In-House Counsel, Whistleblowing, and Ethics

BY JACK TANNER

This article discusses ethical issues that in-house lawyers must consider before reporting a client's improper conduct. It also covers factors that must be considered in determining whether the lawyer can obtain relief based a client's subsequent retaliation.

Ethics rules have traditionally provided a client with complete and unfettered discretion to fire its lawyer for any reason whatsoever. Previously, ethics rules also did not allow a lawyer to disclose client information to third parties, absent a few exceptions. Thus, an in-house employee lawyer who was discharged for reporting client conduct to higher-ups in the organization, to regulators, or to other authorities was unlikely to prevail on a claim for wrongful discharge.

Recent changes in ethics rules and case law have modified these points. Lawyers now have more leeway to disclose client information, including by "whistleblowing," which is notifying higher-ups in the client organization or authorities outside the organization of perceived improper conduct by the client. Further, protections for whistleblowers have undercut the client's authority to discharge a lawyer for any reason (including in retaliation for whistleblowing) without consequences.

A lawyer who considers reporting a client constituent to a higher-up within an organizational client or reporting a client to an outside authority must analyze several ethical issues before doing so. If a lawyer reports a client and is

discharged as a result, several factors can affect a claim for retaliatory (wrongful) discharge. These factors include whether the lawyer notified those inside or outside the client organization, whether protections offered are state or federal, and the relief sought. This article explores this relatively new and yet evolving area of the law.

Ethical Foundations for Client Confidentiality

Under the former Colorado Code of Professional Responsibility (Code), a lawyer was required to maintain "confidences and secrets" of the client with few exceptions.[1] One exception was the "intention of [the] client to commit a crime and the information necessary to prevent the crime."[2] There was no exception that allowed disclosure of client confidences and secrets to prevent a wrong that was not a crime, or to mitigate or rectify damage done by a client. There were exceptions for fee disputes and for defending against malpractice claims, but not for other disputes with a client.[3] Further, under the Code, there was no requirement to report ongoing unlawful conduct to higher-ups within an organizational client.

Under the Colorado Rules of Professional Conduct (Rules) adopted in 1997, the prohibition on disclosing "confidences and secrets" was expanded to prohibit a lawyer from revealing any "information relating to the representation of a client" to third parties, regardless of whether the information was confidential or secret, with only a few exceptions.[4] As originally adopted, these exceptions allowed disclosure to prevent a crime, but not to prevent noncriminal wrongs or to mitigate or rectify damage caused by a crime.[5]

The Rules also expanded a lawyer's ability to disclose client information in a dispute with a client. Under the Code, such disputes were limited to those regarding fees or malpractice claims, but the Rules allow disclosure "to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and client," among other things.[6]

The adoption of the Rules also created, for the first time, the obligation to report "up the ladder" within an organizational client under certain circumstances. When the client constituent was planning or engaging in unlawful conduct, or when the client constituent was violating his or her obligations to the organization, the lawyer was generally required to report this conduct to higher-ups within the organizational client.[7] This process was to be repeated as necessary to change the client's conduct until the lawyer reported to the "highest authority in the organization," generally thought to be the board of directors.[8] However, Rule 1.13 as originally adopted also included numerous factors the lawyer could consider in deciding whether to make a report; thus it essentially made this reporting permissive rather than mandatory.[9]

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In the 1990s a series of corporate financial disasters rocked the United States, including those of Enron, Tyco International, Adelphia, and WorldCom. Lawyers for those companies, even when testifying before Congress, refused to disclose certain client information, including how much the executives in the companies knew about the fraudulent conduct and where missing funds might be located.[10] These lawyers correctly relied on the then-applicable ethical rules in refusing to do so.[11]

As a result, significant changes were made to the ABA Model Rules of Professional Conduct in the "Ethics 2000" rule changes (adopted by Colorado effective February 1, 2008). New exceptions to Rule 1.6 allowed a lawyer to reveal information to "prevent, mitigate, or rectify" even noncriminal financial injury under certain circumstances,[12] and "to comply with other law or a court order."[13]

Perhaps more fundamentally, the exceptions to Rule 1.13's requirement of up-the-ladder reporting were significantly reduced.[14] Previously, there were numerous factors a lawyer could consider that effectively made the reporting permissive rather than mandatory, but with the rule changes, the only exception remaining is when the lawyer "reasonably believes that it is not necessary in the best interest of the organization to do so . . . ."[15]

Another 2008 change to Rule 1.13 requires that, if the lawyer reasonably believes he or she has been discharged for reporting up the ladder, the lawyer must report the termination in such a way that the highest authority within the organization becomes aware of the discharge.[16]

Finally, if reporting up the ladder fails to change the client's conduct, Rule 1.13(c) permits—but does not require—the lawyer to disclose client information outside the organization if (1) the conduct is clearly a violation of the law, and (2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization.[17] The disclosure is allowed, despite Rule 1.6, "only if and to the extent the lawyer reasonably believes

necessary to prevent substantial injury to the organization."[18] But unlike Rule 1.6(b)(4) concerning disclosure to rectify or mitigate damage, this rule only applies to ongoing or future conduct.[19]

Rules 1.6 and 1.13 differ in this regard: Where the client is an individual, under Rule 1.6 the lawyer may disclose client information to third parties only to prevent the client from committing a crime[20] or fraud,[21] when certain other circumstances are present. Under Rule 1.13, however, where the client is an organization, the permission to disclose client information is much broader and applies to prevent any "violation of law," when other circumstances are present.[22]

Meanwhile, the ethical stance that the client has unfettered discretion in terminating a lawyer has remained constant. The official comment that a "client has a right to discharge a lawyer at any time, with or without cause, subject to liability for payment for the lawyer's services" was adopted with the original Rules and has not been changed since.[23] This attitude is echoed in various other places in the Rules. For example, it is an ethical violation for a lawyer to enter into a covenant not to compete[24] or other agreement that restricts the lawyer's right to practice,[25] in part because such an agreement "limits the freedom of clients to choose a lawyer."[26]

The Growth of Whistleblower Protections

Colorado first enacted statutory whistleblower protections for government employees in 1979 with the adoption of the State Employee Protection Act.[27] This statute was expanded in 2016 and again in 2017.[28] In general terms, this act prohibits "any disciplinary action" against a state employee "on account of the employee's disclosure of information."[29] It thus applies to state-employed lawyers.

Colorado enacted statutory protections for private employees in 1988 in the Private Enterprise Employee Protection Act.[30] This act only applies to employees of a private enterprise that has a contract with the State of Colorado.[31] The state legislature expanded these protections in 2017.[32] This act prohibits "any disciplinary action against any employee on account of the employee's disclosure of information concerning said private enterprise."[33] By its own terms, however, this act does *not* apply to an "employee who discloses information which is confidential under any other provision of law."[34]

Colorado also recognizes the common-law tort of wrongful discharge in violation of public policy.[35] This case law creates a remedy in certain circumstances for whistleblowers outside the state government context.[36]

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There are too many federal statutes that provide protection against retaliation for whistleblowers to list in an article of this length. The Sarbanes-Oxley Act of 2002[37] and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010[38] are currently the two most prominent. These acts prohibit the termination of an employee as retaliation for bringing the client's improper conduct to light.

Internal Whistleblowing by In-House Counsel

Internal whistleblowing—that is, reporting perceived improper conduct within an organization—is not only allowed under the Rules but may be required. Rule 1.13(b) requires up-the-ladder reporting in many instances. Even when not required (because, for example, the lawyer is not reasonably certain the conduct will result in substantial damage to the organization), such reporting is at least ethically permitted because the organization is the client.[39] So long as the report is going to the client, there is no violation of Rule 1.6(a). The requirement to report up the ladder under Rule 1.13 only applies to ongoing or planned conduct; it does not apply to completed conduct.[40]

This does not mean that a lawyer discharged for such reporting will necessarily prevail in a claim for wrongful discharge. In *Pang v. International Document Services*,[41] the Utah Supreme Court reaffirmed that the Utah at-will employment policy had an exception for those fired in violation of substantial public policy. However, it also determined that Utah's version of Rule 1.13(b) (requiring reporting up the ladder) did not reflect a public policy of sufficient magnitude to protect the whistleblowing in-house lawyer from discharge.[42]

Pang, who was in-house counsel, was fired for reporting up the ladder that the client was violating usury laws.[43] Before his termination, he did not disclose any information outside the company. Yet his suit for wrongful discharge was dismissed and the dismissal was ultimately affirmed by the Utah Supreme Court. *Pang* held that the ethical requirement of up-the-ladder reporting, standing alone, was not a statement of Utah state policy such that it gave rise to an exception to Utah's state public policy favoring at-will employment.[44]

Kidwell v. Sybaritic[45] is a good reminder that the exact terms of anti-retaliation statutes can matter. There, the in-house counsel sent an internal email to company management raising certain concerns. He was fired a week later, brought suit, and won a jury verdict that he had been fired in retaliation for his email. On appeal, the judgment was reversed because the Minnesota Whistleblower Act[46] did not

protect communications within the scope of the employee's regular duties. *Kidwell* held that the in-house counsel was not protected from retaliatory discharge under Minnesota law because it was part of his job to send emails of the type that got him fired.[47]

External Whistleblowing by In-House Counsel

Both Rules 1.6 and 1.13 allow external whistleblowing under certain circumstances. Regarding past conduct, Rule 1.6 permits external whistleblowing to "mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services."[48]

Regarding current or future conduct, under Rule 1.6 the lawyer may reveal client information to prevent reasonably certain death or substantial bodily harm,[49] to prevent the client from committing a crime,[50] and to prevent the client from committing a fraud that is reasonably certain to result in substantial injury to another (where the lawyer's services were used in perpetuating the fraud).[51]

The permission under Rule 1.13 to report outside the organization arises only after the lawyer has reported up the ladder to the highest authority within the organization and the client's conduct has continued or is still planned. In that instance, and if the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization, the lawyer may report the conduct outside the organization in an effort to prevent substantial injury to the organization.[52]

Federal Protections for External Whistleblowing

Consider an in-house counsel who has tried unsuccessfully to get the company to cease unlawful conduct, chooses to report the company to regulators, and is discharged. The lawyer then sues for wrongful discharge, perhaps relying on the Sarbanes-Oxley or Dodd-Frank Acts. The company defends on the grounds that under the Rules it has the absolute right to terminate the lawyer for any reason, or no reason at all. Federal courts facing this issue have made short work of such a defense under a Supremacy Clause[53] analysis. They have simply held that federal whistleblower protection statutes control over state ethics rules.[54]

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If the whistleblower does not rely on the express protections of a federal statute such as Sarbanes-Oxley, however, the case may be more difficult. In *Douglas v. Dyn McDermott Petroleum Operations*,[55] fired in-house counsel sued for retaliatory discharge under the Civil Rights Act of 1866[56] and won a substantial jury verdict. But the Fifth Circuit reversed, determining that the in-house lawyer's disclosure of confidential information in violation of ethical rules was not protected under § 1981.

State Law Protections for External Whistleblowing

The analysis is more complicated when the fired in-house lawyer relies on state anti-retaliation law. Courts faced with such a claim must analyze whether the state policy that favors protection of whistleblowers controls over state ethics rules permitting clients to fire their lawyer for any reason or no reason.

As of the date of this article, the are no reported appellate cases applying any of the Colorado statutes protecting whistleblowers cited above to in-house counsel. Thus it is uncertain whether the Rules fall within the exception to the State Employee Protection Act or the Private Enterprise Employee Protection Act for information that is "confidential under any other provision of law."[57] Cases from other states vary in their analyses of similar statutes and similar ethical rules.

In *Pang*, the Utah Supreme Court held that the ethical requirement of reporting up the ladder within a company did not override the state's employment-at-will doctrine. However, *Pang* expressly stated that this did not mean that *all* ethical rules were subordinate to the at-will employment doctrine.[58] *Pang* expressly left open, for example, whether permissive reporting outside the company to prevent a serious crime under Utah Rule 1.6 might qualify for protection.[59]

In *Balla v. Gambro*,[60] the Illinois Supreme Court held that an in-house lawyer did not have a claim for retaliatory discharge under Illinois' Whistleblower Protection Act. The Court held that because of the special place that in-house counsel hold in a company, they do not have protection from retaliatory discharge. The Court reasoned in part that the retaliatory discharge exception to the at-will employment doctrine was intended to encourage employees to come forward and report acts that contravene public policy. But because lawyers have an ethical obligation to report such acts under Illinois' version of Rule 1.6(b), however, in-house counsel could not take advantage of the Illinois statutory whistleblower protection.[61]

Perhaps reflecting a swing in public sentiment toward protecting whistleblowers, the Illinois intermediate appellate court later limited *Balla* in *Crowley v. Watson*.[62] There, the court affirmed a jury verdict for a fired in-house lawyer on his claim for retaliatory discharge because the in-house lawyer's duties were primarily administrative, not legal.[63]

In *Crandon v. State*,[64] the Kansas Supreme Court summarily affirmed the dismissal of a former in-house counsel's wrongful discharge claim. The court quoted, then affirmed, the order on summary judgment:

> Mr. Dunnick was well within his discretion to end a public and professional relationship [that] Ms. Crandon had completely and inappropriately destroyed without fear of legal recourse by Ms. Crandon.[65]

In *Heckman v. Zurich Holding Co. of America*,[66] a federal court applying Kansas law rejected the defendant's reading of *Crandon* as prohibiting all claims for retaliatory discharge by a fired in-house counsel. "The Court finds nothing in Crandon which suggests that Kansas courts would refuse to allow in-house counsel to maintain retaliatory discharge claims."[67]

Finally, the California Supreme Court determined that a company did not have unfettered discretion to fire in-house counsel under California law in *General Dynamics Corp. v. Superior Court*.[68] There, in response to a claim for retaliatory discharge brought by former in-house counsel, General Dynamics filed a demurrer arguing that the official comment to Rule 1.2 means what it says: A client can fire a lawyer at any time for any or no reason.[69] The court disagreed and held that, under proper circumstances, the company's conduct can create the reasonable expectation that the lawyer would not be fired without cause. Further, if an amended complaint alleged the attorney was fired in retaliation for following a mandatory ethical obligation, a claim would exist on that basis.[70]

Remedies

Unlike the courts' varied approaches to liability, there seem to be a general consensus regarding remedies. In cases where an in-house lawyer proves wrongful discharge, courts generally award monetary damages. There are numerous cases allowing not just lost past and future wages, but punitive damages as well.[71]

In *Cage v. Harper*,[72] the former general counsel of Chicago State University sued the school alleging wrongful termination for being a whistleblower both under 42 USC § 1983 and the Illinois Ethics Act. School regulations provided that, in the event of termination, someone at

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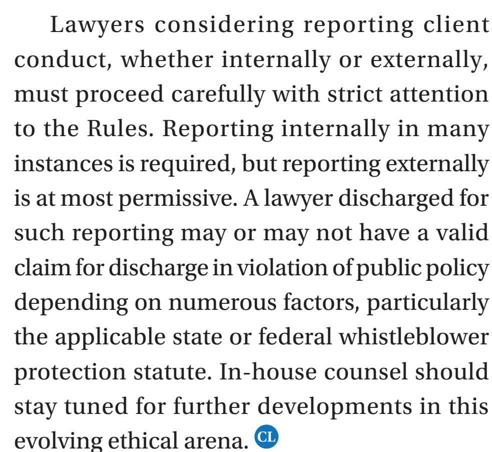

Cage's level of seniority was entitled to a year's notice and pay during that year. On a motion to dismiss under Fed. R. Civ. P. 12, the court ruled that Cage's federal claim was valid under § 1983. As a lawyer, although he could be terminated for any reason or no reason, Cage was still entitled to his one-year notice and payment during that period.[73]

Reinstatement is another matter. Even an in-house attorney who prevails in a wrongful discharge suit generally cannot obtain reinstatement for the simple reason that that client gets to choose the lawyer.[74] However, in one case involving a Kansas state government attorney, the door was left open to reinstatement, at least at the pleading stage, in the event the discharged in-house counsel prevailed in his claim for wrongful discharge.[75]

Conclusion

Just a short time ago, it was unthinkable that an in-house counsel would have a claim for wrongful discharge for any reason, let alone for reporting client conduct outside the organizational client. Recent developments in the law, however, have swung the pendulum away from the client's absolute right to choose counsel as an ethical matter and toward protection of whistleblowers.

Lawyers considering reporting client conduct, whether internally or externally, must proceed carefully with strict attention to the Rules. Reporting internally in many instances is required, but reporting externally is at most permissive. A lawyer discharged for such reporting may or may not have a valid claim for discharge in violation of public policy depending on numerous factors, particularly the applicable state or federal whistleblower protection statute. In-house counsel should stay tuned for further developments in this evolving ethical arena. CL

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