

White-Collar Crime

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Multiple Representation Under New SEC Cooperation Initiative

Client conflict decisions may need to come earlier.

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THE SECURITIES and Exchange Commission's cooperation initiative, announced in January 2010, may raise difficult ethical issues for New York practitioners. By offering cooperation incentives, the SEC hopes to encourage more individuals and companies to self-report wrongdoing. However, these incentives also increase the risk of potential conflicts of interests for counsel who represent multiple clients in an SEC investigation.

In the past, the Commission provided specific guidance on cooperation for corporations but not individuals. The so-called "Seaboard Report" lists the factors that the Commission considers in evaluating the cooperation of companies. See Exchange Act Release No. 44969, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decision, 2001 SEC LEXIS 2210 (Oct. 23, 2001).

The Seaboard factors include such considerations as the company's response upon detection of misconduct, whether the company conducted a thorough and expeditious investigation, and how promptly it self-reported the misconduct to the Commission. The rewards for such diligent "self-policing" range from reduced penalties to "the extraordinary step" of taking no enforcement action at all. Id.

More recently, the SEC announced an initiative to encourage individuals to cooperate and assist in

SEC investigations. See Press Release 2010-6, "SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations" (Jan. 13, 2010), available at <http://www.sec.gov/news/press/2010/2010-6.htm>.

This initiative adopts many of the tools utilized by the Department of Justice (DOJ) to encourage individuals to step forward as cooperating witnesses, such as cooperation agreements, deferred prosecution agreements and non-prosecution agreements, and "streamline[s] the process for submitting witness immunity requests to the Justice Department." Id. The initiative also provides guidelines which, for the first time, specifically provide incentives for cooperation from individuals.

The factors for evaluating the cooperation of an individual are similar to those for corporations outlined in the Seaboard Report, with a few notable differences. For corporations, the Seaboard factors include consideration of how promptly the company notified the Commission of misconduct. A similar factor is included in the guidelines for individuals, with the added component of "whether the individual was first to report the misconduct to the Commission or to offer his or her cooperation in the investigation." 17 C.F.R. §202.12(a)(1)(ii).

In addition, the Commission will afford more credit to an individual who provides assistance "before he or she had any knowledge of a pending investigation or related action." Id. The Commission will also consider "[w]hether the investigation was initiated based on information or other cooperation provided by the individual." 17 C.F.R. §202.12(a)(1)(iii).

By crediting these aspects of an individual's cooperation, the SEC has given an incentive for individuals to be the "first in the door," potentially in competition with other individuals as well as with the corporation itself. For example, an individual who informs the SEC of misconduct before others do may benefit from the timeliness

and importance of his or her cooperation, while others, including the corporation, may no longer benefit, or receive reduced cooperation credit, from self-reporting misconduct of which the SEC was already made aware.

Similarly, a lower-level employee may have more limited involvement than an executive, and thus have additional incentive to come forward first, in order to maximize his cooperation credit. The potential "race to cooperate" could lead to difficult ethical issues for counsel undertaking multiple representations in SEC investigations.

Such multiple representation is quite typical. Indeed, the Commission recognizes that multiple representations are "not unusual" in that context and that counsel "[r]epresenting more than one party in an investigation does not necessarily present a conflict of interest, although it may heighten the potential for a conflict of interest." SEC Enforcement Manual §4.1.1.1., available at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

However, the SEC has traditionally been more reticent than prosecutors in the U.S. Attorney's Office for the Southern District of New York (SDNY) to identify conflicts to defense counsel and "suggest" separate counsel, taking the position that it is the responsibility of counsel and the client to discuss and resolve any possible conflicts of interest. Id.¹ The SEC has long taken the position that its investigations are fact-finding and do not have targets. See SEC Enforcement Manual §3.3.2., available at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>; see also, *SEC v. O'Brien*, 467 U.S. 735 (1984).

New York Professional Conduct Rules

The New York Rules of Professional Conduct (New York Rules) provide requirements and guidance for New York counsel concerning multiple representations.

Under the New York Rules, a lawyer representing multiple clients, for example, both a corporation

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and its constituents, must consider whether the multiple representation “will involve the lawyer in representing differing interests.” N.Y. Rules of Prof. Conduct 1.7(a)(1), 22 N.Y. Comp. Codes R. & Regs. §1200.

Such “differing interests” include “every interest that will adversely affect either the judgment or the loyalty of a lawyer to a client, whether it be a conflicting, inconsistent, diverse, or other interest.” N.Y. Rules of Prof. Conduct 1.0(f), 22 N.Y. Comp. Codes R. & Regs. §1200.

Differing interests encompass not only actual conflicts but threatened ones as well. See *Tekni-Plex v. Meyner & Landis*, 89 N.Y.2d 123, 131 (1996) (upholding broad definition of differing interest that does not require any “actual detriment” or actual conflict); but see, Rule 1.7, Comment [8] (The “mere possibility of subsequent harm” does not necessarily create differing interests).

The critical questions a lawyer should consider are “the likelihood that a difference in interests will eventuate and, if it does, whether it will adversely affect the lawyer’s professional judgment.” N.Y. Rules of Prof. Conduct 1.7, Comment [8], 22 N.Y. Comp. Codes R. & Regs. §1200.

Under Rule 1.7(b), if the representation of multiple clients will involve differing interests, the lawyer may only proceed if all of the following conditions are met:

- (1) the lawyer reasonably believes that he or she will be able to provide competent and diligent representation to each affected client;
- (2) the representation is not prohibited by law;
- (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
- (4) each affected client gives informed consent, confirmed in writing.

N.Y. Rules of Prof. Conduct 1.7(b), 22 N.Y. Comp. Codes R. & Regs. §1200.

In the context of an SEC investigation, counsel’s obligations require identifying when differing interests are present between or among multiple clients, and either obtaining written consent to such conflicts of interest or advising the affected client or clients to obtain separate counsel. As Rule 1.7(b) implies, there are circumstances in which even a client’s written consent will not waive a conflict of interest, such as when there may be claims by one client against another during the same investigation, Rule 1.7(b)(3), or in a more general sense, when the lawyer reasonably believes it is not possible to provide “competent and diligent representation” to each affected client under Rule 1.7(b)(1).

However, applying Rule 1.7(b) during the course of an SEC investigation is particularly challenging. At the outset of a case, counsel may have a limited understanding of the facts, and a limited understanding of the focus of the investigation and the potential culpability of a client. A counsel’s understanding of the facts often changes during the course of the investigation.

Moreover, counsel may have limited insight about whether the Commission staff intends to make an enforcement recommendation against a specific client, until late in the investigative process.²

For these reasons, sometimes SEC defense practitioners may wait to advise clients to obtain separate counsel, unless and until, one or more clients receive a Wells notice advising of recommended charges the SEC staff intends to present to the Commission for approval.

Impact of New Cooperation Program

The SEC’s new cooperation program may change the timing of counsel’s determination of potential conflicts between clients under Rule 1.7(b), and the need for particular client to be referred to or provided separate counsel.

With the new cooperation initiative there are now personal interests at stake for individuals who may be motivated to self report at an early stage to obtain the potential benefits of cooperation. For example, SEC staff may communicate to counsel, either explicitly or implicitly, that a specific individual would benefit from the cooperation program.

Such indications from the staff could take place early in an investigation. Indeed, among the number of new initiatives recently adopted by the SEC Division of Enforcement is an emphasis on investigative speed. In another situation, the benefit to an individual may become apparent to counsel in the course of preparing the client for SEC testimony or as counsel learns more about the nature of the investigation.

Each of these scenarios raises difficult determinations for counsel under Rule 1.7(b) and without the benefit of case law specifically addressing ethical issues directly raised by the SEC’s new cooperation initiative.

Although the Commission’s cooperation initiative incorporates many of the DOJ-type tools and practices for cooperators, it is yet to be seen whether the SEC will adopt a more forthcoming approach, like the SDNY, in communicating with counsel concerning the status of a particular client, or whether a conflict in representation exists from the government’s perspective.

The SEC’s new cooperation program permits, but does not require, the staff to provide oral assurance “that an individual or company has not violated the federal securities laws such as to warrant an enforcement action.” SEC Enforcement Manual §6.2.1., available at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>. However, such oral assurances “are only authorized when the investigative record is adequately developed.” *Id.*

While oral assurances may give guidance to counsel regarding the status of an individual client, and in turn, to potential conflict determinations, any such assurances will likely be given fairly late in an investigation, and it is too soon to determine whether the SEC staff will regularly utilize this tool.

It is also too soon to determine whether the Commission staff will reconsider its traditional reticence in suggesting separate representation when counsel represents multiple witnesses in an investigation. As the agency moves to more of a

“DOJ model,” its staff may adopt a more proactive approach in multiple representation cases. While conflict determinations are most appropriately made by counsel, and not the government, as a practical matter a “suggestion” by SEC staff that separate counsel be provided to individuals would be difficult to reject.

Conclusion

The new cooperation initiative raises new and difficult ethical issues for New York counsel representing multiple clients in an SEC investigation. Counsel should regularly re-visit the requirements of Rule 1.7(b) during the course of an investigation as the factual record is developed and as input, if any, is received by the Commission staff.

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1. The SEC’s Form 1662 that accompanies subpoenas and voluntary requests for information states: “You may be represented by counsel who also represents other persons involved in the Commission investigation. This multiple representation, however, presents a potential conflict of interest if one client’s interests are or may be adverse to another’s. If you are represented by counsel who also represents other persons involved in the investigation, the Commission will assume that you and counsel have discussed and resolved all issues concerning possible conflicts of interest. The choice of counsel, and the responsibility of that choice, is yours.” SEC Form 1662, at §B(2), available at <http://www.sec.gov/about/forms/sec1662.pdf>.

2. During the course of an internal investigation where counsel represents the company and not individual constituents, appropriate *Upjohn* warnings should be given to employees interviewed. The warnings include stating that the lawyer represents the company and not the individual, that while the interview is covered by the attorney-client privilege, the privilege belongs to the company, and that the company may waive the privilege and disclose matters discussed with others. See, *Upjohn v. United States*, 449 U.S. 383 (1981); see also, N.Y. Rules of Prof. Conduct 1.13, Comment [2A], 22 N.Y. Comp. Codes R. & Regs. §1200.