Whistleblowers: Brief Overview of Bio-Rad and Its Implications for Corporate Counsel and Their Employers

WHISTLEBLOWER LITIGATION AND THE BIO-RAD CASE: ETHICS RULES PRE-EMPTION AND OTHER ISSUES

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On February 7, 2017, a California federal jury awarded former General Counsel Sanford Wadler damages for his termination by his former employer Bio-Rad Laboratories, Inc. and its CEO Norman Schwartz. The jury awarded $2,900,000 for past economic loss damages and $5,000,000 in punitive damages on three claims; (1) violation of the Sarbanes-Oxley Act; (2) violation of the Dodd-Frank Act; and (3) under California law, wrongful termination in violation of public policy.[1] Preliminary to the trial, and critical for the ability of plaintiff Wadler to present his evidence, the court permitted, over belatedly filed strenuous objection and motions, and after hearing, the introduction of attorney-client privileged materials. In short, the court held that Sarbanes-Oxley Act's whistleblower protections preempt attorney-client privilege, thus allowing Wadler to use otherwise privileged information as evidence in the case.[2] On appeal to the Ninth Circuit, the briefing in the case is set to begin September 15, 2017.[3]

[1]Order Denying Defendants Renewed Motion for Judgment as a Matter of Law Pursuant to Fed. R. Civ. P. 50(B) and Motion for New Trial Pursuant to Fed. R. Civ. P. 59, Wadler v. Bio-Rad Laboratories, Inc., et al., Case No. 15-cv-02356, U.S. District Court for the Northern District of California (May 10, 2017).

[2]Amended Order Denying Motion to Exclude, Wadler v. Bio-Rad Laboratories Inc. et al., Case Number 3:15-cv-02356, in the U.S. District Court for the Northern District of California (Feb. 16, 2017) ("Exclusion Order") at 36-37.

[3]See Wadler v. Bio-Rad Laboratories, Inc., et al., No. 0:17-cv-16193 (9th Cir., June 8, 2017).

Several important legal standards are implicated by this case. First, how does it impact the role of general counsel (or other legal advisors) as possible whistleblowers?[4] The Plaintiff Wadler as well as the SEC as amicus curiae took the position that his compliance with SEC Rule 205 and the protections provided there against retaliation permit use of the privileged information. Under Sarbanes-Oxley ("SOX"), Section 307, the SEC in 2003 issued 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," to increasingly higher levels, including the audit committee and board of directors.[5] The subsequently adopted rule covering reporting "up the ladder" is known as Part 205.[6] SOX Section 806 protects attorney-whistleblowers against retaliation for reporting up the ladder. In 2010, these types of whistleblowers gained under Dodd-Frank an expanded remedy through the right to sue in federal court directly.[7]

[4]See generally Latham & Watkins, "Attorneys as SEC Whistleblowers: Can an Attorney Blow the Whistle on a Client and Get a Monetary Reward?" (May 2013); see also Lawrence A. West et al., "Can Attorneys Be Award Seeking SEC Whistleblowers?", Harvard Law School Forum on Corporate Governance and Financial Regulation, (June 12, 2013).

[5]15 U.S.C. § 7245.

[6]17 C.F.R. § 205.1 et seq.

[7]18 U.S.C. § 1514A.

The SEC also promulgated Section 205.3(d) (1) permitting the attorney's use of the report in any responses in litigation about his compliance.[8] In the SEC's view, the rule "shall govern" even if "the standards of a state . . . where an attorney is admitted or practices conflict" with it.[9]

Wadler alleged he was terminated for "engaging in mandatory 'up the ladder' reporting" of possible Foreign Corrupt Practices Act ("FCPA") violations involving operations in China, specifically bribery and books and records violations and others under the securities laws, and reporting them consistent with Part 205. He did not report directly to the SEC.

The company investigated the reported violations, even using outside counsel to prepare a report. The audit committee found no substance to the supposed violations, and management terminated Wadler for alleged other reasons – deterioration of his behavior and performance (including a late-appearing performance review by his CEO).

Wadler initially, under SOX, filed a complaint with the Department of Labor, to which Bio-Rad responded with details of his allegations and a report of outside counsel hired to

[8]Dodd-Frank Wallstreet Reform and Consumer Protection Act, Section 922, codified at Section 21F(h) of the Securities Exchange Act, 15 U.S.C. § 78u-6(h).

[9]17 C.F.R. § 205.3(d)(1).

investigate – both documents based in part on client confidential and privileged information. A second inquiry from the Department of Justice met with a similar defense based in part on privileged material and work product. Wadler then under Dodd-Frank filed a direct action.

Second, what procedural hurdles face such a lawyer-whistleblower? Under the two principal federal laws, Sarbanes-Oxley and Dodd-Frank, whistleblowers are defined are those persons reporting conduct which they reasonably believe constitutes a violation of federal law relating to financial, securities or shareholder fraud.[10] Thus, affirmative steps must be taken by the whistleblower to raise –and articulate in some detail – the basis for the concern.

A relevant question affecting all whistleblowers – not just lawyers – is did the person report concerns not only internally but also to the SEC? Because of a split in the circuit courts, whether reporting to the SEC is a prerequisite under Dodd-Frank is now before the United States Supreme Court, to be decided during its term beginning in October 2017.[11]

[10]Section 806 of the Sarbanes-Oxley Act of 2002 (SOX) and Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[11]Somers v. Digital Realty Trust Inc., 850 F. 3d 1045 (9th Cir. 2017), cert. granted, No. 16-1276 (U.S. June 26, 2017). See also, e.g., Smith v. Raytheon Co., No. 17-cv-00438 (E.D. VA., August 11, 2017) (dismissing retaliation claim which did not allege any disclosure to SEC).

Third, what ethical strictures constrain the ability to present evidence learned by the lawyer during his employment or representation when the lawyer is terminated and sues for retaliation claims? As Wadler and the SEC argued, Rule 205 preempts, under an obstacle conflict preemption analysis, state ethics rules that would frustrate the objects of the Rule and the Congressional acts it implemented.

Bio-Rad posited, however, that Rule 205 (1) did not apply since it permitted use of the lawyer's report only to defend against allegations; (2) was permissive, not mandatory; and (3) the Part 205 report and related material was barred by federal common law privilege and FRE 502.

Rulings contrary to that reached by the *Bio-Rad* Court exist. In New York, for example, where different ethical standard language is used than in many states, the Court ruled that in a qui tam case co-plaintiff general counsel's confidential information was not admissible and did not fall under the crime prevention exception to that state's ethical rules.[12] Thus, as the Latham & Watkins survey and Larry West's summary conclude, the variety of ethical rules differ state to state, which means a range of differing results may arise as to whether SEC Rule 205 is

[12] U.S. ex rel. Fair Lab. Practices Assoc. v. Quest Diagnostics, Inc. , 2013 U.S. App. LEXIS 21709 (2nd Cir., Oct. 25, 2013).

preemptive. For instance, under ABA Model Rule of Professional Conduct 1.6, which has been adopted in 47 states (but not California or New York), a lawyer may use client confidential information to litigate claims or defenses against his or her own client.

Finally, what counseling advice can promote both whistleblower protection and effectiveness from the in-house lawyer's perspective or bolster corporate defenses and protection of privileges?[13] Critical to the court's decision to override the attorney-client privilege in *Bio-Rad* was the confluence of (1) late filing by Bio-Rad of its quasi-dispositive motion and (2) the waiver through prior disclosed reports and proceedings of the ability to preserve privilege and foreclose use of the evidence Wadler presented.[14] Thus consideration as to how to investigate and report internally findings as to a whistleblowing counsel's allegations, when and what to disclose to agencies and government investigators, when to assert the privilege, and what methods are employed to deal internally with the whistleblower's position, duties and compensation must be considered. Keeping the whistleblower within the corporate tent without forcing him or her to go public is a delicate tightrope to walk.

[13]See generally Lisa J. Banks and Jason C. Schwartz, Whistleblower Laws: A Practitioner's Guide, Chapter 13 (Law Journal Press, 2017).

[14]Exclusion Order at 26-31.