TENSION AMONG SECTION 307 OF THE SARBANES-OXLEY ACT OF 2002, 17 C.F.R. § 205.3(d)(2), AND STATE RULES GOVERNING DISCLOSURE OF CONFIDENTIAL CLIENT INFORMATION

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I. INTRODUCTION

In response to the financial collapses of a number of large, publicly-owned corporations,[1] Congress passed the Sarbanes-Oxley Act of 2002 ("Act"),[2] which radically changed the relationship between the American corporate world and the United States government.[3] The Act created enhanced criminal penalties for a variety of white-collar crimes,[4] increased the types of financial disclosures certain types of companies must make,[5] and created new rules requiring the independence of financial auditors of certain types of companies.[6] In part, the Act was enacted to prevent future accounting irregularities like those uncovered during investigations following the well-publicized collapses of Enron,[7] WorldCom, Tyco, ImClone, Global Crossing, Sunbeam, and Adelphia.[8] Most of the public financial collapses occurred in late 2000 and early 2001.[9] President George

1. *See* R. William Ide, *Post-Enron Corporate Governance Opportunities: Creating a Culture of Greater Board Collaboration and Oversight*, 54 MERCER L. REV. 829, 829-32 (2003) (providing a thumbnail sketch of the reasons for the Sarbanes-Oxley Act of 2002).

2. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C. (Supp. II 2002)).

3. *See infra* notes 10-14 and accompanying text.

4. *See* Sarbanes-Oxley Act of 2002 §§ 902-906 (codified in scattered sections of 18 and 29 U.S.C.).

5. *See id*. §§ 401-409 (codified in scattered sections of 15 U.S.C.).

6. *See id*. §§ 201-206 (codified in scattered sections of 15 U.S.C.).

7. *See generally* Michael L. Fox, *To Tell or Not to Tell: Legal Ethics and Disclosure After Enron*, 2002 COLUM. BUS. L. REV. 867, 870-85 (2002) (outlining Enron's demise); Marianne M. Jennings, *A Primer on Enron: Lessons from* A Perfect Storm *of Financial Reporting, Corporate Governance and Ethical Culture Failures*, 39 CAL. W. L. REV. 163, 167-97 (2003) (same).

8. *See* Stephen M. Bainbridge, *The Tournament at the Intersection of Business and Legal Ethics*, 1 U. ST. THOM. L.J. (forthcoming 2004) (manuscript at 2, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=429304) (identifying the impetus of the Act as the financial scandals that rocked these companies at the turn of the century); Yaniv Grinstein, *Complementary Perspectives on "Efficient Capital Markets, Corporate Disclosure, and Enron*,*"* 89 CORNELL L. REV. 503, 510 (2004) (same).

9. Stephanie R.E. Patterson, *Section 307 of the Sarbanes-Oxley Act: Eroding the Legal Profession's System of Self-Governance?*, 7 N.C. BANKING INST. 155, 159 n.25

W. Bush called the collection of laws in the Act "the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt."[10] In President Bush's words, in the post-Sarbanes-Oxley world "no boardroom in America [would be] above or beyond the law."[11] The Act created a federal accounting board to oversee the audit of public companies subject to federal securities laws,[12] enhanced criminal penalties for individuals impeding or obstructing "the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case,"[13] and criminalized a broad class of fraudulent practices connected with the issuance of securities.[14]

The Act was drafted and passed swiftly. The bill that evolved into the Act was first introduced in the House of Representatives on February 14, 2002.[15] The final version of the Act passed both houses of Congress in July 2002 with ease: 99-0 in the Senate and 423-3 in the House.[16] President Bush signed the Act into law on July 30, 2002.[17] The total legislative history for the Act comprises less than six months.

A. *Section 307 of the Sarbanes-Oxley Act of 2002*

This Note addresses the potential impact of the problematic regulations promulgated by the Securities Exchange Commission (SEC) in

(2003) (citations omitted).

10. Mike Allen, *Bush Signs Corporate Reforms into Law*, WASH. POST, July 31, 2002, at A4.

11. *Id.*

12. Sarbanes-Oxley Act of 2002 § 101 (codified at 15 U.S.C. § 7211 (Supp. II 2002)).

13. *Id.* § 802 (codified at 18 U.S.C. § 1519). Note that an individual need not even be accused of impeding an investigation focused on suspected violations of federal securities law to fall under the auspices of this section. *See id.*

14. *See id.* § 807 (codified at 18 U.S.C. § 1348) (criminalizing a broad class of schemes resulting in the defrauding of a person in connection with certain types of securities and obtaining by "false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale" of certain types of securities).

15. H.R. REP. NO. 107-807, pt. 9, at 114 (2003), *reprinted in* 2002 U.S.C.C.A.N. 747, 804.

16. 148 CONG. REC. H5480 (daily ed. July 25, 2002) (Roll Call Vote No. 348); 148 CONG. REC. S7365 (daily ed. July 25, 2002) (Roll Call Vote No. 192). Representatives Flake from Arizona, Collins from Georgia, and Paul from Texas voted against the measure. CONG. REC. H5480 (Roll Call Vote No. 348).

17. *See* Sarbanes-Oxley Act of 2002 § 307 (codified at 15 U.S.C. § 7245).

response to section 307 of the Act. Section 307 required the SEC to issue rules establishing "minimum standards of professional conduct for attorneys appearing and practicing before the [SEC] in any way in the representation of issuers."[18] Section 307 further required the SEC to draft a rule "requiring an attorney to report evidence of a material violation of securities law[19] 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)."[20] Additionally, section 307 directs the SEC to require an attorney to report evidence of such a violation or breach "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" if the "counsel or officer [did] not appropriately respond to the evidence" reported by the attorney.[21]

These standards, issued "in the public interest and for the protection of investors,"[22] required, "'for the first time, that counsel inform senior officials of corporate misdeeds.'"[23] However, nothing in section 307, or elsewhere in the Act, empowers the SEC to draft regulations allowing or requiring disclosure of confidential client information by an attorney to the SEC if the attorney became aware of a material violation of a securities law. Thus, despite the fact that section 307 was to "'[make] sure [attorneys practicing before the SEC] . . . don't violate the law and, in fact, more importantly, ensure that the law is being followed,'"[24] the plain language of the Act does not give the SEC authority to either compel or offer attorneys the option to disclose confidential information to aid the SEC in reaching that end.

18. *See id.*

19. A "material violation" is "a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law." 17 C.F.R. § 205.2(i) (2004).

20. Sarbanes-Oxley Act of 2002 § 307(1) (codified at 15 U.S.C. § 7245(1)); *see also* 17 C.F.R. § 205.3(b)(1) (implementing section 307(1)).

21. Sarbanes-Oxley Act of 2002 § 307(2) (codified at 15 U.S.C. § 7245(2)); *see also* 17 C.F.R. § 205.3(b)(3) (implementing section 307(2)).

22. Sarbanes-Oxley Act of 2002 § 307 (codified at 15 U.S.C. § 7245).

23. Fox, *supra* note 7, at 889 (quoting John Caher, *Corporate Reform Bill Means Changes in Client Relations*, N.Y.L.J., July 29, 2002, at 1).

24. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71,670, 71,673 n.27 (Dec. 2, 2002) (quoting 148 CONG. REC. S6552 (daily ed. July 10, 2002)) (statement of Sen. John Edwards, co-sponsor of section 307).

Section 307 afforded the SEC only 180 days from the enactment of the Act to produce the required regulations.[25] The speed with which the Act was legislated coupled with the speed with which the resulting regulations were promulgated only heightens suspicion that the language chosen by Congress in section 307 is not as precise as it could (or should) have been.[26] The complexity of the subject matter section 307 addresses in such brevity (the section is only 167 words long)[27] will likely only aggravate the ambiguities and imprecision highlighted in this Note.

B. *SEC Regulations Promulgated in Response to Section 307*

The SEC first proposed regulations to implement section 307 on November 6, 2002,[28] only 99 days after passage of the Act. Several law firms, bar associations, and other organizations submitted comments to the proposed rules.[29] The heavily revised final rules were issued on February 6, 2003, and became effective on August 5, 2003.[30] The resulting final rules were codified in 17 C.F.R. part 205.[31] Broadly speaking, part 205 creates a framework regarding to whom and what an attorney must disclose when she becomes aware of or suspects a material violation of federal securities

25. Sarbanes-Oxley Act of 2002 § 307 (codified at 15 U.S.C. § 7245).

26. *See* Letter from Alfred P. Carlton, Jr., President, American Bar Association, to Jonathan G. Katz, Secretary, Securities and Exchanges Commission 6 (Dec. 18, 2002), *at* http://www.abanet.org/buslaw/committees/CL410000pub/comments/20021218000000.pdf [hereinafter ABA Letter] (expressing concern "that adequate time has not been allowed to comment upon" rules "that are not specifically mandated by Section 307").

27. *See* Sarbanes-Oxley Act of 2002 § 307 (codified at 15 U.S.C. § 7245).

28. Press Release No. 2002-158, SEC, SEC Proposes Rules to Implement Sarbanes-Oxley Act Provisions Concerning Standards of Professional Conduct for Attorneys (Nov. 6, 2002), *available at* http://sec.gov/news/press/2002-158.htm.

29. *See* SEC, Comments on Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, *at* http://sec.gov/rules/proposed/s74502.shtml (last modified Apr. 22, 2004).

30. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6295, 6296 (Feb. 6, 2003). Notably absent from the final rules were the controversial "noisy withdrawal" rules, which dominated the comments submitted to the SEC. The SEC has continued to consider noisy withdrawal rules. *See id.*; Mary S. Diemer, *SEC Continues Considering Mandatory "Noisy Withdrawal" Rules*, LITIG. NEWS (ABA Section of Litigation, Chicago, Ill.), Sept. 2003, at 1, 3 (noting the SEC's support of permissive withdrawal rules, but desire for further commentary on "noisy withdrawal" rules).

31. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296, 6320-23 (codified at 17 C.F.R. pt. 205).

law.[32] Depending on the circumstances, an attorney may be required by part 205 to report evidence of a violation to the chief legal officer of an issuer client,[33] the chief executive officer and the chief legal officer of the issuer,[34] or the audit committee of the issuer's board of directors.[35] The SEC also created regulations allowing an attorney to disclose evidence of material violations to the SEC without first consulting the client.[36]

The SEC has long held the ability to *discipline* attorneys to "protect its processes and ensure the competence of professionals" appearing and practicing before it.[37] However, the SEC has never, before section 307, "had express statutory authority to promulgate a rule establishing standards of conduct for attorneys representing issuers."[38] That is, even before section 307, the SEC could punish attorneys' misconduct before the SEC, but it could not regulate other types of attorney conduct. This Note addresses whether section 307 gave the SEC the authority to regulate the latter, particularly in light of the long-standing power of the states to govern the conduct of attorneys practicing within their borders.

II. REQUIREMENTS OF THE FINAL RULES

Not all attorneys are governed by part 205,[39] and not all information related to the representation of a client may be disclosed without client consent.[40] Thus, an overview of part 205 is crucial to illustrate what

32. *See* 17 C.F.R. §§ 205.3-.6 (2004).

33. *Id.* § 205.3(b)(1).

34. *Id.*

35. *Id.* § 205.3(b)(3)(iii).

36. *See id.* § 205.3(d)(2).

37. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71,670, 71,671 (Dec. 2, 2002); *see* SEC Rule of Practice 102(e)(1) (2004) (codified at 17 C.F.R. § 201.102(e)(1)) (allowing the SEC to discipline professionals who have engaged in "unethical or improper professional conduct" by failing to satisfy the rules, regulations, or standards to which they are subject, which includes "applicable professional standards"). Note, however, that Rule of Practice 102(e) only allows the SEC to "censure a person or deny . . . the privilege of appearing and practicing before it in any way" to persons who engage in the conduct prohibited by Rule 102(e). *Id.* Rule of Practice 102(e) confines its impact, however, to who may practice or appear before the SEC and does not, as 17 C.F.R. § 205.3(d)(2) purports to do, tell attorneys what information of their clients' they can and cannot disclose to the SEC.

38. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,671.

39. *See* 17 C.F.R. § 205.2(c) (defining attorneys affected by part 205).

40. *See id*. § 205.3(d)(2) (identifying information that may be disclosed).

information, possessed by which attorneys, practicing in which circumstances, are impacted by the disclosure rules in part 205. More attorneys are affected by part 205 than appear at first blush, even attorneys whose practices only tangentially brush securities issues.[41]

A. *Scope of the Regulations*

Part 205 governs the conduct of individuals defined by part 205 as attorneys[42] who appear and practice before the SEC in the representation[43] of an issuer[44] and become aware of a "material violation of an applicable . . . federal or state securities law, a material breach of fiduciary duty arising under . . . federal or state law, or a similar material violation of any . . . federal or state law"[45] "by the issuer or by any officer, director, employee, or agent of the issuer."[46] Such an attorney must appear and practice before the SEC in the context of providing legal services to an issuer with which the attorney has an attorney-client relationship.[47]

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41. *See* discussion *infra* Part II.A–B.

42. *See* 17 C.F.R. § 205.2(c) (defining an "attorney" as "any person who is admitted, licensed, or otherwise qualified to practice law in any jurisdiction, domestic or foreign, or who holds himself or herself out as admitted, licensed, or otherwise qualified to practice law"). This broad language thus includes an attorney who is neither an expert in securities law nor holds herself out to be such an expert. *See id.*

43. *See id.* § 205.2(g) (defining "in the representation of an issuer" as "providing legal services as an attorney for an issuer, regardless of whether the attorney is employed or retained by the issuer").

44. An "issuer" is

> an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 781), or that is required to file reports under section 15(d) of that Act (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a *et seq*.), and that it has not withdrawn, but does not include a foreign government issuer.

Id. § 205.2(h). However, if an attorney provides services to "any person controlled by an issuer, where an attorney provides legal services to such person on behalf of, or at the behest, or for the benefit of the issuer, regardless of whether the attorney is employed or retained by the issuer," the attorney still appears and practices before the SEC, and those services are services rendered in the representation of the issuer itself for part 205 purposes. *Id.*; *id.* § 205.2(a), (g).

45. *Id.* § 205.2(i).

46. *Id*. § 205.3(b)(1).

47. *Id.* § 205.2(a)(2)(i).

An attorney appears and practices before the SEC in one of four ways.[48] First, an attorney meets this requirement by transacting any business with the SEC, including communicating with the SEC in any form.[49] Second, an attorney meets this requirement by "[r]epresenting an issuer in [an SEC] administrative proceeding or in connection with [an SEC] investigation, inquiry, information request, or subpoena."[50] Third, an attorney appears and practices before the SEC by providing advice regarding United States securities laws or the SEC's rules or regulations concerning

> any document that the attorney has notice will be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the [SEC], including the provision of such advice in the context of preparing, or participating in the preparation of, any such document . . . .[51]

Fourth, an attorney appears and practices before the SEC by

> [a]dvising an issuer as to whether information or a statement, opinion, or other writing is required under the United States securities laws or the [SEC's] rules or regulations thereunder to be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the [SEC] . . . .[52]

This language thus provides that any attorney, even one who does not specialize in securities law or never physically appears before the SEC, falls under its regulations for professional conduct if the attorney does so much as advise a client of the content requirements of a single securities law,[53] or communicates with the SEC in any way.[54]

The breadth of part 205 is broader than it might first appear. Instead of merely governing the conduct of securities specialists deeply involved

48. *Id.* § 205.2(a)(1).
49. *Id.* § 205.2(a)(1)(i).
50. *Id.* § 205.2(a)(1)(ii).
51. *Id.* § 205.2(a)(1)(iii).
52. *Id.* § 205.2(a)(1)(iv).
53. *Id.* Noticeably absent from the SEC's definition are an educational requirement (*e.g.*, that the attorney must be educated in securities laws) or a jurisdictional requirement (*e.g.*, that the attorney must physically appear before or directly communicate with the SEC or actively participate in an investigation or inquiry) that the attorney must meet before falling under the SEC's rules.
54. *Id.* § 205.2(a)(1)(i).

with the inner workings of issuer corporations, part 205 governs the conduct of a single practitioner—with limited securities experience—who drafts a document that is later incorporated into an SEC filing.

B. *External Notification of Material Violations: Optional Disclosure of Confidential Client Information to the SEC Without Client Consent*

Nested within part 205 is a regulation that allows attorneys appearing and practicing before the SEC to disclose certain types of confidential client information to the SEC without first consulting the client.[55] This regulation is in direct contravention with a variety of state rules governing attorney conduct.[56] Before addressing what information states' professional conduct rules *prohibit*, it is helpful to understand what information part 205 *allows* an attorney to disclose.

There are three types of confidential information[57] an attorney appearing and practicing before the SEC may reveal.[58] First, an attorney may disclose information the attorney reasonably believes necessary[59] "[t]o prevent an issuer from committing a violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors."[60] Second, an attorney may also release information the attorney

55. *Id.* § 205.3(d)(2).

56. *See infra* notes 68-74 and accompanying text;

57. Part 205 fails to define "confidential information." Confusion as to what information may be disclosed is entirely predictable because states define confidential information differently. *Compare* IOWA CODE OF PROF'L CONDUCT DR 4-101(A), (B)(1) (2004) (prohibiting an attorney from disclosing "information protected by the attorney-client privilege under applicable law" and "other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client"), *with* TEX. RULES OF PROF'L RESPONSIBILITY R. 1.05(a) (2004) (defining confidential information as "information of a client protected by the lawyer-client privilege of Rule 503 of the Texas Rules of Evidence or of Rule 503 of the Texas Rules of Criminal Evidence or by the principles of attorney-client privilege governed by Rule 501 of the Federal Rules of Evidence" and "information relating to a client or furnished by the client, other than privileged information, acquired by the lawyer during the course of or by reason of the representation of the client").

58. *See* 17 C.F.R. § 205.3(d)(2) (identifying information that may be disclosed).

59. The subjective standard within this and other sections of part 205 has caused considerable debate. *See, e.g.*, ABA Letter, *supra* note 26, at 16-18 (criticizing the subjective triggering mechanism used to compel or provide the option for the attorney to disclose crucial information that the client expects to be kept secret).

60. 17 C.F.R. § 205.3(d)(2)(i).

believes necessary to prevent an issuer from committing perjury,[61] suborning perjury,[62] or committing an act in violation of 18 U.S.C. § 1001[63] that is likely to perpetrate a fraud upon the SEC during an SEC investigation or administrative proceeding.[64] Finally, an attorney may disclose otherwise confidential information if the attorney reasonably believes disclosure will remedy "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."[65]

Because each state regulates the types of confidential information an attorney may disclose and the circumstances in which such information may be disclosed, generation of rules by the SEC that allow an attorney to disclose confidential information creates a potential conflict between the SEC's regulations and various states' rules of professional conduct.[66] The situation is particularly problematic in the absence of an explicit congressional mandate authorizing the SEC to draft rules that would grant attorneys permission to disclose confidential information in the manner the SEC ultimately provided.[67] Commentators to the SEC's proposed rules, which contained essentially the same optional disclosure regulation,[68]

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61. *See* 18 U.S.C. § 1621 (2000) (describing perjury).

62. *See id.* § 1622 (criminalizing the practice of procuring another to commit perjury).

63. *See id.* § 1001. Section 1001 criminalizes a broad class of misrepresentations and omissions in a person's statements and representations to the federal government. *Id.*

64. 17 C.F.R. § 205.3(d)(2)(ii).

65. *Id.* § 205.3(d)(2)(iii).

66. *Compare id*. § 205.3(d) (allowing disclosure of confidential information when, for example, an attorney is aware of a client's material breach of a securities law), *with* IOWA CODE OF PROF'L RESPONSIBILITY DR 4-101 (2004) (containing no such exception).

67. *See* Sarbanes-Oxley Act of 2002 § 307 (codified at 15 U.S.C. § 7245) (Supp. II 2002). Indeed, under basic preemption principles, if Congress granted the SEC explicit authority to promulgate such rules, the SEC's rules would trump any state rules to the contrary. *See* discussion *infra* Part IV.A.

68. *See* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71,670, 71,692 (proposed Dec. 2, 2002) (codified at 17 C.F.R. pt. 205). The proposed rules allowed disclosure in the following circumstances:

> (i) To prevent the issuer from committing an illegal act that the attorney reasonably believes is likely to result in substantial injury to the financial interest or property of the issuer or investors;
>
> (ii) To prevent the issuer from committing an illegal act that the attorney

identified this tension, arguing that the disclosure provision "conflicts with, and would (in their eyes impermissibly) preempt, the rules of professional conduct of certain jurisdictions."[69] One commentator realized that it would be unsurprising if one or more states eventually refuse to afford part 205 preemptive power, "leaving those attorneys that rely on the Commission's statements in the Proposing Release concerning the preemptive effect of its rules allowing . . . disclosure of confidential information to the Commission in serious difficulty in disciplinary and civil liability contexts."[70]

Indeed, many jurisdictions have rules barring the same disclosures part 205 permits, particularly with respect to client misconduct that has occurred in the past.[71] However, in both its proposed and final rules, the SEC noted that the majority of states allow for disclosure of the type contemplated by the SEC's regulations.[72] Commentators to the proposed rule suggested the SEC make it clear that section 205.3(d)(2) supplements, and does not preempt, existing state rules prohibiting disclosure of confidential client information.[73] The SEC failed to do this; instead, it

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> reasonably believes is likely to perpetrate a fraud upon the Commission; or
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> (iii) To rectify the consequences of the issuer's illegal act in the furtherance of which the attorney's services had been used.

Id.

69. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296, 6310 (Feb. 6, 2003); *see also id.* n.94 (identifying commentators that argued that the proposed disclosure provisions would impermissibly preempt applicable state ethics rules).

70. Letter from the law firm of Schiff Hardin & Waite, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Dec. 18, 2002), *available at* http://sec.gov/rules/proposed/s74502/ schiffhardin1.htm.

71. *Compare* 17 C.F.R. § 205.3(d)(2) (2004) (allowing disclosure in certain situations), *with infra* Part III.B (discussing states that bar such disclosures).

72. *See* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,692 (stating the SEC's proposed rules "[correspond] to the ABA's Model Rule 1.6 . . . as adopted in the vast majority of states"); Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6310 n.92 (stating that thirty-seven states' rules "permit an attorney to reveal confidential client information in order to prevent the client from committing criminal fraud"). In its final rules, the SEC noted that ABA Model Rule 1.6, which prohibits disclosure to *prevent* criminal fraud, is only a minority rule. *Id.* *See* discussion *infra* Part III.A (discussing disclosure exceptions under Model Rule 1.6). Of course, in its *proposed* rules, the SEC said no such thing. *Compare* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6310 n.92, *with* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71,692.

73. *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6311.

summarily stated that the conflict between state rules prohibiting disclosure and part 205 is "unlikely to arise in practice."[74]

Even assuming part 205 preempts applicable state ethics rules, part 205 could actually be counterproductive to its goal of ferreting out evidence of illegal actions of corporate clients. For example, part 205 may chill communication between corporate executives and attorneys, or even worse, encourage attorneys to turn a blind eye to material violations[75] because an attorney need only report problems of which he "becomes aware."[76] As a result, a "rational lawyer has yet another rationale for closing his eyes to potential misconduct."[77]

III. TENSION BETWEEN 17 C.F.R. § 205.3(d)(2) AND STATE ATTORNEY CONDUCT RULES

Because part 205 is new, its preemptory effect has yet to be litigated. However, if an attorney concludes (and a court with jurisdiction concurs) that part 205 preempts state attorney conduct rules, an attorney may release confidential client information to the SEC without risk of penalty.

Before a court rules, the potentially preemptive nature of part 205 poses difficulties for attorneys appearing and practicing before the SEC with knowledge of client conduct of the type part 205 would allow an attorney to disclose. In fact, before the final rules were drafted, the ABA expressed discomfort with potential disclosure in light of a "nonwaiver of attorney-client privilege, . . . a critical element of requiring or permitting . . . disclosure, [which] would put both attorneys and clients at risk."[78]

A. *Requirements of the Model Rules and the Model Code*

The ABA's *Model Rules of Professional Conduct* provide a

74. *Id.*

75. *See generally*, Bainbridge, *supra* note 8, at 12-16 (applying tournament theory to corporate law firms, arguing that financial and networking incentives that exist for an attorney to stay with a firm outweigh the negative impact the reporting of a material violation would likely have on that attorney's career).

76. *Id.* at 15 (citing 17 C.F.R. § 205.3(b)(1)(2004)).

77. *Id.*

78. ABA Letter, *supra* note 26, at 6; *see also* Letter from Frederick D. Lipman, Blank Rome Comisky & McCaulley, LLP, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Nov. 27, 2002) *available at* http://www.sec.gov/rules/proposed/s74502/fdlipman1.htm [hereinafter Lipman Letter] (arguing that "[t]he SEC has clearly used Section 307 to advance its own agenda, not the agenda of the U.S. Senate").

foundation from which many states pattern their ethics rules. The ABA's *Model Code of Professional Responsibility* is a parallel set of rules predating the Model Rules. Although the Model Rules and Model Code are non-binding, they provide a framework for many states' rules of professional conduct.[79] Both sets of rules permit attorneys to disclose confidential client information without consent in certain situations, but they differ in the circumstances where disclosure is permitted.[80]

Model Rule 1.6 identifies situations where an attorney may disclose confidential client information without client consent.[81] Rule 1.6(a) provides that an attorney "shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b)."[82] Rule 1.6(b) was amended in August 2003 to allow a lawyer to

> reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary . . . to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services; . . . to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services; . . . [or] to comply with other law or a court order.[83]

Thus, Rule 1.6(b) permits disclosure of some of the same information part 205 also allows to be disclosed: information that could harm the financial position of another that is not necessarily the attorney's client.[84] However, even the Model Rules recognize a potential preemption problem if a law were to require disclosure. Comment 12 to Rule 1.6 states that

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79. *See, e.g.*, IOWA CODE OF PROF'L RESPONSIBILITY DR 4-101 (2004) (modeled after MODEL CODE OF PROF'L RESPONSIBILITY DR 4-101 (1980)); ILLINOIS RULES OF PROF'L CONDUCT R. 1.6 (2004) (modeled after MODEL RULES OF PROF'L CONDUCT R. 1.6 (2004)).

80. *Compare* MODEL RULES OF PROF'L CONDUCT R. 1.6, *with* MODEL CODE OF PROF'L RESPONSIBILITY DR 4-101.

81. MODEL RULES OF PROF'L CONDUCT R. 1.6(b).

82. *Id.* R. 1.6(a).

83. *Id.* R. 1.6(b).

84. *See id.*

> [o]ther law may require that a lawyer disclose information about a client. Whether such a law supersedes Rule 1.6 is a question of law beyond the scope of these Rules. When disclosure of information relating to the representation appears to be required by other law, the lawyer must discuss the matter with the client to the extent required by Rule 1.4. If, however, the other law supersedes this Rule and requires disclosure, paragraph (b)(6) permits the lawyer to make such disclosures as are necessary to comply with the law.[85]

It is clear from comment 12 that the drafters passed on the question of whether a law requiring disclosure of confidential information would trump a permissive disclosure rule like Rule 1.6. That is, if a law *required* disclosure, Rule 1.6(b)(6) would *allow* disclosure,[86] but is unclear about whether disclosure would similarly be *required*. In other words, the Model Rules do not state whether preemption would actually occur.

The Model Code permits disclosure in more situations than the Model Rules, allowing an attorney to disclose "[t]he intention of [a] client to commit a crime and the information necessary to prevent the crime."[87] Thus, the Model Code, like part 205, permits disclosures in situations where a material violation of a securities law would occur in the future, provided the violation constituted a crime.[88] However, even the Model Code does not allow some disclosures part 205 allows: the Model Code does not permit disclosures of past violations,[89] which part 205 expressly permits.[90]

B. *State Rules*

State rules governing when an attorney may choose to or is required to disclose information relating to the representation of a client are far from uniform. For example, some states *permit* lawyers to disclose information the lawyer reasonably believes will prevent criminal or

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85. *Id*. cmt. 12.

86. *See* MODEL RULES OF PROF'L CONDUCT R. 1.6(b) (2004) (stating that a "lawyer *may* reveal information relating to the representation of a client" in certain circumstances, including when a lawyer believes disclosure is needed "to comply with other law or a court order") (emphasis added).

87. MODEL CODE OF PROF'L CONDUCT DR 4-101(C)(3) (1980).

88. *Id*.

89. *Id.*

90. *See* 17 C.F.R. § 205.3(d)(2)(iii) (2004) (authorizing disclosure "[t]o rectify the consequences of a material violation by the issuer that *caused*" injury to the issuer or investors (emphasis added)).

fraudulent conduct that will result in financial harm,[91] while other states *require* disclosure of such information.[92] Other states' rules are ambiguous.[93] In a small number of states, future criminal conduct of a

91. ALASKA RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004); ARIZ. RULES OF PROF'L CONDUCT ER 1.6(d)(1) (2004); CONN. RULES OF PROF'L CONDUCT R. 1.6(c)(1) (2003); DEL. RULES OF PROF'L CONDUCT R. 1.6(b)(2) (2004); GA. RULES OF PROF'L CONDUCT R. 1.6(b)(1)(i) (2004); HAW. RULES OF PROF'L CONDUCT R. 1.6(c)(1) (1994); IDAHO RULES OF PROF'L CONDUCT R. 1.6(b)(3) (2004) (but only if the client uses the attorney's services in furtherance of the crime); ILL. RULES OF PROF'L CONDUCT R. 1.6(c)(2) (2002); LA. RULES OF PROF'L CONDUCT R. 1.6(b)(2) (2004); MD. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2002); MASS. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2002) (but note that Rule 4.1(b) would discipline an attorney for "fail[ing] to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act" because such disclosure is not *prohibited* by Rule 1.6); NEV. SUP. CT. R. 156(3)(a) (2001) (but only if the attorney's services are used to further the crime or fraud and only after the attorney attempts to persuade the client to take corrective action); N.H. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004); N.M. RULES OF PROF'L CONDUCT R. 16-106(C) (2003); N.D. RULES OF PROF'L CONDUCT R. 1.6(d) (2003); PA. RULES OF PROF'L CONDUCT R. 1.6(c)(1) (2002); TENN. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2002) (but note that an attorney may *not* reveal such information if the disclosure would violate Tennessee Rule of Professional Conduct 3.3); UTAH RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2002).

92. FLA. RULES OF PROF'L CONDUCT R. 4-1.6(b)(1) (2003) (requiring lawyer to reveal information to the extent necessary to "prevent a client from committing a crime"); ME. CODE OF PROF'L RESPONSIBILITY R. 3.6(b) (2002) (requiring an attorney to disclose any fraud a client has perpetrated upon any person or tribunal, unless the information the attorney would disclose is privileged); N.J. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004) (disclosure required to prevent a client "from committing a criminal, illegal or fraudulent act that . . . is likely to result in . . . substantial injury to the financial interest or property of another"); VA. RULES OF PROF'L CONDUCT R. 1.6(c)(1) (2004) (requiring an attorney to disclose the intention of a client "to commit a crime and the information necessary to prevent the crime," but only after attempting to dissuade the client from committing the crime); WIS. RULES OF PROF'L CONDUCT R. 20:1.6(b) (2004) (requiring an attorney to reveal information "necessary to prevent the client from committing a criminal or fraudulent act . . . likely to result in . . . substantial injury to the financial interests or property of another").

93. For example, some states allow an attorney to disclose *criminal* conduct, but do not address whether *non*-criminal conduct of a client that is likely to substantially harm the financial interest of others may be disclosed. Of course, if the attorney reasonably believes that *criminal* conduct would have the effect of harming the financial interests of others, attorneys in such states would be *permitted* to disclose confidential information. *See* ARK. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2002) (allowing disclosure "to prevent the client from committing a criminal act"); COLO. RULES OF PROF'L CONDUCT R. 1.6(b) (2003) (allowing an attorney to "reveal the intention of the . . . client to commit a crime and the information necessary to prevent the crime"); IND. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2003) (permitting disclosure "to prevent the client from committing any criminal act"); IOWA CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(3) (2004) (allowing an attorney to disclose "[t]he

client may only be disclosed if the conduct is likely to result in imminent death or serious bodily injury, thus disallowing the types of disclosures of future conduct by a client that part 205 allows.[94]

intention of the client to commit a crime and the information necessary to prevent the crime"); KAN. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004) (allowing disclosure of information reasonably believed to be necessary "[t]o prevent the client from committing a crime"); MICH. RULES OF PROF'L CONDUCT R. 1.6(c)(4) (2004) (permitting disclosure of "the intention of a client to commit a crime and the information necessary to prevent the crime"); MINN. RULES OF PROF'L CONDUCT R. 1.6(b)(3) (2004) (permitting an attorney to disclose "the intention of a client to commit a crime and the information necessary to prevent a crime"); MISS. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004) (permitting disclosure of confidential information the attorney reasonably believes necessary "to prevent the client from committing a criminal act"); NEB. CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(3) (2003) (allowing the "intention of the . . . client to commit a crime and the information necessary to prevent the crime" to be disclosed); N.Y. CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(3) (2002) (allowing a lawyer to disclose "[t]he intention of a client to commit a crime and the information necessary to prevent the crime"); N.C. RULES OF PROF'L CONDUCT R. 1.6(b)(2) (2002) (giving a lawyer the option of disclosing confidential information necessary to "prevent the commission of a crime by the client"); OHIO CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(3) (2003) (allowing disclosure of "[t]he intention of [a] client to commit a crime and the information necessary to prevent the crime"); OKLA. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004) (allowing an attorney "to disclose the intention of the client to commit a crime and the information necessary to prevent the crime"); OR. CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(3) (2003) (permitting disclosure of "[t]he intention of the lawyer's client to commit a crime and the information necessary to prevent the crime"); S.C. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004) (allowing disclosure "[t]o prevent the client from committing a criminal act"); TEX. DISCIPLINARY RULES OF PROF'L CONDUCT R. 1.05(c)(7) (2004) (allowing disclosure "[w]hen the lawyer has reason to believe it is necessary to do so in order to prevent the client from committing a criminal or fraudulent act"); VT. RULES OF PROF'L CONDUCT R. 1.6(c)(1) (2004) (allowing a lawyer to disclose "the intention of the client to commit a crime not likely to result in imminent death or substantial bodily harm and the information necessary to prevent the crime," but note that Rule 1.6(b)(2) *requires* a lawyer to reveal confidential information when the attorney reasonably believes that failing to disclose would "assist a criminal or fraudulent act by a client"); WASH. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004) (allowing disclosure "[t]o prevent the client from committing a crime"); W. VA. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004) (permitting disclosure "to prevent the client from committing a criminal act"); WYO. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004) (same). South Dakota allows disclosure only to prevent criminal conduct of a client that is likely to result in imminent death or serious bodily injury, thus *prohibiting* the type of disclosures part 205 permits. S.D. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004). However, if the conduct has *already occurred*, a South Dakota attorney may disclose. *Id.* R. 1.6(b)(3).

94. In Alabama, California, Kentucky, Missouri, and Rhode Island, confidential information may be disclosed to prevent the client from committing a criminal act likely to result in imminent death or substantial bodily injury. ALA. RULES

Some states permit an attorney to disclose confidential information to rectify the consequences of a client's commission of a crime or fraud using the lawyer's services,[95] while at least one state requires such disclosures.[96] There is further disagreement with respect to the number of specific situations where a lawyer may disclose such information.[97]

In some states, part 205 creates no conflict because the new regulations can be read harmoniously with existing state rules.[98] For

OF PROF'L CONDUCT R. 1.6(b)(1) (2004); CAL. RULES OF PROF'L CONDUCT R. 3-100(B) (2004); KY. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004); MO. RULES OF PROF'L CONDUCT R. 4-1.6(b)(1) (2004); R.I. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004). In Montana, an attorney may disclose confidential information to "prevent reasonably certain death or substantial bodily harm." MONT. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004). The implication of Montana's rule is that client conduct need not necessarily be criminal before it may be disclosed. *Compare id.*, *with e.g.*, ALA. RULES OF PROF'L CONDUCT R. 1.6(b)(2) (requiring conduct reasonably believed to cause imminent death or seriously bodily injury to also be criminal before it can be disclosed).

95. ARIZ. RULES OF PROF'L CONDUCT R. 1.6(d)(2); CONN. RULES OF PROF'L CONDUCT R. 1.6(c)(2); IDAHO RULES OF PROF'L CONDUCT R. 1.6(b)(3); MD. RULES OF PROF'L CONDUCT R. 1.6(b)(2); MICH. RULES OF PROF'L CONDUCT R. 1.6(c)(3); MINN. RULES OF PROF'L CONDUCT R. 1.6(b)(4); NEV. RULES OF PROF'L CONDUCT R. 156(3)(a) (allowing disclosure only after the lawyer "make[s] a reasonable effort to persuade the client to take corrective action" if practicable); N.J. RULES OF PROF'L CONDUCT R. 1.6(c)(1); N.C. RULES OF PROF'L CONDUCT R. 1.6(d)(5); N.D. RULES OF PROF'L CONDUCT R. 1.6(f) (unless prohibited by Rule 3.3(c)); OHIO CODE OF PROF'L RESPONSIBILITY DR 7-102(B)(1); OKLA. RULES OF PROF'L CONDUCT R. 1.6(b)(2) (permitting disclosure only if the lawyer has been unable to contact the client or has unsuccessfully attempted to persuade the client to rectify the crime or fraudulent act); PA. RULES OF PROF'L CONDUCT R. 1.6(c)(1); TEX. DISCIPLINARY RULES OF PROF'L CONDUCT R. 1.05(c)(8); UTAH RULES OF PROF'L CONDUCT 1.6(b)(2); VA. RULES OF PROF'L CONDUCT R. 1.6(b)(3) (allowing disclosure of "information which clearly establishes that the client has, in the course of the representation, perpetrated upon a third party a fraud related to the subject matter of the representation"); WIS. RULES OF PROF'L CONDUCT R. 20:1.6(c)(1).

96. HAW. RULES OF PROF'L CONDUCT R. 1.6(b); *see also* WIS. RULES OF PROF'L CONDUCT R. 20: 1.6(b) (requiring an attorney to disclose confidential information "the lawyer reasonably believes necessary to prevent the client from committing a criminal or fraudulent act that the lawyer reasonably believes is likely to result in . . . substantial injury to the financial interest or property of another").

97. *Compare*, *e.g.*, N.D. RULES OF PROF'L CONDUCT R. 1.6 (containing seven exceptions when an attorney may reveal information relating to the representation of a client), *with e.g.*, IOWA CODE OF PROF'L RESPONSIBILITY DR 4-101(C) (containing four such exceptions).

98. Marc I. Steinberg, *Lawyer Liability After Sarbanes-Oxley—Has the Landscape Changed?*, 3 WYO. L. REV. 371, 375-76 (2003). *But cf.* Jennifer Wheeler, *Securities Law: Section 307 of the Sarbanes-Oxley Act: Irreconcilable Conflict With the*

example, in Wisconsin, a lawyer must reveal information that the lawyer believes will "prevent the client from committing a criminal or fraudulent act that the lawyer reasonably believes is likely to result in . . . substantial injury to the financial interest . . . of another."[99] Disclosure is optional in Wisconsin "to rectify the consequences of a client's criminal or fraudulent act in the furtherance of which the lawyer's services had been used."[100] For contemplated crimes or fraudulent conduct, the Wisconsin rule allows for broader disclosure than part 205: a Wisconsin attorney must disclose more readily than an attorney governed solely by part 205 because Wisconsin requires disclosures in situations where part 205 only permits disclosure.[101] Additionally, part 205 *permits* disclosure when financial harm will occur to an *issuer* or *investor*.[102] Wisconsin's rules *require* disclosure if financial harm would occur to *others*.[103] Both rules allow disclosure of past conduct to rectify a past crime or fraud in furtherance of which the lawyer's services were used.[104]

Therefore, an attorney who appears before the SEC representing an issuer who will engage in future fraudulent or criminal conduct that would negatively impact the financial status of another would be required to disclose that conduct under applicable Wisconsin rules without invoking part 205. The two sets of rules can thus be read in harmony with one another.[105]

ABA's Model Rules and the Oklahoma Rules of Professional Conduct?, 56 OKLA. L. REV. 461, 480-85 (2003) (noting the absence of a conflict in Oklahoma because its applicable rules allow for disclosure in situations broader than part 205 contemplates).

99. WIS. RULES OF PROF'L CONDUCT R. 20:1.6(b) (2004).

100. *Id.* R. 20:1.6(c)(1).

101. *Compare id*. R. 20:1.6(b) (requiring disclosure if client's conduct is likely to cause substantial financial injury), *with* 17 C.F.R. § 205.3(d)(2)(i) (2004) (permitting disclosure of confidential information to prevent an issuer "from committing a material violation that is likely to cause substantial injury to the financial interest . . . of the issuer or investors").

102. 17 C.F.R. § 205.3(d)(2)(i).

103. WIS. RULES OF PROF'L CONDUCT R. 20:1.6(b).

104. *Id.* R. 20:1.6(c)(1); 17 C.F.R. § 205.3(d)(2)(iii).

105. Note, however, that Wisconsin does not have rules allowing for disclosure in situations analogous to those identified in 17 C.F.R. § 205.3(d)(2)(ii). *See* 17 C.F.R. § 205.3(d)(2)(ii) (allowing disclosure in certain circumstances to prevent the issuer from committing or suborning perjury or committing certain kinds of fraud). Contemplated future client perjury, for example, cannot be swept under the mandatory disclosure requirements of Wisconsin Rule 20:1.6(b). If the attorney does not believe disclosing past perjurious conduct of a client will rectify the harm done, past perjury does not even fall within the auspice of Wisconsin Rule 20:1.6(c). As a result, there is a disconnect between the Wisconsin rules and part 205 in this area.

Although the matter has yet to be litigated, attorneys in some states may disclose confidential information under provisions permitting disclosure if the attorney believes disclosure will comply with a law or court order, provided part 205 is classified as a law.[106] Other states allow for or require disclosure of confidential information only when *permitted* by applicable ethics rules or *required* by law or court order.[107] Attorneys practicing in states which permit (but do not require) disclosures to comply with a law or court order,[108] must be cautious before disclosing because part 205 does not *require* disclosure, it merely *permits* disclosure.[109]

Attorneys practicing in states that do not have rules allowing for the release of confidential information in circumstances part 205 allows face the most difficult of quandaries. Missouri, for instance, only allows disclosure without client consent in two limited circumstances, neither of which are analogous to the types of situations governed by part 205, and does not contain the (potential) catch-all "comply with other law" provision common in other states.[110]

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106. *See, e.g.*, GA. RULES OF PROF'L CONDUCT R. 1.6(d) (2004) (*requiring* disclosure "as the applicable law requires"); HAW. RULES OF PROF'L CONDUCT R. 1.6(c)(6) (1994) (*allowing* disclosure "[t]o comply with other law or court order"); KY. RULES OF PROF'L CONDUCT R. 1.6(b)(3) (2004) (same); MD. RULES OF PROF'L CONDUCT R. 1.6(b)(4) (2002) (permitting disclosure to comply with state rules of professional conduct, court order, or other law); TEX. DISCIPLINARY RULES OF PROF'L CONDUCT R. 1.05(c)(4) (2004) (same); VT. RULES OF PROF'L CONDUCT R. 1.6(c) (2004) (permitting disclosure when allowed by state ethics rules or required by law or court order); VA. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2004) (allowing disclosure "to comply with law or other court order").

107. *E.g.*, ILL. RULES OF PROF'L CONDUCT R. 1.6(c)(1) (2002); IOWA CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(2) (2004); MASS. RULES OF PROF'L CONDUCT R. 1.6(b)(4) (2002); MICH. RULES OF PROF'L CONDUCT R. 1.6(c)(2) (2004); MINN. RULES OF PROF'L CONDUCT R. 1.6(b)(2) (2004); NEB. CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(2) (2003); N.Y. CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(2) (2002); OHIO CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(2) (2002); OR. CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(2) (2003).

108. For example, attorneys in Illinois, Iowa, Minnesota, and Nebraska are of this type. *See* ILL. RULES OF PROF'L CONDUCT R. 1.6(c)(1); IOWA CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(2); MINN. RULES OF PROF'L CONDUCT R. 1.6(b)(2); NEB. CODE OF PROF'L RESPONSIBILITY DR 4-101(C)(2).

109. *See* 17 C.F.R. § 205.3(d)(2) (2004).

110. *See* MO. RULES OF PROF'L CONDUCT R. 4-1.6(a), (b)(1)-(2) (2002). Rule 4-1.6(a) states that an attorney may not reveal confidential information without consent unless the lawyer is impliedly authorized to do so to carry out the representation of a client, unless disclosure is allowed by Rule 4-1.6(b). *Id.* R. 4-1.6(a). Rule 4-1.6(b) identifies two situations in which an attorney may disclose confidential client information:

The conflict is particularly evident in Washington, where the Washington State Bar Association has already weighed in, arguing that part 205 simply does not permit disclosure of any confidential client information.[111] Washington rules do not permit disclosure under the circumstances contemplated in part 205.[112] In Washington, an attorney may only disclose confidential information without the client's permission if the client's conduct rises to the level of a crime; part 205 allows disclosure of conduct that does not necessarily rise to the level of a crime.[113] Further, Washington rules only permit disclosure to prevent the client from committing a crime in the future, whereas part 205 allows disclosure of

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> (1) to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm; or
>
> (2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client.

Id. R. 4-1.6(b).

111. Washington Bar Association Board of Governors, Interim Formal Ethics Opinion Re: *The Effect of the SEC's Sarbanes-Oxley Regulations on Washington Attorneys' Obligations Under the RPCs* 4-7 (July 26, 2003), *available at* http://www.wsba.org/lawyers/groups/ethics2003/formalopinion.doc [hereinafter Washington Interim Formal Ethics Opinion].

112. Applicable Washington ethics rules allow an attorney to reveal confidences or secrets relating to the representation of a client without consultation if necessary

> (1) To prevent the client from committing a crime; or
>
> (2) To establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, to respond to allegations in any proceeding concerning the lawyer's representation of the client, or pursuant to a court order.

WASH. RULES OF PROF'L CONDUCT R. 1.6(b) (2004). Disclosure is also allowed when the information would reveal a "breach of fiduciary responsibility by a client who is a guardian, personal representative, receiver, or other court appointed fiduciary." *Id.* R. 1.6(c).

113. Washington Interim Formal Ethics Opinion, *supra* note 111, at 5. *Compare* WASH. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (permitting disclosure of criminal conduct), *with* 17 C.F.R. § 205.3(d)(2)(i) (allowing disclosure if conduct is a "material violation").

both past and future crimes.[114] The Washington Bar Association argued that "to the extent that this SEC regulation authorizes but does not require revelation of client's confidences and secrets, the Washington lawyer cannot reveal such confidences and secrets unless authorized to do so under the Washington [rules]."[115]

Although part 205 may eventually be interpreted to preempt the Washington rules, "a cautious attorney should refrain from making any disclosures in violation of the Washington [rules] until this issue is resolved by the courts."[116] Interestingly, the Washington Bar did not decide this question because it determined applicable Washington rules and part 205 could be read to coincide with one another.[117] The Washington Bar Association concluded that "[s]ection 205(d)(2) states that a lawyer 'may reveal' confidential information but does not mandate a revelation [that] gives the lawyer discretion to determine whether to make a disclosure."[118] Under this reading, there is no conflict because part 205 disclosures are optional;[119] Washington's *prohibition* on disclosure (in some circumstances) that part 205 allows takes nothing away from a Washington attorney. The attorney may decide not to disclose and still be in compliance with both sets of regulations. This reading, however, renders part 205 impotent. By stating that part 205 *permits* disclosure, then noting the Washington rules do not allow disclosure, then concluding that no conflict exists between the two, the Washington Bar precludes an attorney from even *using* part 205, rendering it meaningless.

The Washington Bar also considered 17 C.F.R. § 205.6(c) in relation to applicable Washington rules. Section 205.6(c) reads: "An attorney who complies in good faith with the provisions of [part 205] shall not be subject to discipline or otherwise liable under inconsistent standards imposed by

114. *Compare* WASH. RULES OF PROF'L CONDUCT R. 1.6(b)(1), *with* 17 C.F.R. § 205(d)(2)(i), (iii).

115. Washington Interim Formal Ethics Opinion, *supra* note 111, at 5.

116. *Id.* at 6. In fact, only one court has cited either the proposed or final rules, and it did not discuss the optional disclosure provisions. *See* SEC v. Spiegel, Inc., No. CIV.A 03 C 1685, 2003 WL 22176223, at *44 (N.D. Ill. Sept. 15, 2003) (discussing the proposed rules' provisions for up-the-ladder reporting and the never-adopted "noisy withdrawal" proposals).

117. *See* Washington Interim Formal Ethics Opinion, *supra* note 111, at 5-7; *see also* S.C. RULES OF PROF'L CONDUCT R. 1.6 (2004) (comments following Rule 1.6 state that if there is a conflict between the rules and another provision of law, "a presumption should exist against such a supercession" but the question of supercession is "beyond the scope" of the South Carolina ethics rules).

118. Washington Interim Formal Ethics Opinion, *supra* note 111, at 7.

119. *See* 17 C.F.R. § 205.3(d)(2).

any state or other United States jurisdiction where the attorney is admitted or practices."[120] The Washington Bar concluded that an attorney could in good faith comply with part 205, because part 205 makes disclosure permissive.[121] Thus, an attorney that does not disclose information that part 205 contemplates, even if barred from doing so by state rules, would still comply with part 205. However, this reading also renders part 205 meaningless. Arguably, the Washington Bar's approach hardly resolves the conflict between the two sets of rules. The Washington Bar simply chose to interpret the two acts of rules so they do not conflict by making one rule unavailable.

The Florida Bar noted a potentially irreconcilable conflict between 17 C.F.R. §§ 205.3(d)(i) and 205(d)(iii) with applicable Florida bar rules.[122] Under Florida rules, "disclosure to rectify or correct a past violation is only permitted . . . in an active court or administrative proceeding before a tribunal," and is "limited to misrepresentations or omissions discovered while the attorney is still representing the client."[123] Under part 205, an attorney may disclose *any* past violation of the type identified in section 205.3(d)(2)(iii), without regard to whether the attorney was representing the client at the time the violation occurred.[124] Consequently, the restrictions on when a client's misconduct occurs present under Florida rules do not exist under part 205, making a broader array of information subject to disclosure under the SEC's regulations.

The Florida Bar concluded that "[s]ection 205.3[] will alter the lawyer-client landscape dramatically in Florida and most other states as well."[125] The SEC's encouragement of "the attorney to report to the commission any past conduct that has not been rectified even when the attorney is terminated from his engagement" would result in "a vast chilling effect on the lawyer-client relationship."[126] More importantly, "this direct conflict would subject a Florida attorney to discipline in one forum or another depending on which rule he or she decided to follow."[127]

120. 17 C.F.R. § 205.6(c).

121. Washington Interim Formal Ethics Opinion, *supra* note 111, at 6-7.

122. Letter from Tod Aronovitz, President of the Florida Bar Ass'n, & Ian M. Comisky, Board of Governors, to Jonathan G. Katz, Secretary, SEC (Apr. 7, 2003), *available at* http://www.sec.gov/rules/proposed/s74502/flbar040703.htm [hereinafter Aronovitz Letter].

123. *Id.*

124. *See* 17 C.F.R. § 205(d)(2)(iii).

125. Aronovitz Letter, *supra* note 122.

126. *Id.*

127. *Id.*

Florida attorneys are thus posed "with a Hobson's choice of discipline under SEC rules or potentially by state bars or other jurisdictions, depending on the choice the lawyer makes."[128] In fact, "[e]ven if the SEC moves to pre-empt the application of inconsistent state rules, it will still remain unclear whether an attorney will have full immunity from a client asserting a violation of common law fiduciary duty for choosing a duty to a governmental agency over loyalty to a client."[129] The prospect that a lawyer would be subject to discipline regardless of which set of rules she chooses to follow is indeed troubling.

The California Committee on Professional Responsibility and Conduct, a component of the California Bar Association, noted that "[t]he Commission rules requiring or permitting disclosure of corporate secrets outside the corporate structure . . . will necessarily subvert and turn on its head the relationship of trust between client and lawyer."[130] "[E]xtra-corporate disclosure of confidential client information[] would frustrate the lawyer's ability to acquire the information necessary to ensure compliance with the law . . . ."[131] The potential for such information to be disclosed allows "the client's trusted confidante, upon whom the client will rely to help it chart its way through complex legal thickets, [to] in the future turn on the client."[132] In the eyes of the California Bar, "[n]othing . . . could be more destructive of the attorney-client relationship."[133]

The conflict between part 205 and states whose rules bar part 205-type disclosures, or allow disclosures in situations different than those allowed by part 205, poses difficulties for attorneys governed by both sets

128. *Id.*

129. *Id.*

130. Letter from Kevin E. Mohr, Chair, Committee on Professional Responsibility & Conduct, California Bar Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission 3 (Apr. 4, 2002), *available at* http://www.sec.gov/rules/proposed/s74502/copracsbc040403.htm [hereinafter California Bar Letter].

131. *Id.*

132. *Id.*

133. *Id.* The California Bar Association actually equated a decree that permits a trusted legal advisor to reveal the client's confidential information to "saying that an issuer may not have a trusted legal advisor." *Id.* Although this is perhaps overstating the rule somewhat—since the disclosure is, after all, permissive—the point is clear. If the ability to disclose information rests squarely within the attorney's discretion, it reduces the likelihood that a client will share information that it even suspects constitutes a material violation, for fear that their counsel will disclose the information to the SEC.

of rules.[134] Rather than taking the Washington Bar Association's approach by pretending the two sets of regulations can be read harmoniously when in actuality stripping part 205 of power,[135] the better question is one of preemption because many states' rules and part 205 do, in fact, conflict. At its very core, the issue is whether the SEC was afforded power by section 307 of the Act to draft part 205.

IV. ANALYSIS

The preemption analysis for regulations of a federal administrative agency is different than for acts of Congress because the focus is not on whether Congress properly exercised legislative power, but on "whether the federal agency has properly exercised its own delegated authority."[136] Thus, there is no presumption against preemption, instead, the propriety of a federal agency's regulations turns on a determination of whether Congress conferred authority upon the agency.[137] Where an agency's choice to preempt "represents a reasonable accommodation of conflicting policies that were committed to the agency's care by statute," the agency's regulations will not be disturbed "unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned."[138] Thus, a two-pronged test has emerged. The first question is whether the federal agency actually attempted to preempt state law.[139] The second question is whether the agency acted with statutorily authorized power when attempting to preempt a state law or a state regulation.[140] There is little question the SEC attempted to preempt state law with part 205.[141] However, there is considerable room for argument on

134. *Contra* Jeffrey W. Stempel, *Lawyer Professional Responsibility, and a Heightened Role for Business Lawyers*, 11 NEV. LAW. 8, 15 (Mar. 2003) (stating that "Sarbanes-Oxley probably controls [if a conflict between Nevada rules and part 205 exists] by benefit of [the] federal preemption doctrine"). However, Stempel's analysis is cursory: he cites no provision of part 205, no case law to support his contention, nor does he specifically address whether a conflict exists. *See id.*

135. *See* Washington Interim Formal Ethics Opinion, *supra* note 111, at 5-7.

136. City of New York v. FCC, 486 U.S. 57, 64 (1988); *see also* Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 154 (1982) (requiring analysis to focus on not whether Congressional intent was to supersede state law, but instead on whether an agency's action was within the scope of its delegated authority).

137. New York v. Fed. Energy Regulatory Comm'n, 535 U.S. 1, 17-19 (2002).

138. United States v. Shimer, 367 U.S. 374, 383 (1961).

139. *See* City of New York v. FCC, 486 U.S. at 64 (requiring, as a threshold matter, that a federal agency regulation "seek[ ] to displace state law").

140. *Id.*; Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. at 154.

141. *See* 17 C.F.R. § 205.1 (2004) ("Where the standards of a state or other

the second prong: whether the SEC had the power to create part 205 by relying on section 307.[142]

If the SEC would have "adopt[ed] a rule which echoe[d] the exact wording of Section 307," there would be no preemption question.[143] That is, if Congress had expressly directed the SEC to create the regulations permitting disclosure of confidential client information relating to an attorney's representation of a client in the manner that the SEC eventually did, the issue would be quite simple: the SEC regulation would preempt any state regulation that controlled the same subject matter.[144] Congress did no such thing.[145]

A. *The Preemption Doctrine*

The Supremacy Clause of the United States Constitution[146] has been interpreted to hold that federal statutes and statutorily authorized federal regulations trump if a conflict exists between a federal provision and a state provision.[147]

United States jurisdiction where an attorney is admitted or practices conflict with this part, this part shall govern.").

142. *See* ABA Letter, *supra* note 26, at 33 (answering this question in the negative: "the Commission should refrain from considering . . . disclosure provisions unless and until it receives express Congressional authority to preempt state privilege rules").

143. Lipman Letter, *supra* note 78.

144. *See, e.g.*, New York v. Fed. Energy Regulatory Comm'n, 535 U.S. 1, 18 (2002) (stating that whether Congress has authorized an administrative agency to draft regulations resolves the issue of preemption); City of New York v. FCC, 486 U.S. 57, 63-64 (1988) (recognizing that "'a federal agency acting within the scope of its congressionally delegated authority may pre-empt state regulation' and hence render unenforceable state… laws that are otherwise not inconsistent with federal law") (quoting La. Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 369 (1986)); Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 699 (1984) (stating that federal regulations, if authorized, "'have no less pre-emptive effect than federal statutes'") (quoting Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. at 153).

145. *See* Sarbanes-Oxley Act § 307 (codified at 15 U.S.C.A. § 7245) (Supp. II 2002).

146. U.S. CONST. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.").

147. There are three ways a federal law (and a federal regulation) can displace a state law: (1) where Congress expressed a clear intent to preempt state law; (2) where Congress has established a comprehensive regulatory scheme in the area, thus removing the entire field from state control; and (3) where a state law directly conflicts

Section 307 represents the first time that an agency of the federal government has, in one form or another, been given authority to govern the conduct of attorneys practicing before it.[148] There are "serious and legitimate issues of federalism raised by Congress' intrusion into legal ethics, an area long governed by states."[149] Such an intrusion raises separation of powers and federalism concerns.[150]

The SEC downplayed the potentiality of a preemption problem, stating in its final rules that a conflict between state ethics rules and the SEC's regulations are "unlikely to arise in practice" because most states' rules already permit the very disclosure part 205 allows.[151] That may be true, but the rarity of a conflict does not negate the requirement that the SEC have statutory authority for regulations it promulgates.

with a federal law or frustrates the achievement of a federal objective. Capital Cities Cable, Inc. v. Crisp, 467 U.S. at 698-99; *see also* Steve A. Radom, *Balkanization of Securities Regulation: The Case for Federal Preemption*, 39 TEX. J. BUS. L. 295, 320 (2003) (discussing the three ways in which federal law can displace state law). However, "[a]bsent promulgation by means of a statute or a court rule, ethical provisions of the ABA or other groups are not legally binding . . . ." Culebras Enters. Corp. v. Riverea-Rios, 846 F.2d 94, 98 (1st Cir. 1988) (citing Int'l Electronics Corp. v. Flanzer, 527 F.2d 1288, 1293 (2d Cir. 1975)). Here, though, each state provision governing disclosure has been adopted by means of either a statute or court order. Note that even Radom, who makes a compelling case for the federalization of securities practices generally, recognizes that "[e]xpress congressional preemption appears to be the only viable means of preempting the aggressive state actions in question." Radom, *supra*, at 322.

148. David A. Beck, *The Legal Profession at the Crossroads: Who Will Write the Future Rules Governing the Conduct of Lawyers Representing Public Corporations?*, 34 ST. MARY'S L.J. 873, 906-07 (2002); *see generally* Patterson, *supra* note 8, at 155-76 (arguing that Section 307 impinges on the states' traditional ability to govern attorney conduct).

149. Bainbridge, *supra* note 8, at 9-10; *see also* ABA Letter, *supra* note 26, at 11 (noting that "lawyers are primarily regulated by the highest courts in jurisdictions in which they are admitted to practice").

150. Bainbridge, *supra* note 8, at 10; Beck, *supra* note 148, at 906-12 (identifying problems with the federalization of rules governing attorney conduct); E. Norman Veasey, Reflections on Key Issues of the Professional Responsibilities of Corporate Lawyers in the Twenty-First Century, Address Before the Washington University School of Law (Oct. 28, 2002), *in* 12 WASH. U. J.L. & POL'Y 1, 18-23 (2003) (although speaking before the proposed SEC rules were finalized, Justice Veasey identified many of the policy arguments against allowing a federal administrative agency to govern attorney conduct).

151. 68 Fed. Reg. 6295, 6311 (Feb. 6, 2003).

B. *Trying to Head off a Future Conflict: The SEC General Counsel's Attempt to Demonstrate the Supremacy of Section 205.3(d)(2)*

In July 2003, Giovanni P. Prezioso, the SEC's General Counsel, responded to the Washington State Bar Association's comments directing Washington attorneys to refrain from disclosing information in reliance on part 205.[152] (Such a directive, even if by the SEC's general counsel, does not have the force of law.[153]) Prezioso's comments illustrate the SEC's belief that part 205 preempts any state rules to the contrary, and would allow disclosure in the face of state rules prohibiting disclosure.[154] Prezioso cited two cases in support of the proposition that the United States Supreme Court "has consistently upheld the authority of federal agencies to implement rules of conduct that diverge from and supersede state laws that address the same conduct"[155]: *Sperry v. Florida*[156] and *Fidelity Federal Savings and Loan Association v. de la Cuesta*.[157] However, neither *Sperry* nor *de la Cuesta* supports the SEC's position.

In *de la Cuesta*, the United States Supreme Court considered the preemptive effect of a regulation issued by the Federal Home Loan Bank Board (Board) allowing federal savings and loan associations to use "due-on-sale" clauses in mortgage contracts.[158] In response to growing

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152. Letter from Giovanni P. Prezioso, to J. Richard Manning & David W. Savage (July 23, 2003), *available at* http://www.sec.gov/news/speech/spch072303gpp.htm [hereinafter Prezioso Letter]; *see supra* notes 111-119 and accompanying text (discussing the Washington Bar Association's directive that Washington attorneys not disclose information as permitted by Part 205 if barred from doing so by applicable Washington rules).

153. *See* Christensen v. Harris County, 529 U.S. 576, 586-87 (2000). Agency interpretations of a statute contained in "opinion letters[,] . . . policy statements, agency manuals, and enforcement guidelines . . . lack the force of law. *Id.* at 587. "Instead, interpretations contained in formats such as opinion letters are 'entitled to respect' . . . but only to the extent that those interpretations have the 'power to persuade.'" *Id.* (citations omitted).

154. Prezioso Letter, *supra* note 152.

155. *Id.* (citing Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 155 (1982); Sperry v. Florida, 373 U.S. 379 (1963)).

156. Sperry v. Florida, 373 U.S. 379, *cited in* Prezioso Letter, *supra* note 152.

157. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. at 155, *cited in* Prezioso Letter, *supra* note 152.

158. *Id*. at 144. Due-on-sale clauses allow a lender to declare the entire balance of a loan due if property securing a loan is sold or transferred by the borrower without the lender's permission. *See id.* at 145 n.2 (listing an example of a standard due-on-sale clause used by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association); *see also id.* at 146-47 (discussing 12 C.F.R. § 545.8-3(f) (1982), which outlines the Board's description of a due-on-sale clause).

controversy as to the authority of the federal savings and loan associations to exercise such clauses, the Board simply promulgated regulations that expressly authorized them.[159] Relying on the Home Owners' Loan Act of 1933 (HOLA) for Congressional authority to do so, the Board declared that "'[f]ederal associations shall not be bound by or subject to any conflicting State law which imposes different . . . due-on-sale requirements.'"[160] Fidelity Federal Savings and Loan Association was such an organization.[161]

Several individuals purchased real property in California from an individual who had borrowed money from Fidelity Federal Savings and Loan Association (Fidelity).[162] The borrower had given Fidelity deeds of trust containing due-on-sale clauses for the properties as security for the loan.[163] The deeds of trust contained both a due-on-sale clause and a clause stating that the deed would be governed by the state where the property was located, California in this case.[164]

Fidelity was not notified of the transfer of property from the borrower to the purchasers.[165] Fidelity offered to consent to the transfer, but only if the purchasers agree to pay a higher interest rate than the borrower.[166] The purchasers refused.[167] As a result, Fidelity moved to enforce the due-on-sale clause and accelerate payment of the loans, and eventually initiated foreclosure proceedings.[168] The purchasers claimed that enforcement of the due-on-sale clauses violated California's prohibition of unreasonable restraints on alienation unless the lender showed enforcement was "'reasonably necessary to protect against impairment to its security or risk of default.'"[169] The Supreme Court held that the Board's regulations preempted regulations imposed on federal savings and loans institutions by California law.[170]

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159. *Id.* at 145-47.
160. *Id.* at 158 (quoting 41 Fed. Reg. 18,286, 18,287 (June 8, 1976)).
161. *Id*. at 147.
162. *Id.* at 147-48.
163. *Id.* at 148.
164. *Id.*
165. *Id.*
166. *Id.*
167. *Id.*
168. *Id.*
169. *Id.* at 149 (quoting Wellenkamp v. Bank of America, 582 P.2d 970, 977 (Cal. 1978)).
170. *Id.* at 170.

Indeed, comparisons can be drawn between the Board's express allowance of due-on-sale clauses and the SEC's allowance of disclosure of confidential information. Just as part 205 *permits* but does not *require* disclosure of confidential information, the regulations promulgated by the Board *permitted* but did not *require* due-on-sale clauses that were prohibited by California law.[171] Just as part 205 expressly claims to supersede any state law to the contrary, the regulations promulgated by the Board specifically indicated that any restrictions on due-on-sale clauses were to originate only with the Board.[172] So far, so good, for Prezioso's argument.

However, in determining that the federal regulations at issue in *de la Cuesta* should preempt any contrary state regulation or statute, the Supreme Court noted that "Congress delegated to the Board ample authority to regulate the lending practices of federal savings and loans."[173] Section 5(a) of HOLA authorized the Board "to 'provide for the . . . *operation*[] and *regulation* of associations to be known as "Federal Savings and Loan Associations""" like Fidelity.[174] This broad language expressed "no limits on the Board's authority to regulate the lending practices of federal savings and loans."[175]

But merely because the type of regulation issued by the SEC in part 205 is analogous to that promulgated by the Board in *de la Cuesta*, it is not persuasive evidence that the result of a preemption analysis should be the same. First, in *de la Cuesta* the Supreme Court expressly recognized Congressional intent for the *specific* regulations in question.[176] Moreover, Congressional support for the *specific* regulations in part 205 permitting disclosure to the SEC is much weaker, and is arguably *against* the regulations.[177]

171. 17 C.F.R. 205.3(d)(2) (2004); Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. at 155.

172. 17 C.F.R. 205.3(d)(2); Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. at 155-56, 158-59.

173. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. at 159.

174. *Id.* at 160-61 (quoting 12 U.S.C. § 1464(a)(1) (Supp. IV 1976)) (emphasis added by the *de la Cuesta* Court). The Court later concluded that a saving and loan's mortgage lending practices are a critical aspect of its "operation." *Id.* at 167.

175. *Id.* at 161. In fact, "'[i]t would have been difficult for Congress to give the . . . Board a broader mandate.'" *Id.* (quoting Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 910 (C.D. Cal. 1978)).

176. *Id.* at 159-60.

177. *See* discussion *infra* Part IV.C.2-3 (asserting a lack of Congressional support for 17 C.F.R. § 205.3(d)(2)).

Second, despite the "exigencies of the time" in which HOLA was passed, and despite the "sparse" nature of HOLA's legislative history,[178] the Court quoted congressional testimony at length[179] that demonstrated Congress's intent that "federal savings and loans would be governed by what the Board—not any particular State—deemed to be the best practices."[180] No such history exists here, despite similar exigencies in time that existed when Congress passed the Sarbanes-Oxley Act.[181]

Moreover, the mere presence of HOLA demonstrates Congress's active role in regulating the home mortgage market at the federal level. Regulation of what an attorney may and may not disclose is a matter historically within the power of state bar associations and legislatures.[182] Thus, although the *de la Cuesta* Court concluded that a regulation *permitting* conduct *forbidden* by some states preempted state regulation of the subject matter of the federal regulation, Congressional support the regulations in *de la Cuesta* enjoyed is simply not present for 17 C.F.R. § 205.3(d)(2). Consequently, Prezioso's reliance on *de la Cuesta* is unavailing.

Prezioso's reliance on *Sperry* is similarly unpersuasive.[183] In *Sperry*, the Supreme Court considered whether the Florida Bar could prevent a lawyer who was not admitted to practice law in Florida (or any other state) from practicing in Florida even though he was engaged in activities exclusively covered by a federal license to practice before the Patent Office.[184] The Supreme Court of Florida held that the "[practitioner's] conduct constituted the unauthorized practice of law which the State, acting under its police power, could properly prohibit, and that neither federal statute nor the Constitution of the United States empowered any federal body to authorize such conduct in Florida."[185]

After recognizing that "Florida has a substantial interest in regulating

178. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. at 163.

179. *Id.* at 160-61, 164-67.

180. *Id*. at 161 (quotation omitted).

181. *See supra* notes 15-17 and accompanying text (identifying the swiftness with which the Act was passed); *infra* Part IV.C.2-3 (noting the lack of Congressional intent for 17 C.F.R. § 205.3(d)(2)).

182. *See supra* notes 148-50 and accompanying text. The presence of state rules governing disclosure in all fifty states and the presence of precisely zero similar SEC regulations before part 205 further illustrates this traditional deference to the states.

183. *See* Prezioso Letter, *supra* note 152.

184. Sperry v. Florida, 373 U.S. 379, 382-83 (1963).

185. *Id*. at 382 (citing State v. Sperry, 140 So. 2d 587, 594-95 (Fla. 1962)).

the practice of law within the State and that, in the absence of federal legislation, it could validly prohibit nonlawyers from engaging in" the type of conduct in question, the Court analyzed whether any such legislation granted a federal body that authority.[186] The Court noted that Congress expressly granted the Commissioner of Patents the authority to "'prescribe regulations governing the *recognition . . . of agents*, attorneys, or *other persons* representing applicants or other parties before the Patent Office.'"[187] Pursuant to that authority, the Commissioner drafted a regulation allowing "'[a]n applicant for [a] patent . . . [to] be represented by an attorney *or* agent authorized to practice before the Patent Office in patent cases.'"[188] Thus, the statute did "authorize practice before the Patent Office by nonlawyers, and the Commissioner has explicitly granted such authority," by creating two separate types of people: lawyers and agents.[189]

The Florida Bar argued that the federal statute and regulations promulgated in response to it could be read to be not inconsistent with Florida's law.[190] This reading was based on the final regulation, which, when combined with a *draft* of the regulation, prevented non-attorneys from practicing under a federal license in Florida.[191] The state argued that the final regulation, stating that "'[r]egistration in the Patent Office . . . shall only entitle the persons registered to practice before the Patent Office,'"[192] combined with the predecessor provision, stating that registration "'shall not be construed as authorizing persons not members of the bar to practice law,'"[193] meant that non-lawyers authorized to practice before the patent office by 37 C.F.R. § 1.341 could not practice anywhere but before the Patent Office.[194] The Court found this argument unavailing, holding that

> the progression to the more circumscribed language without more tends to indicate that the provision was intended only to emphasize

186. *Id*. at 383.
187. *Id*. at 384 (quoting 35 U.S.C. § 31 (1952)).
188. *Id.* (quoting 37 C.F.R. § 1.31 (2003)) (emphasis added).
189. *Id*. at 385.
190. *Id.*
191. *See id.* at 385-86 (setting forth the argument made by the state regarding authorization to practice).
192. *Id.* at 386 (quoting 37 C.F.R. § 1.341).
193. *Id.* (quoting Patents and Copyrights, 3 Fed. Reg. 2429, 2429 (Oct. 8, 1938)).
194. *Id.*

> that registration in the Patent Office does not authorize the general practice of patent law, but sanctions only the performance of those services which are reasonably necessary and incident to the preparation and prosecution of patent applications.[195]

Moreover, a provision in a different proposed regulation that would have given "the states . . . the power to circumscribe and limit the rights of patent attorneys who are not lawyers" was deleted after objections were lodged against the provision.[196] The legislative history of the federal statute,[197] as well as the traditional power of the Commissioner of Patents to regulate practice before the office "*without* regard to whether the State within the practice is conducted would otherwise prohibit such conduct"[198] also supported preemption of the Florida provision by the Commissioner's regulations.

Sperry does not support Prezioso's assertion that section 205.3(d)(2) preempts state regulations forbidding or disfavoring disclosure of confidential client information. The *Sperry* Court noted that the practice of non-lawyers before the Patent Office enjoyed a long history.[199] No such history exists for SEC regulation of disclosure of confidential client information; in fact, section 205.3(d)(2) is the first attempt at such regulation.[200]

It is true that in *Sperry*, the Court recognized that each state court considering the problem of whether non-attorneys could participate in agency proceedings before the regulations at issue were finalized "agreed that the authority to participate in administrative proceedings conferred by the Patent Office and by other federal agencies was either consistent with or pre-emptive of state law."[201] However, that recognition should be confined to situations where federal agencies authorize non-attorneys to participate in a federal proceeding,[202] not where a federal agency authorizes

195. *Id.*
196. *Id.* at 386-87.
197. *See id.* at 387-90, 387 n.8.
198. *Id.* at 388 (emphasis added).
199. *See id.* at 387-89.
200. Beck, *supra* note 148, at 906-07.
201. *Sperry v. Florida*, 373 U.S. at 399-400, 399 n.43. Note, however, that the Supreme Court does *not* cite a case involving securities regulations. This is not surprising, in part, because there was no securities issue in *Sperry*.
202. *Id.* at 384-85 (noting that Congress has the power to authorize non-attorneys to participate and that, while such authorizations are usually consistent with state law, federal authorization preempts state law when they are incompatible).

an attorney to disclose confidential information.[203] The situations are not analogous because the issues are different. The *Sperry* Court held that "rights conferred by the issuance of letters patent are *federal* rights," bestowed upon the *federal* government by the Constitution.[204] The power to regulate attorney conduct has traditionally been an issue of state regulation,[205] and is not constitutionally conferred upon the federal government. Moreover, despite ultimately recognizing that federal regulations granting non-lawyers the ability to practice before the Patent Office preempt state regulations to the contrary, the Court recognized limits on that power: "[S]ince patent practitioners are authorized to practice *only* before the Patent Office, the State maintains control over the practice of law within its borders except to the limited extent necessary for the accomplishment of the federal objectives."[206] Unlike persons that practice before the Patent Office, all persons governed by section 205.3(d)(2) are attorneys.[207] As a result, for those not practicing before the Patent Office, the *Sperry* Court recognized that regulating the conduct of lawyers was a state issue unless "federal objectives" were served by the federal government's regulation of the practice of law.[208] Determining whether such objectives are served by section 205.3(d)(2) is discussed shortly.[209]

Finally, like the regulation in *de la Cuesta*, the regulation at issue in *Sperry* derived considerable support from the legislative history of the act relied on in drafting the regulation at issue.[210] The SEC cannot rely on similar legislative history for section 205.3(d)(2) because it does not exist.[211]

Read together, *Sperry* and *de la Cuesta* would allow the SEC, through

203. Beck, *supra* note 148, at 906-10 (discussing the importance of states, not federal agencies, in authorizing disclosure of confidential information).

204. Sperry v. Florida, 373 U.S. at 401 (emphasis added).

205. *See, e.g.*, Beck, *supra* note 148, at 907 ("Traditionally, the responsibility for promulgating the rules governing the professional conduct of attorneys has been entrusted to the highest courts of each state.").

206. Sperry v. Florida, 373 U.S. at 402 (emphasis added).

207. *See* 17 C.F.R. § 205.3(d)(2) (2004) (applying only to "attorney[s] appearing and practicing before the Commission" in certain capacities).

208. *See* Sperry v. Florida, 373 U.S. at 402.

209. *See infra* Part IV.C (analyzing section 205.3(d)(2) in light of the Supreme Court's jurisprudence with respect to agency regulations' preemptive effect on state laws).

210. *See* Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 159-61 (1982); Sperry v. Florida, 373 U.S. at 387-402.

211. *See infra* Part IV.C.3 (discussing the lack of legislative history for Section 307 supporting 17 C.F.R. § 205.3(d)(2)).

section 205.3(d)(2), to preempt any contrary state ethics rule if Congress had either recognized the practice or authorized the SEC to promulgate the regulations that it did. Congress did no such thing. Consequently, the SEC stepped outside the *zone* of power Congress granted in section 307 of the Act when it drafted 17 C.F.R. § 205.3(d)(2).

C. *Application of the Supreme Court's Jurisprudence Reveals the Impropriety of Section 205.3(d)(2)*

1. *The Test*

A federal agency may only preempt state law "when and if it is acting within the scope of its congressionally delegated authority."[212] A federal agency requires such authorization because

> [f]irst, an agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it. Second, the best way of determining whether Congress intended the regulations of an administrative agency to displace state law is to examine the nature and scope of the authority granted by Congress to the agency.[213]

When an agency chooses to preempt state law, a court's inquiry is limited: "If [the administrator's] choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, [a court] should not disturb it unless it appears from the statue or its legislative history that the accommodation is not one that Congress would have sanctioned."[214]

Thus, analyzing whether a regulation is properly within the purview of a federal agency's congressionally authorized power proceeds in two steps.[215] "First, always, is the question whether Congress has directly spoken to the precise question at issue."[216] If congressional intent is clear, and if the agency has followed the unambiguous intent of Congress, the analysis ends.[217] However, if "Congress has not directly addressed the precise question at issue, the court does not simply impose its own

212. La. Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 374 (1986).
213. *Id.*
214. United States v. Shimer, 367 U.S. 374, 383 (1961).
215. Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842 (1984).
216. *Id.*
217. *Id.* at 842-43.

construction on the statute" as if there were no administrative agency interpretation.[218] "Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute."[219] An agency must have room to regulate: "'The power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress.'"[220] However, the agency's interpretation of a statute must still be reasonable. If Congress did not explicitly intend for the regulations to be constructed as they eventually were, the question is not whether the regulation is inappropriate, but instead whether the agency's view that it is appropriate is a reasonable one.[221]

In *Chevron U.S.A. v. Natural Resources Defense Council, Inc.*, the Supreme Court considered whether regulations promulgated by the Environmental Protection Agency (EPA) permitting states to treat all pollution-emitting devices within one industrial grouping as if they were within the same industrial "bubble" were based on a reasonable interpretation of the statutory term "stationary source" contained in the Clean Air Act,[222] as amended.[223] If states were permitted to treat all pollution-emitting devices at one plant as though they were in a single "bubble," an industrial plant could change one piece of polluting equipment that would otherwise fail stringent permit requirements without meeting the permit requirements, so long as total pollution from the plant did not increase.[224] The question presented was whether the "bubble"

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218. *Id.* at 843 (citations omitted).

219. *Id.* (citations omitted); *see also* United States v. Shimer, 367 U.S. at 383 (holding that the Court should not disturb agency interpretation of a statute unless it is one that Congress would not have sanctioned).

220. Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. at 843 (quoting Morton v. Ruiz, 415 U.S. 199, 231 (1974)).

221. *Id.* at 845.

222. Clean Air Act § 172(b)(6), 42 U.S.C. § 7502(b)(6) (1982).

223. Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. at 840. The EPA defined "stationary source" as "'any building, structure, facility, or installation which emits or may emit any air pollutant subject to regulation under the Act.'" *Id.* at 840 n.2 (quoting 40 C.F.R. § 51.18(j)(1)(i) (1983)). A building, structure, facility or installation means "'all of the pollution-emitting activities which belong to the same industrial grouping, are located on one or more contiguous or adjacent properties, and are under the control of the same person (or persons under common control) except for the activities of any vessel.'" *Id.* (quoting 40 C.F.R. § 51.18(j)(1)(ii)).

224. *Id.*

concept could be applied to the permit program because the statute did not make the term "stationary source" applicable to the permit program.[225] After examining both the legislation and its history, the Court held that "Congress did not have a specific intention on the applicability of the bubble concept [but] the EPA's use of that concept [in the permit programs was] a reasonable policy choice for the agency to make."[226] The Court conducted an exhaustive analysis of the legislative history of then-recent amendments to the Clean Air Act.[227] Specifically, the Court noted that although the amendments did not contain any specific comment on whether the "bubble" concept or plant-wide definition of "stationary source" was permissible under the Clean Air Act, the amendments did "plainly disclose that in the permit program Congress sought to accommodate the conflict between the economic interest in permitting capital improvements to continue and the environmental interest in improving air quality."[228] Despite an inconclusive analysis of the text of the Clean Air Act and its amendments,[229] the Court concluded that the amendments' legislative history illustrated "the plantwide definition is fully consistent with one of [the policy concerns of the act]—the allowance of reasonable economic growth . . . [and] that the EPA has advanced a reasonable explanation for its conclusion that the regulations serve the environmental objectives" of the Act.[230] The Court deemed the EPA's definition of "source" was a permissible construction of the statute, which sought to "accommodate progress in reducing air pollution with economic growth."[231]

The Supreme Court applied the same analysis more recently in *New York v. Federal Energy Regulatory Commission*.[232] There, the Court considered whether the Federal Energy Regulatory Commission (FERC) properly construed its statutory authority granted by the 1935 Federal Power Act, as amended,[233] by requiring a public utility to transmit

225. *Id.* at 840, 845, 859-60.

226. *Id.* at 845.

227. *See id.* at 851-57, 862-64.

228. *Id.* at 851.

229. *See id.* at 859-62.

230. *Id.* at 863. The Court recognized that the EPA's explanation was supported by "the public record developed in the rulemaking process, as well as by certain private studies." *Id.* (footnotes omitted).

231. *Id.* at 866.

232. New York v. Fed. Energy Regulatory Comm'n, 535 U.S. 1 (2002).

233. Congress had granted the Federal Power Commission, the predecessor to FERC, the power "'to provide effective federal regulation of the expanding business of

competitors' electricity over its lines on terms identical to those the utility applied to its own energy transmissions when the company "unbundled" the cost of transmitting energy from the cost of the energy itself when billing customers, and by not requiring that practice for utilities only offering "bundled" retail sales.[234]

The State of New York argued that the FERC exceeded its Congressionally authorized power "by including unbundled retail transmissions within the scope of its open access requirements" because such transmissions, as retail transactions, are the subject of state regulation.[235] The Court concluded the "best way" to determine the proper scope of the agency's power is by "'examin[ing] the nature and scope of the authority granted by Congress to the agency.'"[236]

First, the Court analyzed the language of the statute at issue.[237] The Court noted that the text of the Federal Power Act of 1935 gave "FERC jurisdiction over the 'transmission of electric energy in interstate commerce and . . . the sale of electric energy at wholesale in interstate commerce,'"[238] thus "unambiguously" authorizing FERC to assert jurisdiction over both the transmission and sale of electric energy.[239] FERC's jurisdiction over the *sale* of power was confined to the wholesale market; jurisdiction over *transmission* contained no similar limitations.[240] "Because the [Federal Power Act] authorizes FERC's jurisdiction over interstate transmissions, without regard to whether the transmissions are sold to a reseller or

selling electric power in interstate commerce.'" *Id.* at 6 (quoting Gulf States Util. Co. v. FPC, 411 U.S. 747, 758 (1973)). At issue in *Federal Energy Regulatory Commission* were statutory provisions granting FERC jurisdiction over "the transmission of electric energy in interstate commerce" and "the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. § 824(a), (b) (2000), *quoted in* New York v. Fed. Energy Regulatory Comm'n, 476 U.S. at 6-7. FERC was also charged with correcting any discrimination "with respect to any transmission or sale subject to the jurisdiction of the Commission." 16 U.S.C. §§ 824d(a)-(b), 824e(a), *cited in* New York v. Fed. Energy Regulatory Comm'n, 535 U.S. at 7.

234. *New York v. Fed. Energy Regulatory Comm'n*, 535 U.S. at 4-5. Only FERC's power to regulate retail (and not wholesale) transactions was challenged. *Id.* at 16.

235. *Id.* at 16.

236. *Id.* at 18 (quoting La. Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 374 (1986)).

237. *See id.* at 18-20.

238. *Id.* at 18-19 (quoting 16 U.S.C. § 824(b) (2000)).

239. *Id.* at 19-20.

240. *Id.* at 20.

directly to a consumer, FERC's exercise of the power is valid."[241]

Next, the Court considered the legislative history of the Federal Power Act.[242] The State of New York argued that the 1935 Congress only intended to close the so-called "*Attleboro* gap," by allowing federal regulation of wholesale (and not retail) interstate electricity transmissions the Supreme Court had held were beyond the reach of the states in *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co*.[243] Thus, New York argued, Congress "did not intend to supplant any traditionally state-held jurisdiction," thus preserving state control over local facilities.[244] The Court agreed that Congress did intend to close the *Attleboro* gap, but "did a good deal more" by authorizing "federal regulation not only of wholesale sales that had been beyond the reach of state power, but also the regulation of wholesale sales that had been *previously subject* to state regulation."[245] The *Attleboro* gap was consequently not the sole area addressed by the Federal Power Act of 1935.[246] In fact, even if the *Attleboro* gap was the only area FERC could regulate, because unbundled interstate transmissions were traditionally beyond state regulation, New York's argument still failed.[247] The Court noted that FERC did not impede on two areas Congress intended to reserve to state regulation (as illustrated through the Federal Power Act's legislative history[248]): retail sales and local facilities.[249] As a result, neither the language nor legislative history of the Federal Power Act of 1935 undercut FERC's ability to order unbundling of wholesale transactions and

241. *Id.*

242. *Id.* at 20-24.

243. *See id*. (discussing New York's interpretation of the intent of the 1935 Congress in passing the Federal Power Act of 1935 and the Supreme Court's holding in Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co., 273 U.S. 83 (1927)).

244. *Id.* at 20. New York relied on section 201(a) of the Federal Power Act, which provides that any "federal regulation is 'to extend only to those matters which are not subject to regulation by the States.'" *Id.* (quoting 16 U.S.C. § 824(a) (2000)).

245. *Id.* at 20-21. For example, Congress authorized "federal regulation of interstate *transmissions* as well as of interstate wholesale sales," neither of which were at issue in *Attleboro*. *Id.* at 21.

246. *See id.* at 21 (recognizing that "even if *Attleboro* catalyzed the enactment of the [Federal Power Act of 1935], *Attleboro* does not define the outer limits of the statute's coverage").

247. *Id.*

248. *See id.* at 22-24 (construing § 201(b) of the FPA as "describing Congress's intent to preserve state jurisdiction over local facilities").

249. *Id.*

regulate unbundled transmissions of electricity retailers.[250]

Relevant Supreme Court holdings illustrate that whether the SEC properly exercised authority granted by section 307 of the Act when promulgating 17 C.F.R. § 205.3(d)(2) turns on two questions. First, did Congress, acting through the Sarbanes-Oxley Act, explicitly give the SEC authority to draft section 205.3(d)(2)? If the answer is yes, then section 205.3(d)(2) is proper, and the inquiry ends. If the answer is no, an analysis of the legislative history of the Act is necessary to determine whether the SEC's interpretation of section 307 is a reasonable one. Section 205.3(d)(2) fails both prongs.

2. *The Statutory Language of Section 307 of the Sarbanes-Oxley Act Does Not Give Implicit or Explicit Support to 17 C.F.R. § 205.3(d)(2)*

Because a federal agency may only preempt state law "when and if it is acting within the scope of its congressionally delegated authority," the best place to look for support for such authority is within the pertinent act itself.[251] Nothing in the text of the Sarbanes-Oxley Act lends implicit or explicit support to the SEC's creation of regulations permitting disclosure of confidential information in the circumstances section 205.3(d)(2) allows.[252] All section 307 allows the SEC to do is create rules that set forth "minimum standards of professional conduct for attorneys appearing and practicing before the Commission" with certain reporting requirements governing to whom an attorney must report evidence of material violations.[253]

Admittedly, the power section 307 gives the SEC is broad: "Section 307 leaves the SEC free to craft its own code of ethics restricted only by the mandate that the rules require attorneys to climb the corporate ladder in cases of material violations."[254] However, section 307 provides only a floor, and is unclear as to the maximum authority the SEC has to regulate attorney conduct. Indeed, "it does not take much imagination to see where the SEC can go under the guise of implementing 'minimal standards of

250. *Id.* at 19-20, 23-24.

251. La. Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 374 (1986); *see also* Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842 (1984) ("First, always, is the question whether Congress has directly spoken to the precise question at issue.").

252. Sarbanes-Oxley Act of 2002 § 307 (codified at 15 U.S.C. § 7245 (Supp II. 2002)); 17 C.F.R. § 205.3(d)(2) (2004).

253. Sarbanes-Oxley Act of 2002 § 307 (codified at 15 U.S.C. § 7245).

254. Patterson, *supra* note 9, at 174-75.

professional conduct,' as authorized under [s]ection 307."[255] In fact, if section 307 is read to its fullest possible extent, it would require imagination to see where the SEC *cannot* go under the guise of section 307. If the SEC's rules, however broadly they are to be interpreted, supposedly complied with section 307 by requiring attorneys to climb the corporate ladder upon acquiring knowledge of a material violation, then language *not* in section 205.3(d)(2) becomes crucial to determining whether the SEC complied with section 307 of the Act. Section 307 requires the SEC's rules to include provisions mandating up-the-ladder disclosure *within* a corporate client.[256] Contrarily, section 205.3(d)(2) *does not require* an attorney to climb the corporate ladder with knowledge of a material violation before disclosing the violation externally.[257] The only prerequisite to disclosure is that an attorney must appear and practice before the SEC and be aware of certain types of material violations of securities laws.[258] No disclosure to *anyone*, within the corporate client or otherwise, is required.[259]

Additionally, it is unlikely Congress intended to grant the SEC power to disrupt state disclosure rules without expressly stating it intended to do so.[260] There is no explicit support in section 307 for the types of regulations the SEC created.[261] Unlike the regulation in *Federal Energy Regulatory Commission*, which could uncreatively be read in compliance with the Federal Power Act,[262] the regulations here cannot be read in harmony with section 307.

Moreover, section 307 does not implicitly provide support for the regulations in question. In fact, section 307, when read in its entirety, supports an interpretation that would not allow section 205.3(d)(2). Section 307 is very clear with respect to what types of rules the new

255. John Levin, *A Battle Brewing: Sarbanes-Oxley and Attorney-Client Privilege*, CBA REC., Oct. 2003, at 46.

256. *See* Sarbanes-Oxley Act of 2002 § 307 (codified at 15 U.S.C. § 7245) (requiring the attorney to report to the chief legal counsel or the chief executive officer of the company or the equivalent thereof).

257. *See* 17 C.F.R. § 205.3(d)(2) (2004).

258. *See id.*

259. *See id.*

260. *Cf.* Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 699-700 (1984) (recognizing that the Communications Act of 1934 expressly grants "broad responsibilities" to the FCC "to regulate all aspects of interstate communication").

261. *See* Sarbanes-Oxley Act of 2002 § 307 (codified at 15 U.S.C. § 7245) (containing no optional disclosure language).

262. *See supra* notes 237-41 and accompanying text.

regulations were to include.[263] Each of the rules Congress directed the SEC to create via section 307 involves disclosing evidence of material violations *within* a company.[264] The SEC could therefore reasonably conclude it had implicit authorization to create rules like those mentioned in section 307 or rules that were necessary to implement section 307. Section 205.3(d)(2) is different from the rules expressly mentioned in section 307 in at least three ways.

First, the SEC allows an attorney to report evidence of material violations outside a company.[265] Nothing in section 307 mentions this prospect.[266] Second, section 205.3(d)(2) informs attorneys what they may do if they uncover evidence of past violations.[267] Section 307 does not address past violations.[268] Third, section 307 requires the SEC to create rules establishing "minimal standards of professional conduct."[269] An *optional* rule does not change how attorneys practice: there is no minimal standard established by a rule attorneys do not need to follow. Moreover, because section 307 only allows internal disclosure, optional external disclosure rules are unnecessary to implement section 307. As a result, section 307 does not provide implicit support for section 205.3(d)(2) because the rules the SEC actually created are materially different than

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263. Sarbanes-Oxley Act of 2002 § 307 (codified at 15 U.S.C. § 7245). Congress authorized the SEC to create rules:

> 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 . . . 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.

Id.

264. *Id.*

265. *See* 17 C.F.R. § 205.3(b)(2) (2004) (stating that an attorney may make a report to "a qualified legal compliance committee").

266. *See* Sarbanes-Oxley Act § 307 (codified at 15 U.S.C. § 7245) (requiring an attorney to report to the chief legal counsel or the chief executive officer of the company, or to the audit committee of the board of directors if the counselor or the officer does not take appropriate action).

267. *See* 17 C.F.R. § 205.3(d)(2)(iii).

268. *See* Sarbanes-Oxley Act § 307 (codified at 15 U.S.C. § 7245).

269. *Id*.

those Congress authorized.

3. *The Legislative History of Section 307 Does Not Weigh in Favor of Preemption*

In the event a clear reading of the statute is inconclusive, as in *Chevron*,[270] the legislative history of the statue in question is paramount to determining if the federal agency actually possesses the claimed authority. The legislative history of section 307 does not support regulations governing disclosure of confidential information to the SEC. To the contrary, the legislative history of section 307 indicates it was not intended to allow an attorney to disclose confidential information to the SEC.

Section 307 was drafted by Senators John Edwards, Mike Enzi, and Jon Corzine.[271] Their comments reflect an intention that section 307 not be construed to permit disclosure outside a corporate client. For example, during floor debates, Senator Corzine stated that the rationale behind the amendment was to enforce the theory that "[w]hen lawyers know of illegal actions by a corporate agent, they should be required to report the violation *to the corporation*."[272] Senator Enzi explained that the amendment was "designed to assure that attorneys are responsible for fully informing their *corporate client* of evidence of material violations of Federal securities law."[273] Senator Corzine explained how a corporate

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270. *See supra* note 229 and accompanying text.

271. *See* 148 CONG. REC. S6523-24, S6551, S6556 (daily ed. July 10, 2002). The original text of the amendment that became section 307 read:

> (c) Rules of Professional Responsibility for Attorneys—Not later than 180 days after the date of enactment of this section, the Commission shall establish 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 public companies, including a rule requiring an attorney to report evidence of a material violation of law 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, 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 or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the company, or to the board of directors.

Id. at S6552.

272. *Id.* at S6556 (statement of Sen. Corzine) (emphasis added).

273. *Id.* at S6554 (statement of Sen. Enzi) (emphasis added).

client was to be informed of such violations: "It is a simple practice . . . . If a manager doesn't respond appropriately, including remedying any violation, the lawyer would then be required to report the violation to the board of directors which represents the shareholders."[274] Senator Edwards also recognized the sufficiency of an internal up-the-ladder reporting procedure:

> 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.[275]

The boardroom is where Senator Edwards's chain of disclosure ends: he did not advocate for disclosure to outside parties.[276] In fact, the amendment was to solidify the fact that for an attorney, the "ultimate duty of representation is not to the people to whom they normally report but to the shareholders through the board of directors. . . . It is *all within the corporation*."[277] The proposed amendment did "not require the attorneys to report violations to the SEC, only to corporate legal counsel or the CEO, and ultimately, to the board of directors."[278]

Senator Enzi even anticipated the debate over external disclosure requirements:

> 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

274. *Id.* at S6556 (statement of Sen. Corzine).

275. *Id.* at S6552 (statement of Sen. Edwards).

276. *Id*. Senator Enzi asserted that section 307 was to create a rule "similar" to 33 U.S.C. § 330, which concerns the ability of the Treasury Department to regulate the practice of attorneys appearing before the IRS. *Id*. at S6555 (statement of Sen. Enzi). Senator Enzi noted that

> under 31 CFR, part 10.21 of the IRS regulations, each attorney who knows the client has not complied with the revenue laws or who has made an error or omission on any return or document required by the IRS shall advise the client promptly of the fact of such noncompliance, error, or omission.

Id. (citing 31 C.F.R. § 10.21 (2002).

277. *Id.* at S6555 (statement of Sen. Enzi) (emphasis added).

278. *Id*.

> the privilege occurs, because it is all *internal*—within the corporation and not to an outside party, *such as the SEC*.[279]

The amendment did not "empower the SEC to cause attorneys to breach their attorney/client privilege."[280] The provisions in section 205.3(d)(2) permitting disclosure to the SEC hardly reflect the intent that disclosure of material violations remain internal.

Senator Edwards envisioned the type of rule section 307 was designed to allow:

> 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. . . . If the violation isn't addressed properly, then you go to the board.[281]

Thus, section 307 was to obligate attorneys with issuer clients to report evidence of material violations up the corporate ladder. Disclosure was to end in the boardroom.

In fact, prior to drafting the amendment that would become section 307, Senator Edwards wrote to Harvey Pitt, then-chairman of the SEC, requesting the SEC to enforce the up-the-ladder principle of reporting as it had done in the past.[282] A representative for Chairman Pitt responded that if Congress wished something to be done, it should act.[283] Congress did, but only insofar as it authorized up-the-ladder disclosure. External disclosure was not part of the legislation Congress either envisioned or enacted.

4. *Section 205.3(d)(2) Undercuts the Free Flow of Information Required for an Attorney to Adequately Represent a Client*

Both the *Federal Energy Regulatory Commission* and *Chevron* Courts considered the policy implications of their interpretations of the acts and

279. *Id.* (emphasis added).
280. *Id.*
281. *Id.* at S6552 (statement of Sen. Edwards).
282. *Id.*
283. *Id.*

regulations in question.[284] Consequently, policy considerations of allowing attorneys to disclose confidential client information without first consulting the client are key to determining if the SEC's interpretation of section 307 is reasonable. Legitimate policy arguments weigh against allowing an attorney to disclose a client's material violation of a securities law. The free flow of information between the client and an attorney is a keystone to the attorney-client relationship and is crucial to an attorney's ability to adequately represent a client's interests.[285] The purpose of protecting such communications "is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice."[286]

It is axiomatic that if a client considers committing an unlawful act, it is more likely the client could be steered away from such conduct by a lawyer capable of fully informing the client of the consequences of such conduct as opposed to one who is not. If clients feel they are unable to fully communicate for fear that conversations with their attorney could one day be disclosed to another entity, such as the SEC, nondisclosure is virtually assured. Such hesitance undermines the attorney's ability to represent clients' interests.[287] For example, assuming the propriety of

284. *See* New York v. Fed. Energy Regulatory Comm'n, 535 U.S. 1, 24 (2002) (holding that FERC's reading of the Federal Power Act of 1935 represented "sound energy policy"); Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 864-66 (1984) (identifying the EPA's goal of accommodating progress in reducing air pollution while still allowing economic growth as a proper goal consistent with a fair reading of amendments to the Clean Air Act).

285. *See* Hunt v. Blackburn, 128 U.S. 464, 470 (1888) (noting that the assistance of attorneys "can only be safely and readily availed of when free from the consequences or the apprehension of disclosure"); *but cf.* John C. Coffee, *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1307 (2003) (arguing that "the ultimate goal of the law is to achieve law compliance, not to maximize uninhibited communications between the attorney and the client. Client confidentiality is a means to an end, not an end in itself."). Professor Coffee, discussing the crime/fraud exception to attorney-client privilege, thus appears to argue that the protection of confidential information should be sacrificed in the name of law enforcement. That proposition would hold true here, as well, if the SEC was actually authorized by Congress to draft the regulations it did, because disclosure would then be in furtherance of enforcing a law.

286. Upjohn Co. v. United States, 449 U.S. 383, 389 (1981).

287. *See* ABA Letter, *supra* note 26, at 7-8 (asserting that "representation by independent counsel" is a "core principle of our democratic values," and that to ensure independence, "lawyers need to be able to act in the best interests of the client" and "clients need to feel free to confide all relevant information to counsel without undue concern that counsel will be required to disclose those confidences to others, particularly governmental agencies").

section 205.3(d)(2), if a client were eventually tried, it would be entirely possible for an attorney representing a client to learn of information known by the client for the first time during the cross-examination of the client or through another witness. Any uncertainty regarding what may or may not be disclosed to the SEC chills communication in an attorney-client relationship, especially because the choice to disclose under section 205.3(d)(2) has been removed from the hands of the client, and placed in the amorphous field of what an attorney "reasonably believes."[288]

The policy debate is not one-sided. Legitimate policy reasons also support the argument that an attorney should be permitted to release confidential information without first consulting with the client. The rules, as implemented, only allow for disclosure of information if an attorney reasonably believes a serious violation of federal securities law either has or is about to occur.[289] The rules further provide that an attorney is permitted to release only such information necessary to remedy a violation that has or is about to occur.[290] Therefore, an attorney may only release information related to the representation of a client that the attorney believes is engaged in a serious illegality the issuer has failed to remedy.[291]

The SEC, responding to the assertion that permissive disclosure without consultation would undermine the attorney-client relationship, stated that "the vast majority of states already permit (and some even require) disclosure of information in the limited situations covered by [17 C.F.R. § 205.3(d)(2)], and that the Commission [saw] no evidence that those already-existing disclosure obligations have undermined the attorney-client relationship."[292] Thus, the SEC concluded, if the attorney-client relationship was not degraded in states where permissive or mandatory disclosure requirements already existed, then the attorney-client relationship should not suffer if disclosures occur at the federal level.[293] The Commission also relied on the proposition that an impact to

288. *Id*. at 33 (arguing that preemptive uncertainty will likely have a "chilling effect on the attorney-client relationship, as companies will be uneasy about retaining or freely communicating with counsel that may or may not eventually rely on the Commission's privilege rules and disclose confidential information to the Commission").

289. 17 C.F.R. § 205.3(d)(2) (2004).

290. *Id*.

291. *Id.*

292. 68 Fed. Reg. 6295, 6311 (Feb. 6, 2003) (footnote omitted).

293. *See id.* This proposition, however, might not be as concrete as the SEC posits. *See supra* notes 91-97 and accompanying text (discussing the disarray in state ethics rules regarding what information may be disclosed and when it may be

"the attorney-client relationship must yield to the public interest where an issuer seeks to commit a material violation . . . ."[294]

Until the conflicts between section 205.3(d)(2) and state ethics rules are resolved, that very uncertainty is itself problematic. "It is fundamentally unfair to clients and their attorneys to require the attorneys to make . . . decisions regarding the pre-emptive effect of the Commission's rules when the consequences of a wrong decision may be disastrous to the attorney or the client."[295] The ABA noted that "[a]s an optimal goal, the Commission should seek to make its rules under [s]ection 307 as consistent as possible with the prevailing state court rules of professional conduct."[296] Striving for harmony between the two groups of rules would "help avoid conflicts between the SEC requirements and state mandates[,] . . . facilitate compliance by lawyers[, and] . . . enhance the ability of state authorities to enforce compliance."[297] Simply put: "[section 205.3(d)] goes beyond any corrective measures Congress contemplated in passing section 307, does not comport with the realities of practice, will interfere with the dynamic of trust inherent in the attorney-client relationship, and ultimately will thwart precisely what Congress sought to achieve with section 307: compliance with the law."[298]

V. CONCLUSION

The SEC's regulations permitting disclosure of confidential client information without the permission of the client conflicts with a number of states' rules governing attorney conduct. Neither the language of section 307 nor its legislative history authorized the SEC to create rules allowing for disclosure of confidential client information outside the corporation the attorney represents. As a result, the regulations exceed the SEC's congressionally authorized power to create minimum standards of professional conduct. Consequently, the validity of the regulations and their ability to preempt existing state rules should be scrutinized by attorneys before disclosing sensitive confidences of clients.

It is also clear "that Congress, and many Americans, hope that attorneys will continue to make headway into the need for disclosure to

disclosed).

294. 68 Fed. Reg. at 6311.

295. ABA Letter, *supra* note 26, at 33.

296. *Id.* at 9.

297. *Id.*

298. California Bar Letter, *supra* note 130.

corporate boards, so that corporate decisions can be made in the 'full light of day.'"[299] Section 205.3(d)(2) is simply not the proper way to do it. At a future date, the SEC may promulgate regulations properly preempting state ethics rules, thereby allowing an attorney to disclose information to the SEC. Using section 307 of the Act is simply not the proper way to do it.

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299. Fox, *supra* note 7, at 890-91.

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