https://perma.cc/C3NE-7XAB] ("If you find out that the managers are breaking the law, you must tell them to stop. If they won't stop, you go to the board of directors, which represents the shareholders, and tell them what is going on. If they won't act responsibly and in compliance with the law, then you go to the board and say something has to be done; there is a violation of the law occurring. It is basically going up the ladder, up the chain of command."); *id.* ("The SEC shall make one rule in particular, and it is a simple rule with two parts. No. 1, a lawyer with evidence of a material violation of the law has to report that evidence either to the chief legal counsel or the chief executive officer of the company. No. 2, if the person to whom that lawyer reports doesn't respond appropriately by remedying the violation, by doing something that makes sure it is cured, that lawyer has an obligation to go to the audit committee or to the board. It is that simple. You report the violation. If the violation isn't addressed properly, then you go to the board."); *id.* at S6556 ("When lawyers know of illegal actions by a corporate agent, they should be required to report the violation to the corporation."); *id.* ("I am pleased that Senator Edwards and Senator Enzi and I have been able to craft an amendment that will firmly establish the ethical duty of corporate lawyers to report wrongdoing to their client, including, if necessary, to the board of directors that represents a company's shareholders.").

139. Abbe R. Gluck & Lisa Schultz Bressman, *Statutory Interpretation from the Inside—An Empirical Study of Congressional Drafting, Delegation, and the Canons: Part 1*, 65 STAN. L. REV. 901, 967 (2013).

140. Letter from Robert D. Evans, Dir., ABA Governmental Affairs Office, to Paul S. Sarbanes, Sen., 107th Cong. (July 19, 2002), https://web.archive.org/web/20051102071427/http:/www.abanet.org/poladv/letters/107th/business071902.html [https://perma.cc/VQ2S-XQTW].

141. *Id.*

> relationship. By granting these entities unlimited authority to adopt new sets of national ethical rules for lawyers who represent accounting firms or who practice before the commission, the legislation could threaten a number of important existing state court ethical rules designed to protect the fiduciary relationship between attorney and client. In particular, both the oversight board and the SEC would have the power to override the attorney-client privilege, the work product doctrine and other evidentiary rules designed to encourage open and frank communications between the client and advocate. There is no reason why certain types of clients, like corporations and accounting firms, should have fewer rights in this regard than those currently enjoyed by all other clients under the existing state court rules.[142]

The Senate nonetheless passed the bill, and the language it adopted in § 307 survived to the final act. However, the survival of this language despite the ABA's concerns does not signal that Congress intended the SEC to preempt confidentiality rules. In fact, congressmembers key to passing the bill affirmatively declared that the law would do no violence to attorney–client confidentiality because any reporting mandated by the Statute would be done solely within the company. The Republican senator from Wyoming, Mike Enzi, who was a key player in the bipartisan passage of the Democrat-sponsored bill,[143] asserted:

> Some argue that the amendment will cause a breach of client/attorney privilege, which is ludicrous. The attorney owes a duty to its client which is the corporation and the shareholders. By reporting a legal violation to management and then the board of directors, no breach of the privilege occurs, because it is all internal—within the corporation and not to an outside party, such as the SEC. This amendment also does not empower the SEC to cause attorneys to breach their attorney/client privilege.[144]

Accordingly, the legislative history supports the text: Congress did not delegate power to the SEC to preempt state privilege laws in the text of Sarbanes-Oxley because it had no intent to do so.

### *C. No Basis for Agency Preemption*

Other scholars have argued that not only does the SEC have the statutory authorization to preempt state privilege laws but also that preemption is a "valid exercise of the SEC's authority to promulgate" Part 205.[145] But without statutory authorization, such agency preemption is also invalid.

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142. *Id.*

143. David S. Hilzenrath et al., *How Congress Rode a 'Storm' to Corporate Reform*, WASH. POST (July 28, 2002, 1:00 AM), https://www.washingtonpost.com/archive/politics/2002/07/28/how-congress-rode-a-storm-to-corporate-reform/8b86dffc-430a-4434-8bda-1858d63d7d0f/ [https://perma.cc/X9GX-Y568].

144. 148 CONG. REC. S6555 (daily ed. July 10, 2002), https://www.congress.gov/congressional-record/volume-148/issue-92/senate-section/article/S6524-2 [https://perma.cc/C3NE-7XAB].

145. Pacella, *supra* note 122, at 531.

An agency may preempt state law in its regulations when it intends to preempt state law and preemption is within the scope of the agency's delegated authority.[146] Although the SEC, in drafting Part 205, indisputably intended to preempt state laws governing attorney–client confidentiality, this ability, for the reasons discussed in the previous Section, was not delegated by Congress.[147] Arguments based on Supreme Court precedent "authorizing federal agencies to implement rules of conduct governing professionals that may be divergent from or supersede state law" also miss the mark.[148] The arguments rely on *Sperry v. Florida ex rel. Florida Bar*,[149] in which the Florida bar sought to enjoin a non-lawyer from practicing before the U.S. Patent Office because such conduct constituted the practice of law in Florida. However, in this instance, not only the regulations but also *the statute upon which they were based* explicitly authorized practice by non-lawyers.[150]

### *D. No Basis for the Preemption of Foreign and Other Privileges*

The SEC purports to preempt the privilege laws of the states. It does not yet claim the same with respect to the privilege laws of foreign jurisdictions or with respect to other types of privilege. However, the SEC's muscular interpretation of its own authority to preempt state privilege might give observers pause regarding other confidentiality rules, such as those governing foreign lawyers or other professions and circumstances.

The SEC's decision explicitly to preempt state privilege rules, as opposed to other privilege rules, is understandable. Since the SEC regulates the American securities markets, it seems likely that many of the lawyers practicing before the Commission, whose conduct Sarbanes-Oxley charged the SEC to regulate, are American lawyers. These lawyers spoke loudly in response to Sarbanes-Oxley and the SEC's proposed rules. Since lawyers, more than other professionals, likely err on the side of suing, explicit preemption was likely seen as the prudent option. But this leaves open the question whether information disclosed in violation of other privileges—those governing lawyers in Brazil, for example, or the psychiatrist–patient relationship—could form the basis for an SEC enforcement action, and ultimately, a bounty for the informant.

The short answer is that because of the confidentiality rules protecting whistleblowers, we simply do not know. But there may be reasons to worry. The SEC's reports indicate that a growing proportion of whistleblower tips come from foreign whistleblowers, and for the reasons described earlier, foreign lawyers involved in internal investigations or their precursors are likely to have information that the SEC values highly.[151] Moreover, in an environment where "event-driven"

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146. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 154 (1982).
147. *See supra* Sections III.A–B.
148. *See* Pacella, *supra* note 122, at 532.
149. 373 U.S. 379 (1963).
150. *Id.* at 385.
151. SEC, 2021 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM, *supra* note 50, at 24.

securities cases are on the rise,[152] SEC enforcement actions may involve a broad range of industries and incidents about which other professionals with confidentiality duties are well-positioned to inform.[153] The SEC, however, has even less authority to preempt these privileges than it does to preempt the privilege laws of the states.

*1. Foreign Attorney–Client Confidentiality Rules*

Foreign lawyers may qualify as attorneys "appearing and practicing before the Commission" and thus may fall within the ambit of Part 205.[154] In promulgating the final rule, the SEC noted that "many commenters expressed concerns about the extraterritorial effects of a rule regulating the conduct of attorneys licensed in foreign jurisdictions."[155] In particular, many foreign attorneys commenting on the rule cited "conflict with their obligations under the laws of their home jurisdictions,"[156] and the SEC "recognized that the proposed rule could raise difficult issues for foreign lawyers and international law firms because applicable foreign standards might be incompatible with the proposed rule."[157] Although the SEC, in response to these comments, provided a definition for "non-appearing foreign attorneys" who do not fall within the rule,[158] it acknowledged that the "effect of this definition will be to exclude many, *but not all*, foreign attorneys from the rule's coverage."[159] The SEC "consider[ed] it appropriate . . . to prescribe standards of conduct for an attorney who, although licensed to practice law in a foreign jurisdiction, appears and practices on behalf of his clients before the Commission."[160] Accordingly, foreign privilege laws could be implicated in the application of Part 205, and by extension, the whistleblower rules, to foreign attorneys.

The SEC so far has not purported to preempt international privilege laws for the purpose of collecting whistleblower tips and awarding bounties. But neither has it offered assurance that it does not use information privileged under the laws of other jurisdictions to inform enforcement actions, and the confidentiality of whistleblower identity means that generally no one other than the whistleblower and

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152. Emily Strauss, *Is Everything Securities Fraud?*, 12 U.C. IRVINE L. REV. 1331, 1334 (2022).

153. *See id.* at 1347 n.71 (noting that many event-driven cases arise in the pharmaceuticals industry).

154. 17 C.F.R. § 205.1.

155. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296, 6304 (Feb. 6, 2003) (codified at 17 C.F.R. pt. 205).

156. *Id.*

157. *Id.* at 6303–04.

158. *See id.* at 6303 (stating that "definition excludes from the rule those attorneys who: (1) [a]re admitted to practice law in a jurisdiction outside the United States; (2) do not hold themselves out as practicing, or giving legal advice regarding, United States law; and (3) conduct activities that would constitute appearing and practicing before the Commission only (i) incidentally to a foreign law practice, or (ii) in consultation with United States counsel. A non-United States attorney must satisfy all three criteria of the definition to be excluded from the rule").

159. *Id.* (emphasis added).

160. *Id.* at 6304.

the SEC would know if tips were received and acted upon in violation of foreign privilege rules. For the reasons below, the SEC should not preempt such rules in letter or in practice.

To begin with, statutes presumptively have no extraterritorial application.[161] This principle "rests on the perception that Congress ordinarily legislates with respect to domestic, not foreign, matters."[162] The rule applies "regardless of whether there is a risk of conflict between the American statute and a foreign law,"[163] meaning that even where foreign privilege laws resemble those of the United States, preemption is unwarranted. Accordingly, neither § 922 of Dodd-Frank prescribing the whistleblower program nor § 307 of Sarbanes-Oxley mandating that the SEC promulgate rules governing lawyer conduct should apply extraterritorially.

Moreover, if Congress had wanted the SEC to make use of information from foreign whistleblowers irrespective of whether it was privileged, there is plenty of evidence that it knew how to say so. In response to *Morrison v. National Australia Bank*, which held that § 10b of the Exchange Act did not apply extraterritorially, Congress explicitly gave courts extraterritorial jurisdiction to hear cases brought by the SEC.[164] Moreover, § 922 of Dodd-Frank itself allows for the sharing of whistleblower tips with foreign authorities and states that those authorities "shall maintain such information in accordance with such assurances of confidentiality as the Commission determines appropriate."[165] If Congress had wanted to give the SEC discretion to accept whistleblower tips based on disclosures that violate foreign privilege rules, it could have, and Dodd-Frank would have been a logical place to do it.

The jurisprudence to date reinforces this conclusion. Although there have been no challenges alleging that the SEC has accepted tips in violation of foreign privilege (since no one knows if this has been done), there have been lawsuits challenging the extraterritorial application of the antiretaliation provisions of the whistleblower statute. Every court to examine whether these provisions apply extraterritorially has concluded that they do not. [166]

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161. SCALIA & GARNER, *supra* note 110, at 268; Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 255 (2010).

162. *Morrison*, 561 U.S. at 255.

163. *Id.*

164. However, this did not conclusively give extraterritorial application to § 10(b). *See* A.C. Pritchard, *Securities Law in the Roberts Court: Agenda or Indifference?*, 37 J. CORP. L. 105, 142 (2011) ("The Morrison decision produced an immediate, if somewhat clumsy, reaction from Congress . . . Unfortunately, Congress enacted language ensuring only that the courts would have jurisdiction to hear cases with extraterritorial application, not that Section 10(b) would have extraterritorial application. Thus, Congress repeated the Second Circuit's error of treating the scope of the law as jurisdictional, rather than a merits question.").

165. 15 U.S.C. § 78u-6(h)(2)(D)(ii)(II).

166. Almeida v. W. Digit. Corp., No. 20-CV-04735-RS, 2021 WL 4441991, at *4 (N.D. Cal. June 25, 2021); Ulrich v. Moody's Corp., 721 F. App'x 17, 19 (2d Cir. 2018); Liu Meng-Lin v. Siemens AG, 763 F.3d 175, 182 (2d Cir. 2014); Asadi v. G.E. Energy (USA) LLC, No. 4:12-345, 2012 WL 2522599 (S.D. Tex. June 28, 2012).

Finally, we note that the SEC's inability to preempt foreign attorney–client confidentiality rules reveals something important about its purported ability to preempt those of the states. As discussed above, the SEC cannot plausibly claim to preempt the privilege laws of other nations, and so far, it has not even tried. Yet the statutory basis upon which such preemption would rest—Congress's directive to regulate the conduct of attorneys who "practice before the Commission"—makes no distinction between domestic and foreign attorneys. Indeed, the SEC itself noted this in its first attempt at Part 205.[167] Preempting the privilege laws of one while respecting those of the other, based on the same statutory language, makes no sense.

*2. Other Privileges*

The SEC also does not purport to preempt other common-law privileges, such as the physician–patient privilege, the priest–penitent privilege, and spousal privilege. This may be, in part, because internal investigations are not the province of these confidants; physicians, clergy, and other confidants typically do not engage in team production activities that cause potentially valuable whistleblower information to be shared among large numbers of potential whistleblowers. Incentives to race to the Commission and the ability to hide in a crowd are therefore weaker outside of the modern law firm.

But while the SEC carves out information disclosed in violation of the attorney–client privilege—excepting disclosures permitted by Part 205—from the definition of "original information" that may be awarded with a bounty, there are no such exceptions for information disclosed in violation of other privileges.[168] The availability of potentially lucrative bounties could induce such confidants to violate their confidentiality obligations, and because of the confidentiality with which the SEC guards its informants, it is unlikely that anyone would ever be the wiser. As with foreign privilege rules, the SEC is currently opaque on its treatment of information disclosed in violation of these privileges. The SEC should clarify that it cannot and will not pay bounties for information received in violation of these privileges.

Neither the SEC rules, nor Dodd-Frank, nor Sarbanes-Oxley mention other professional privileges in the whistleblowing context. Whereas numerous bar associations weighed in during and after the drafting of these statutes and regulations,[169] no legislative history or comment letters evidence engagement by other professionals whose communications are privileged. It is unlikely that Congress intended to abrogate such privileges, and the SEC should clarify that it does not and has no intent to do so.

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167. Implementation of Standards of Professional Conduct for Attorneys, *supra* note 155, at 6303 ("Proposed Part 205 drew no distinction between the obligations of United States and foreign attorneys.").

168. 17 C.F.R. § 240.21F-4(b).

169. *See* ETHICS ALERT, *supra* note 43; Letter from Robert D. Evans, Dir., ABA Governmental Affairs Office, to Paul S. Sarbanes, Sen., *supra* note 140.

## IV. SKEPTICISM OF PRIVILEGE TEAM PRACTICE

At the same time that it purports to preempt attorney–client confidentiality rules, the SEC is known to operate so-called "privilege teams"—also known as "filter teams" and "taint teams"—to prevent its staff from incorporating privileged information in their enforcement actions. Little detailed information about the SEC's handling of privileged information is publicly available; virtually all that is publicly acknowledged is that when the SEC is aware that "documents provided by a whistleblower present privilege issues, the Staff will set up a 'taint team' to review those documents to ensure, to the greatest extent possible, that privileged documents do not end up in the hands of investigators."[170]

This practice suggests that the SEC does recognize the importance of privilege, but it seems at odds with the SEC's position that Part 205 trumps state confidentiality laws. If the SEC is confident that its rules supersede those of other jurisdictions, why waste the time and expense to ensure that unauthorized confidential information does not fall into the hands of enforcement staff? There are several reasons the SEC could assert in arguing that its use of privilege teams is not inconsistent with its position on preemption.

First, the SEC could argue that not all tips submitted by attorneys fall within Part 205. While possible, this scenario seems unlikely because of Part 205's extraordinary breadth. The rules allow for the reporting of confidential client information not only to prevent an issuer from committing a "material violation," suborning perjury, or defrauding the Commission, but also to "rectify the consequences of a material violation that caused, or may cause, substantial injury to the financial interest . . . of the issuer or investors" if the attorney's services were used in furtherance of the violation.[171] Although one can imagine exceptions, it seems likely that any tip worth reporting that would ordinarily be encompassed by attorney–client confidentiality rules would fall within the ambit of Part 205.

Second, and more plausibly, the SEC could contend that privileged information that is not within Part 205 might be supplied by accident. It is not difficult to imagine that voluminous documents from a law firm, furnished to support an attorney tipster's claims, might contain privileged information unrelated to the tip. While this might be a plausible reason to have privilege teams, the goals of teams doing such work might be better served by a broad directive excluding privileged information from submission in the first instance.

Finally, a likely explanation is the "belt and suspenders" rationale. By operating privilege teams, the Commission reduces the probability that an unfortunate circumstance arises where it might use privileged information in an enforcement proceeding. If such use occurs, the Commission would likely argue that

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170. SEC Compliance and Enforcement Answer Book (2021) at 22-40 to 22-41. *See also* SEC v. Lek Sec. Corp., No. 17cv1789(DLC), 2018 WL 417596, at *2 n.3 (S.D.N.Y. Jan. 16, 2018) ("Under the privilege review protocol [in this case], an SEC filter team uses filter terms to search the documents, segregating potentially privileged documents until [the defendant] agrees the document is not privileged or until the Court rules on any privilege dispute.").

171. 17 C.F.R. §§ 205.3(d)(2)(i)–(iii).

because Sarbanes-Oxley preempts conflicting state law of privilege, the Commission retains the ability to use the privileged information precisely because of preemption. However, for the reasons described above, there is a substantial risk that this argument would fail.

We argue that the SEC should retain its use of privilege teams, not as a complement to preemption, but as a replacement. We discuss this argument in greater detail in Part V. However, we also argue that the SEC's privilege team practice as currently constituted is in serious need of reform. We discuss critiques of these practices below.

### *A. Common Privilege Team Procedures*

Privilege teams have been used extensively by other prosecutors and have generated significant controversy.[172] The best known and most challenged procedures are those used by the DOJ. The DOJ "privilege team" must consist of "agents and lawyers not involved in the underlying investigation," and the agents and lawyers on the privilege team must not have participated in the search that produced the information they review.[173] Instructions to the team "should be given and thoroughly discussed with the privilege team prior to the search. The instructions should set forth procedures designed to minimize the intrusion into privileged material, and should ensure that the privilege team does not disclose any information to the investigation/prosecution team unless and until so instructed by the attorney in charge of the privilege team."[174]

### *B. Pragmatic Critiques*

This approach—and the concept of the privilege team in general—has drawn substantial criticism. First, and most broadly, "[a]ny internal review of a target's sensitive and privileged material by the government agency that is ultimately responsible for prosecuting the matter represents an inherent conflict of interest."[175] In practice, this can play out in many ways. For instance, prosecutors on a privilege team may take a restrictive view of privilege and make close calls in favor of the prosecution.[176] They may be motivated to do this because even privilege

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172. *See, e.g.*, Jim Brochin & Pat Linehan, *DOJ 'Taint Teams' Pose Privilege Risks For Defendants*, STEPTOE (July 29, 2020), https://www.steptoe.com/en/news-publications/doj-taint-teams-pose-privilege-risks-for-defendants.html [https://perma.cc/849Q-VX9H]; Roland Behm et al., *"Trust Us:" Taint Teams and the Government's Peek at Your Company's Privileged Documents*, 28 No. 5 ACC DOCKET 74, 75 (2010); Heidi Boghosian, *Taint Teams and Firewalls: Thin Armor for Attorney-Client Privilege*, 1 CARDOZO PUB. L. POL'Y & ETHICS J. 15, 31 (2003); Emily E. Eineman, *Congressional Criminality and Balance of Powers: Are Internal Filter Teams Really What Our Forefathers Envisioned?*, 16 WM. & MARY BILL RTS. J. 595, 603 (2007).

173. U.S. DEP'T OF JUST., JUSTICE MANUAL § 9-13.420.

174. *Id.*

175. Robert Anello, *SEC Mishap Highlights Taint on Government "Taint Teams"*, FORBES (Apr. 14, 2022), https://www.forbes.com/sites/insider/2022/04/14/sec-mishap-highlights-taint-on-government-taint-teams/?sh=d6dd9633932e [https://perma.cc/UD34-Z6PL].

176. Kara Brockmeyer et al., *Key Factors for Challenging the DOJ "Taint Team" Procedure*, LAW360 (Dec. 8, 2021, 12:41 PM), https://www.law360.com/articles/1445667/key-factors-for-challenging-doj-taint-team-procedure [https://perma.cc/C8WT-X8X5].

team members who are not part of the investigation are nonetheless prosecutors who want to see their colleagues succeed.[177] Even where such calls are not motivated by bias, whether a privilege applies is often a fact-intensive inquiry[178] that privilege team members may not be well-positioned to conduct,[179] and the DOJ's procedures require no input either from the putative holder of the privilege or from a court.[180] Even where sharing of privileged information with the enforcement team is not deliberate, accidental disclosure may occur, and if a court finds that no prejudice resulted from the violation, defendants have no recourse.[181]

### *C. Constitutional Critiques*

Courts in recent years have also chimed in with criticism of privilege teams. In 2019, the Fourth Circuit held that a magistrate's authorization of a filter team to review all documents seized from a law firm constituted an impermissible delegation of power from the judicial to the executive branch.[182] In a scathing opinion, the court remarked that the magistrate had "compounded [the] error . . . by delegat[ing] judicial functions to *non-lawyer* members of the filter team."[183] The court also emphasized other problems with filter teams, including the

> possibility that a filter team—even if composed entirely of trained lawyers—will make errors in privilege determinations and in transmitting seized materials to an investigation or prosecution team . . . . [Further,] a filter team might "have an interest in preserving privilege, but it also possesses a conflicting interest in pursuing the investigation, and . . . some [filter] team attorneys will make mistakes or violate their ethical obligations. It is thus logical to suppose that [filter] teams pose a serious risk to holders of privilege."[184]

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177. *Id.*

178. Kirkland & Ellis, *"Evolution" of Controversial Filter Teams Practice is Underway* (May 5, 2023), https://www.kirkland.com/news/in-the-news/2023/05/evolution-of-controversial-filter-teams-practice-is-underway [https://perma.cc/2WGJ-ZDTB] (noting that "privilege review is highly fact-specific").

179. Daniel Suleiman & Molly Doggett, *Despite Inherent Risks to the Attorney-Client Relationship, Taint Teams Are Here to Stay (for Now)*, THE ABA/CJS WHITE COLLAR CRIME COMMITTEE NEWSLETTER (Winter/Spring 2022) ("[P]rivilege calls can be challenging, so a team of prosecutors and agents who lack context for the documents under review are often ill-equipped to make accurate privilege determinations.").

180. Brockmeyer et al., *supra* note 176.

181. Anello, *supra* note 175. One notable instance of such accidental disclosure in fact involved the SEC; dating back to 2017, the SEC's adjudication staff submitted memoranda to the Commission, but because its databases were not properly configured, enforcement personnel had access to these memoranda. *Id.* This represents an inadvertent mishandling of the SEC's own documents, but illustrates how even unintentional breaches of internal firewalls may occur.

182. *In re* Search Warrant Issued June 13, 2019, 942 F.3d 159, 176 (4th Cir. 2019), *as amended* (Oct. 31, 2019) ("Put simply, a court is not entitled to delegate its judicial power and related functions to the executive branch, especially when the executive branch is an interested party in the pending dispute.").

183. *Id.* at 177.

184. *Id.* (second and third alterations in original).

The court also remarked that "due to the appearances of unfairness caused by the Filter Team, and in view of the other problems associated with the Filter Team, it is surprising that the government has so vigorously supported it. We simply observe that prosecutors have a responsibility to not only see that justice is done but to also ensure that justice appears to be done."[185]

### *D. The DOJ's Response: Specialized Privilege Teams and Increased Transparency*

In response, the DOJ quickly established the Special Matters Unit to "focus on issues related to privilege and legal ethics."[186] This unit is responsible for conducting privilege reviews to ensure that enforcement attorneys are not exposed to privileged material.[187] This is a change from previous practice, where other prosecutors were pulled from their cases on an ad hoc basis to conduct privilege reviews;[188] a dedicated team might mean less bias of the kind that could induce career prosecutors to take an overly narrow view of privilege. But courts have continued to be skeptical. In 2021, the Fifth Circuit reversed denial of a pre-indictment motion seeking the return of seized documents where the government refused to return or destroy documents that its privilege team had concluded were privileged.[189] The government stated that the documents had not "been destroyed for the potential for a future filter team [to examine them], if the criminal team looks at the privilege logs and disagrees for some reason."[190] The court concluded that "[a] privilege team serves no practical effect if the government refuses to destroy or return the copies of documents that the privilege team has identified as privileged. The government has thus conceded that it has no intent to respect [defendant]'s interest in the privacy of its privileged materials as the investigation unfolds."[191] Soon after, the Eleventh Circuit upheld a filter team review protocol modified by the district court requiring the government to allow intervenors to conduct an initial privilege review and prohibiting the government's privilege team from disclosing purportedly privileged documents to investigators without the intervenors' permission or a court order.[192] Thus, even the DOJ's revamped practices have been subject to critique, and further reforms may be in order.

### *E. SEC Privilege Teams: No Specialization and No Transparency*

By contrast, SEC privilege teams have received remarkably little attention. The only reference to their use in the SEC Enforcement Manual involves purposeful

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185. *Id.* at 183.

186. U.S. DEPT. JUST. FRAUD SECTION, YEAR IN REVIEW 4 (2020), https://www.justice.gov/criminal-fraud/file/1370171/download [https://perma.cc/GTM8-HTUN].

187. *Id.*

188. Jim McGovern et al., *The Department of Justice Introduces a New Privilege Team*, HOGAN LOVELLS (May 2020), https://www.engage.hoganlovells.com/knowledgeservices/news/the-department-of-justice-introduces-a-new-privilege-team [https://perma.cc/GRG3-Z582].

189. Harbor Healthcare Sys., L.P. v. United States, 5 F.4th 593, 599 (5th Cir. 2021).

190. *Id.*

191. *Id.*

192. *In re* Sealed Search Warrant & Application for a Warrant by Tel. or Other Reliable Elec. Means, 11 F.4th 1252 (11th Cir. 2021).

productions without privilege review, a process by which investigated parties may make productions to the SEC without reviewing for privilege, allowing SEC filter teams to perform that role.[193] Extremely little information on SEC privilege teams, other than that they exist, is public. And their intersection with the privilege issues involving whistleblowers is completely opaque. It is not public, for instance, how SEC privilege teams are composed; do they consist of ad hoc teams assembled from other cases, and if so, how close are the relationships of the filtering attorneys (or non-lawyers!) to the investigating staff? Are whistleblower tips analyzed in light of confidentiality issues other than those arising under the attorney–client privilege? How many whistleblower tips actually come from attorneys, and of those, how many come from jurisdictions where the applicable rules are inconsistent with Part 205? Do the SEC privilege teams examine the heterogeneity of confidentiality rules to determine whether whistleblower information is privileged under laws inconsistent with Part 205? It may be the case that SEC privilege teams examine whistleblower tips closely to assess whether they are permissible not only under Part 205 but also under state law; it is also conceivable that a situation involving an attorney whistleblower whose communications were allowed under Part 205 but not under state law has never arisen. But all this is pure speculation, and if recent opinions are any guide, the opacity of the SEC's current practices is unlikely to be viewed generously by courts.

## V. FOUR RECOMMENDATIONS

The potential avenues for private parties to challenge the SEC's preemption of state privilege rules are multiple, but uncertain. This stems primarily from the confidentiality rules with which the SEC protects its whistleblowers. Though such rules may be warranted in the whistleblower context, they create serious difficulties in challenging the SEC's rules, as reflected by the fact that, in the nearly 20 years since the passage of Part 205, few such challenges have been undertaken.[194]

In view of the improbability of private challenge, it is important that the SEC itself undertake some measures to change its whistleblower rules. This Part will discuss potential remedial measures the SEC could take. The renewed attention to attorney conduct rules could present a good opportunity for such a project.

### *A. The Commission Should Retract its Claim of Preemption*

The most obvious fix is for the SEC to amend Part 205 to allow reporting out to the SEC only when an attorney would be permitted to do so by the applicable confidentiality rules. An alternative is amending the whistleblower rules to prohibit collecting a bounty for privileged information. We discuss each of these possibilities in turn.

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193. SEC ENFORCEMENT MANUAL 75 (2017), https://www.sec.gov/divisions/enforce/enforcementmanual.pdf [https://perma.cc/MFQ8-DC9L]; *see also* Dan Portnov, *Bring In the SEC Taint Team*, KROPF MOSELEY (Mar. 19, 2018), https://kmlawfirm.com/2018/03/19/bring-in-the-sec-taint-team/ [https://perma.cc/C8A4-5DP7].

194. One of us discusses in another work the issue of standing and the problems it poses for judicial challenge of the preemptive provision of Part 205. *See* Emily Strauss, *Standing and Snitches*, THE BUS.LAW. (forthcoming).

We preface these proposals with the acknowledgement that any of them could reduce the number of securities violations that are reported to the SEC by lawyers, who are likely to have excellent information on such violations. The SEC and others would likely reject our proposals on these grounds; a previous head of SEC enforcement commented:

> Underlying all evidentiary privileges—which . . . are disfavored at law, for the simple reason that they interfere with fact-finding—is the idea that there is an offsetting benefit that justifies the cost to the truth-seeking process. That somehow—by protecting these relationships with . . . lawyers—we, as a society, end up encouraging better conduct, not worse.[195]

This may be true as a policy matter. But the SEC's lack of authority to override state laws governing attorney–client confidentiality moots this point.[196] As stated in a comment letter in response to the original proposed rule that evolved into Part 205, "[i]f the Commission wishes to adopt certain provisions here at issue, then it should request from Congress the delegation of authority that the Commission lacks today."[197]

In the absence of such a request, there are several ways in which Part 205 could be amended to eliminate the SEC's purported preemption of state privilege rules. The first is to eliminate the option for attorneys to report misconduct "out" to the SEC. This option was not envisioned by Congress in drafting § 307 of Sarbanes-Oxley; rather, the legislative history and the text of the Act itself discuss only the obligation for attorneys to report violations up through the ranks of the company and ultimately to the board if no remedial measures are taken.[198] The "reporting up" requirement maintains attorney–client confidentiality, as was pointed out by the legislators who supported it.[199] This approach would not prevent the SEC from

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195. Linda Chatman Thomsen, Director, SEC, Division of Enforcement, Remarks Before the 27th Annual Ray Garrett, Jr. Corporate and Securities Law Institute 2007 (May 4, 2007), https://www.sec.gov/news/speech/2007/spch050407lct.htm [https://perma.cc/LW6N-N36N].

196. *See* Grundfest et al., *supra* note 108 ("We are, however, unanimous in the view that, whatever the wisdom of the Commission's proposals, '[p]olicy considerations cannot override . . . interpretation of the text and structure of the Act.' . . . Some of us might [agree with these considerations]. Some of us might oppose [them]. All of us agree, however, that the Commission cannot arrogate unto itself power that Congress has not delegated to it.").

197. *Id.*

198. *See* 148 CONG. REC. S6552 (daily ed. July 10, 1992); 15 U.S.C. § 7245.

199. 148 CONG. REC. S6552 (daily ed. July 10, 1992), https://www.congress.gov/congressional-record/volume-148/issue-92/senate-section/article/S6524-2 [https://perma.cc/C3NE-7XAB] ("[T]he SEC shall make one rule in particular, and it is a simple rule with two parts. No. 1, a lawyer with evidence of a material violation of the law has to report that evidence either to the chief legal counsel or the chief executive officer of the company. No. 2, if the person to whom that lawyer reports doesn't respond appropriately by remedying the violation, by doing something that makes sure it is cured, that lawyer has an obligation to go to the audit committee or to the board. It is that simple. You report the violation. If the violation isn't addressed properly, then you go to the board.").

receiving tips from attorneys in jurisdictions where the applicable privilege laws allow for such disclosure.[200]

However, some might argue that there is a signaling benefit to retaining the text of Part 205 allowing for attorneys to report out. Retaining the text could remind lawyers in jurisdictions where reporting out under specific circumstances is permitted that such an option exists and thus could encourage those attorneys permitted to blow the whistle to do so. If the SEC were to choose this option, it should eliminate the final sentence of 17 C.F.R. § 205.1, which currently reads: "Where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with this part, this part shall govern."

The portion of the text that authorizes "reporting out" to the SEC, 17 C.F.R. § 205.3(d)(2), should be revised to read as follows: "An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer's consent, *to the extent permitted by state law*, confidential information related to the representation to the extent the attorney reasonably believes necessary [to report a violation]."

There are several objections to the heterogeneity of whistleblower rules that this approach would create. First, and most broadly, such an approach would create potentially arbitrary rules for attorney whistleblowers, who would be permitted in some jurisdictions but not in others. This argument proves too much; the same is true for all attorney conduct rules, corporate laws, and indeed, any laws which are committed to the states. More on point might be an argument that such a system could breed regulatory arbitrage. States housing the operation of many large public firms—and the lawyers that serve them—might craft deliberately restrictive confidentiality rules to reduce the likelihood of whistleblowing attorneys. Such an approach would assuage the concerns of large corporations in relying on their lawyers, particularly those conducting internal investigations. Conversely, more restrictive confidentiality rules would clamp down on potentially informative whistleblower tips in precisely the jurisdictions where the SEC has the strongest enforcement interest. Indeed, there is an argument that, deliberately or not, this has already occurred. The privilege laws of California and New York are among those that are inconsistent with Part 205, and these jurisdictions are the primary hubs for public companies.[201] The potential for this kind of arbitrage, however, is not for the SEC to remedy unilaterally. Confidentiality rules barring attorney whistleblowers are not the first, nor the most important, state laws creating the potential for regulatory arbitrage among the states and between state and federal regulators.[202]

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200. *See, e.g.*, North Carolina State Bar, *Lawyer for Publicly Traded Company May "Report Out" Pursuant to SEC Regulations*, adopted Jan. 20, 2006, https://www.ncbar.gov/for-lawyers/ethics/adopted-opinions/2005-formal-ethics-opinion-9/?opinionSearchTerm=law (concluding that North Carolina attorneys may report out under Part 205).

201. *See supra* notes 33–35 and accompanying text.

202. An area where this tension has played out for virtually the entire history of the U.S. is in banking law; the existence of both state and federal banking charters and regulators has created an environment where entities seeking to maximize profit and minimize regulatory interference have ample opportunity to do so. *See, e.g.*, Lydia Beyoud, *MUFG*

But Congress has not eliminated that potential, and indeed, in some instances, it has even gone out of its way to protect the heterogeneity that gives rise to such arbitrage.[203] Unless and until it does so, the SEC—and indeed, everyone else—must tolerate the potential for regulatory arbitrage.

Even if the SEC declines to amend Part 205 to align with state privilege rules, it should refuse to pay bounties for information received in violation of attorney–client confidentiality rules. To be clear, this does not solve the problem that attorneys may "report out" to the SEC in violation of state privilege laws. However, paying an award for such information surely throws fuel on the fire and increases the rate at which such violations are likely to occur. Critically, bounties also create ethical problems for lawyers as fiduciaries. No court, to our knowledge, has addressed this, but several commentators in academia[204] and in practice[205] have weighed in on the issue. The general consensus is that an attorney who receives a bounty for blowing the whistle on a current client is likely violating ethical standards, both under model ethical rules[206] and the broader fiduciary duties that lawyers owe to their clients.[207] Although less explored, at least one scholarly work has expressed the same view with respect to former clients.[208] At least one state bar

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*Pays New York $33 Million After Shifting to OCC Oversight*, BLOOMBERG L. (June 24, 2019, 2:55 PM) https://news.bloomberglaw.com/banking-law/mufg-reaches-33-million-settlement-over-charter-switch [https://perma.cc/HU9H-YWEH] (documenting bank's switch from a New York state to a federal charter to evade enforcement action by New York state regulators).

203. *See* 12 U.S.C. § 25b(b)(1)(B) (codifying *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996), which provides that state consumer financial protection laws are only preempted if they "prevent[] or significantly interfere[] with the exercise by the national bank of its powers").

204. Jennifer M. Pacella, *Advocate or Adversary? When Attorneys Act as Whistleblowers*, 28 GEO. J. LEGAL ETHICS 1027, 1054 (2015); Clark & Moore, *supra* note 122.

205. Barry R. Temkin & Ben Moskovits, *Lawyers as Whistleblowers Under the Dodd-Frank Wall Street Reform Act*, N.Y. STATE BAR J., at 10, 1 (2012); ATTORNEYS AS WHISTLEBLOWERS, *supra* note 12.

206. *See* Clark & Moore, *supra* note 122, at 1722 ("[T]here is a significant risk that the lawyer's representation will be limited by the lawyer's personal pecuniary interest in obtaining the whistleblower award, which is likely to compromise the lawyer's ability to objectively consider and advise the company concerning such questions as whether the company is violating the law, whether the legal violation poses a threat to the company, and whether suspected wrongdoing should be reported to a higher level in the company. Moreover, such a conflict will be nonconsentable if, given the amount of money at stake, the lawyer cannot reasonably believe that he or she can provide diligent and competent representation.").

207. *Id.* at 1750 ("[F]iduciary law continues to broadly prevent the lawyer from receiving a significant financial reward at the client's expense.").

208. *Id.* at 1751 ("[W]e believe that Dodd-Frank lawyer-whistleblowers do have a conflict of interest when they blow the whistle on a former client . . . . Our conclusion is based not on the disciplinary rules themselves, but rather on the existence of common-law fiduciary duties that are broader than the specific fiduciary duties codified in state disciplinary rules. An attorney's fiduciary duty extends to former clients and includes the duty not to engage in self-dealing and to account for profits made with confidential information obtained during the lawyer-client relationship.").

association has also publicly taken the stance that disclosing current and former clients' information in violation of state privilege law in exchange for a bounty is impermissible.[209]

In sum, if the SEC declines to amend Part 205 to clarify that lawyers may not, without repercussion, "report out" in violation of state privilege laws, it should at least refuse to pay for information disclosed in such reports. Paying bounties for information disclosed in violation of state confidentiality rules adds an additional ethical problem that was contemplated neither by Congress nor the drafters of Part 205, and indeed, it is unclear in drafting the whistleblower regulations that the SEC even considered ethical obligations other than attorney–client privilege.[210] Accordingly, bounties to lawyers for information disclosed in breach of the attorney–client privilege should be eliminated.

### *B. SEC Privilege Team Practice Should Be at Least as Rigorous and Transparent as DOJ Practice*

While the DOJ's privilege team practices have continued to draw fire, they nonetheless represent a good place for the SEC to start in reforming its privilege team practices. The conflicts that courts and practitioners have identified in allowing line-level prosecutors pulled from other matters to make privilege determinations regarding documents that could contain information critical to a colleague's case are equally salient in the SEC context. The formation of a specialized team for the handling of potentially privileged information would, at least, make internal firewalls more plausible and perhaps contain the existence or appearance of bias that could result from allowing enforcement attorneys to make such calls on an ad hoc basis.

An equally important recommendation is that the SEC publish an account of its privilege procedures. The DOJ's accounts of its new procedures are not detailed, but they were published by the agency itself,[211] and revelations continue to be made public in judicial filings.[212] The SEC, by contrast, is completely opaque about the privilege procedures it adopts, and apart from scattered references in a few lawsuits,[213] we know virtually nothing about them. Transparency by the SEC is even more important with respect to privilege procedures in the whistleblower context, since lawsuits challenging the use of privileged information by a whistleblower are highly unlikely. Greater transparency would help remedy the appearance that "the

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209. N.Y. Cnty. Laws. Ass'n Comm. on Pro. Ethics, Formal Op. 746 (2013), https://www.nycla.org/resource/ethics-opinion/nycla-committee-on-professional-ethics-formal-opinion-746-on-ethical-conflicts-caused-by-lawyers-as-whistleblowers-under-the-dodd-frank-wal-street-reform-act-of-2010/ [https://perma.cc/ZT73-J77C].

210. Clark & Moore, *supra* note 122, at 1761–62 ("[I]t is unclear whether, in drafting the regulation, the SEC ever considered conflicting ethical obligations other than those found in confidentiality rules, and it is similarly unclear whether it intends to grant an award if it is convinced that the lawyer is violating a state law that is not preempted by the prior SOX regulation.").

211. See U.S. DEP'T JUST., *supra* note 173.

212. *See supra* notes 182, 185, 189, 192.

213. *See, e.g.*, SEC v. Lek Sec. Corp., No. 17cv1789(DLC), 2018 WL 417596 (S.D.N.Y. Jan. 16, 2018).

government's fox is left in charge of the [law firm's] henhouse, and may err by neglect or malice, as well as by honest differences of opinion."[214]

### *C. The SEC Should Warn Whistleblowers that It Does Not Accept Privileged Information and Cannot Reward Breaches of Privilege*

In conjunction with revising Part 205 to withdraw its claim of preemption, the SEC should clarify loudly that it will not accept or pay for privileged information from whistleblowers. Claiming preemption while simultaneously operating filter teams in case preemption turns out to be invalid is a costly approach. In so doing, the SEC creates incentives for whistleblowers to submit privileged information but must expend the resources to screen for such tips. We do not know the procedures for such screens, but they are surely more likely to be overwhelmed where whistleblowers believe they can receive bounties for privileged information. If this incentive were removed, privilege teams would have a narrower field to police and could focus their attention on breaches that are accidental, or, as described below, deceptive and difficult to detect. We note that discouraging the submission of privileged information in the first instance is even more important because not all tips are submitted through the formal channels (and thus may not be screened by privilege teams); indeed, many successful ones appear to be passed directly to SEC enforcement attorneys from whistleblower lawyers who previously worked at the agency.[215]

### *D. SEC Privilege Teams Should Employ Enhanced Scrutiny to Deter Disguised Privileged Information*

A unique feature of internal investigations, which furnish the basis of most SEC enforcement activity, is the ease with which confidential or privileged information can be disguised as nonconfidential or nonprivileged information. The investigative process generally consists of reading many millions of documents—most of which are, in some form, available to employees of the firm under investigation, to whom no privilege or professional confidentiality rules apply.[216] Investigations also draw heavily on employee interviews where the content of the interview is obviously furnished primarily by the employee. Although there are always exceptions, there is often little way to tell, based on the substance a particular tip, whether it came from a disgruntled employee or from the desk of a lawyer investigating the conduct of that employee. The ability to disguise such information as nonprivileged by, for example, furnishing it to the Commission through a third party or anonymously through a lawyer, means that defendant issuers may have no way of knowing that it was in fact an attorney who blew the whistle (without even broaching the thorny task of discovering which attorney it was).

SEC privilege teams should recognize this hazard and devote enhanced resources to tackling it. Clarifying that bounties will not be paid for privileged

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214. *In re* Search Warrant Issued June 13, 2019, 942 F.3d 159, 177–78 (4th Cir. 2019), *as amended* (Oct. 31, 2019).

215. *See* Platt, *supra* note 4, at 727–30 (giving examples of instances where whistleblower tips were submitted outside the formal process).

216. If the information is proprietary, the employee may well be subject to a nondisclosure agreement, but this is irrelevant for our purposes.

information could induce more frequent attempts at subterfuge. The SEC should carefully vet and, if possible, corroborate the sources of its tips to ensure that privileged information is not being channeled through third parties to avoid detection of a breach.

## CONCLUSION

The SEC's purported ability to receive confidential attorney–client information in exchange for a bounty has persisted, with decreasing commentary, for more than a decade. We demonstrate the weaknesses of this position. Although the SEC's stance is, for pragmatic reasons, a difficult one to challenge in court, the SEC may operate privilege teams in part based on an understanding of the tenuousness of its preemption claim. We recommend that these teams be revamped to operate as a robust and transparent substitute for, rather than a complement to, the SEC's purported preemption of privilege law.