**Ethics and Financial Issues: Balancing Dueling Obligations**

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**William R. Terpening[[1]](#footnote-1)**

**Terpening Law, Charlotte, NC**

[**terpening@terpeninglaw.com**](mailto:terpening@terpeninglaw.com)

**(980) 265-1700**

A. **Loyalty and Confidentiality vs. Duty of Fairness and Reporting Obligations.**

***Introduction***

In addition to typical fiduciary duties, every state’s Rules of Professional Conduct governing the legal profession impose and reinforce duties similar to fiduciary duties. For instance, North Carolina Rule of Professional Conduct 0.1 instructs not only that a lawyer should “zealously assert [] the client’s position” and “seek[]” a result advantageous to the client,” but the lawyer must do so “consistent with requirements of honest dealing with others.” A lawyer cannot “counsel a client to engage…in conduct that the lawyer knows is criminal or fraudulent…” N.C. R. Prof. Conduct 1.2(d). Further, a lawyer must keep client information confidential, of course. N.C. R. Prof. Conduct 1.6. It is the lawyer’s duty to act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client’s behalf, and the duty to preserve the integrity of the attorney-client relationship by maintaining the confidentiality of communications, that are perhaps the most fundamental of the profession. N.C. Rules of Prof’l Conduct, r. 1.3 and 1.6. Despite these fiduciary duties imposed by the Rules of Professional Conduct, on the other hand, attorneys are obligated by the same Rules of Professional Conduct not to make false representations to others, counsel or aid and abet a client in the commission of a crime. Attorneys who become aware that a client is engaging in conduct that violates the law, or will violate the law, face a dilemma in determining the nature and scope of their reporting obligations in upholding their ethical duties. While the lawyer must remain faithful in fulfilling their duties to the client, the lawyer must also uphold the integrity of the profession.

Lawyers, however, are not the only professionals obligated by law and/or professional rules governing their respective profession to diligently pursue their client’s best interests and maintain confidentiality while still obligated to uphold certain ethics. While financial professionals, including CPAs and investment advisors may not owe a *de jure* fiduciary relationship to their clients under North Carolina law, often the financial professional-client circumstances establishing a relationship of confidence and trust will give rise to a *de facto* fiduciary relationship. *Silverdeer, LLC v. Berton*, 2013 NCBC 24, 73, 2013 NCBC LEXIS 21, \*27-28, 2013 WL 1792524 (Apr. 24, 2013). Financial professionals are almost always fiduciaries in whom “special confidence has been reposed and is obligated in equity and good conscience to act in good faith and due regard to the interest of the one reposing the confidence.” *Green v. Freeman*, 367 N.C. 136, 141, 749 S.E.2d 262, 268 (2013). Nor are lawyers the only professionals that learn secrets or private information with the express or implied understanding that the information will be kept confidential. While there are numerous sources governing a financial professional’s confidentiality obligations to the client, financial professionals also have certain reporting obligations and duties to maintain the integrity of the profession when they uncover evidence of illegal activity or conduct.

With almost complete certainty, there will be times when a lawyer, accountant or other financial professional finds themselves at the intersection of attempting to satisfy their fiduciary duties by faithfully advancing their client’s interests and preserving confidentiality, while needing to conduct themselves in a way that fulfills their ethical or legal reporting obligations. The dilemma of whether to maintain confidentiality, refuse to make misrepresentations, or disclose confidential information in order to avoid aiding or abetting the commission of a crime, harm to the client or a third party can be a difficult scenario for one providing professional services in the legal or financial world.

Thus, the question naturally presented for both lawyers and financial professionals is, where is the line? When does a lawyer or financial professional have a duty to report a client’s financial misconduct when also required to maintain confidentiality and pursue the client’s best interest. What can and should the lawyer or financial professional do?

***Attorneys: The North Carolina Professional Rules of Responsibility Generally***

Under The North Carolina Rules of Professional Conduct, which are analogous to the rules of professional conduct in almost all jurisdictions in the United States, an attorney is prohibited from counseling a client to engage in, or assisting a client in conduct the lawyer knows is criminal or fraudulent.” N.C. Rules of Prof’l Conduct, r. 1.2(d). While an attorney may not counsel a client in, or aid and abet a client in the commission of a crime, in some circumstances balancing the lawyer’s fiduciary duty to act in the client’s best interest while abiding by the Rules of Professional Conduct to maintain client confidentiality can be tricky.

NC Rule of Professional Conduct 1.6 establishes that “a lawyer shall not reveal information acquired during the professional relationship with 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).” Rule 1.6(b) establishes that a lawyer *may* reveal confidential information in certain circumstances when the lawyer reasonably believes necessary, including to prevent the commission of a crime by a client, to prevent reasonably certain death or bodily harm, or to prevent, mitigate, or rectify the consequences of a client’s criminal or fraudulent act in the commission of which the lawyer’s services were used, among other limited circumstances. Rule 1.6(b)(2)-(4). Essentially, the Rules of Professional Conduct *permit* disclosure of confidential client information if the attorney reveals such information to prevent the commission of a crime or fraud, or to prevent impending harm. *See id*. Whether the attorney chooses to make such disclosure is ultimately a matter of discretion under the NC Rules. N.C. Rules of Prof’l. Conduct 1.6(b).

On the other hand, there are circumstances in which the lawyer does not learn of the client’s crime or fraud until after it has been consummated. *See* Comment 9 to Rule 1.6. The instances permitting disclosure of client information do not apply “when a person who has committed a crime or fraud [and] thereafter employs a lawyer for representation concerning that offense.” *Id*. Nor do the Rules of Professional Conduct prohibit a lawyer from representing or counseling a client that has already consummated a crime or fraud. Permitting disclosure of client information relating to a crime or fraud for which the client has engaged the lawyer, or rules prohibiting representation of a person whom has already committed a crime or fraud would effectively negate the concept that everyone is entitled to legal representation. The Rules, however, do not expressly prohibit a lawyer from disclosing information, which is learned in the course of representing a client, about crimes or frauds for which the client has not engaged the lawyer. In such instances, the lawyer may, in their discretion, disclose such information if disclosure will prevent death or bodily harm or will mitigate or rectify the consequences of the client’s conduct. N.C. Rules of Prof’l Conduct 1.6(b).

Sometimes, however, the line between past and future (or ongoing) criminal conduct is not always patently clear. Deciding which communication is protected and which is part of ongoing criminal activity or fraud is particularly hard in organized economic ventures regulated by complex criminal statutes where a client’s conduct may be a mix of legitimate and criminal behavior. Attorneys may encounter such situations in any number of contexts, but particularly in counseling or representing a client regarding tax matters, providing counsel in transactional matters, or in the securities context. For instance, an attorney that is engaged by a corporation to provide general tax counsel may learn in the course of representation that the corporation has structured their business in a way that resulted in the misreporting of profits and losses in years prior. Under the North Carolina Rules, while the lawyer does not have an affirmative and mandatory duty to disclose confidential information and report the corporation for past conduct (although the lawyer may do so if they reasonably believe it necessary to mitigate or rectify consequences), the lawyer may not assist or counsel the corporation to continue such conduct even though the client indicates it is “in their best interest.” Rather, the lawyer must make an effort to bring the corporation into compliance or decline further representation if the corporation refuses to effect changes.

***Attorneys Revealing Confidential Information in the SEC Context***

As required by the Sarbanes-Oxley Act of 2002, the SEC prescribed minimum standards of professional conduct for attorneys appearing and practicing before the Commission on behalf of issuers. These standards are set forth in “Part 205.”[[2]](#footnote-2) Part 205 applies only to attorneys “appearing and practicing” before the Commission in the context of providing legal services for an “issuer.” “Appearing and practicing” is broadly defined. It includes, for example, merely advising on a US securities law issue regarding a document that the attorney has notice will be incorporated into a document to be filed with or submitted to the Commission. “Issuer” is also broadly defined; it includes 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. 17 CFR § 205.2.

Part 205 deals primarily with when an attorney must cause reporting “up the ladder” when they become aware of evidence of a “material violation” by the issuer. Part 205, however, does not create a mandatory obligation to “report out” to the SEC or anyone else in any circumstance, but does permit attorneys it covers to “report out” to the SEC. That is, the attorney may reveal confidential information related to the representation to the SEC without the issuer’s (the client) consent, but only to the extent that attorney believes necessary to:

* Prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
* Prevent the issuer, in a SEC investigation or administrative proceeding, from committing perjury, or knowingly and willfully perpetrating a fraud upon the SEC; or
* Rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in furtherance of which the attorney’s services were used.

While Part 205 does not prohibit disclosure of confidential client information without client consent, that prohibition is found in the professional rules of conduct in every jurisdiction. The rules of the jurisdiction in which the attorney practices apply at all times to all attorneys practicing before the Commission. Therefore, attorneys subject to Part 205, both the state professional rules and SEC rules apply.

Part 205 sets forth minimum standards of professional conduct, which means that to the extent that Part 205 permits disclosure while the state professional rules do not, the attorney may disclose to the SEC the confidential information. Therefore, if an attorney reasonably believes his or her client is a continuing bad actor, such that Part 205 permits disclosure, while the applicable jurisdictional rules forbid disclosure, Part 205 governs, and the disclosure will be permitted absent client consent.

***Accountant Disclosure of Confidential Information***

Beyond owing a duty of confidentiality to the client or organization under professional rules and often as a de facto fiduciary state boards governing CPAs and the American Institute of CPAs (AICPA) have long had guidance dealing with confidential client information. AICPA Rule 1.400.070 governing Confidential Information Obtained from Employment and the Confidential Client Information Rule, set forth 1.700.001 of the AICPA Code of Professional Conduct, provide that nonpublic confidential information obtained by a CPA during the course of providing professional services cannot be disclosed to a third party unless the CPA obtains specific client consent for the disclosure. Internal Revenue Code Sections 6713 and 7216 also impose strict confidentiality requirements on tax return preparers, including CPAs, regarding the use or disclosure of any information provided by a taxpayer in connection with the preparation of a tax return unless the taxpayer provides informed written consent. The same principle of confidentiality is invoked by auditors when fraud is uncovered during an audit. Statements on Auditing Standards No. 99 establishes that disclosure of fraud to parties other than the client and its audit committee “would be precluded by the auditor’s ethical and legal obligations of confidentiality.” But, given the confidentiality obligations, how should an accountant respond to non-compliance with laws and regulations and when, if ever, should the accountant disclose confidential information?

Beyond the rules imposed by governing associations for CPAs, the North Carolina State Board of Certified Public Accountant Examiners, in the administrative code, has established the Rules of Professional Ethics and Conduct. *See* 21 NCAC 08N. The North Carolina Rules of Professional Ethics and Conduct specifically address a CPA’s duty of confidentiality. Specifically, 21 NCAC 08N .0205 establishes that “a CPA shall not disclose any confidential information obtained in the course of employment or a professional engagement except with the consent of the employer or client.” As is true with the Rules of Professional Conduct governing the legal profession, this rule is also not without exception. 21 NCAC 08N .0205. The Administrative Code enumerates seven instances in which a CPA may disclose confidential information. Among others, a CPA may disclose confidential client information in response to a court order or validly issued subpoena by the NC Board of CPA Examiners, to respond to an inquiry made by the AICPA Ethics Division or Trial Board, or a duly constituted investigative or disciplinary body of a state CPA society, or in disclosing confidential information to state or federal authorities when the CPA concludes in good faith based upon professional judgment that a crime is being or is likely to be committed. 21 NCAC 08N .0205(b).

Of importance is the fact that the rule precluding disclosure of confidential information by a CPA relating to a crime operates similarly to the Rules of Professional Conduct governing lawyer disclosure of confidential information. 21 NCAC 08N .0205(b)(6) specifically states that a CPA may disclose confidential information “to state or federal authorities when the CPA concludes in good faith based upon professional judgment that a crime is being or is likely to be committed.” The plain language of the rule only contemplates ongoing or future criminal conduct. *Id*. The language of the rule does not permit a CPA to disclose confidential information relating to past, or already consummated crimes. *Id*.

AICPA Rule 1.400.070 contemplates circumstances in which member CPAs “are permitted or may be required to disclose confidential information or when such disclosure may be appropriate.” Specifically, the rule permits disclosure when: required by law; to initiate or respond to complaints or inquiries made by the AICPA Professional Ethics Division or a state CPA society, board of accountancy, or other regulatory body; or on behalf of the employer to obtain financing with lenders, or in communicating with vendors, clients, customers, external accountants, regulators, attorneys or other business professionals. *Id*.

AICPA Rule 1.700.005 establishes that if another Rule does not specifically address “a particular relationship or circumstance, a member should apply the Conceptual Framework for Members in Public Practice” in determining if disclosure is warranted, permitted, and necessary. Under the Conceptual Framework approach, detailed in AICPA Rule 1.000.010, “members should identify threats to compliance and evaluate the significance of those threats.” If a member cannot demonstrate that safeguards were applied to eliminate or reduce significant threats to an acceptable level, a member would be considered in violation of the Confidential Client Information Rule. AICPA Rule 1.700.005.

In essence, CPAs owe their clients and/or employers a duty of confidentiality. The rules discussed herein do *permit* disclosure in certain circumstances, but do not require disclosure in most instances absent extenuating circumstances. Rather, CPAs should not disclose confidential information relating to previous crimes or non-compliant conduct, unless required to do so by law or in response to certain investigative or disciplinary actions. On the other hand, CPAs may disclose confidential information in instances of future or ongoing illegal activity or noncompliance. In any event, the disclosure should only be made after a full understanding of the circumstances is achieved, safeguards to eliminate the threat have been implemented and the noncompliance or illegal activity is not rectified through remedial efforts.

**B. Misconduct and Dishonesty.**

***Attorney Misconduct and Dishonesty***

The clearest guidance regarding attorney misconduct and dishonesty is set forth in Rules 8.1 through 8.6 of the North Carolina Rules of Professional Conduct (and, for other states, in very similar sets of rules of professional conduct). The highlights are:

Rule 8.3(a) – Reporting Professional Misconduct: “A lawyer who knows that another lawyer has committed a violation of the Rules of Professional conduct that raises a **substantial** question as to that lawyer’s **honesty**, **trustworthiness** or **fitness** as a lawyer, **shall** inform the North Carolina State Bar **or** the court having jurisdiction over the matter.” In other words, if you are a lawyer and know that another lawyer engaged in conduct raising a “substantial question” about whether the lawyer is honest, trustworthy, or fitness as a lawyer, you *must* (“shall”) notify the Bar. The commentary emphasizes “substantial,” meaning that not every instance of misconduct has to be reported, just misconduct that is “serious” and that affects honesty, trustworthiness, and fitness to practice. The commentary to the rule urges lawyers to use their judgment in determining what conduct is substantial. This suggests that conduct involving minor transgressions pertaining to honesty, for example, might perhaps be left unreported – but the question is: where is the line? Also, potentially unreportable would be crimes or bad acts that do not implicate honesty, trustworthiness, or fitness. But, decisions regarding which crimes or bad acts qualify, and which do not, can be challenging. Also note that the conduct can be reported to the Bar *or* the court – another judgment call.

The commentary and rule provide some important reporting exceptions. Information acquired from a lawyer in the context of an attorney-client relationship (e.g., a lawyer representing a lawyer) is generally not-reportable. As well, North Carolina has an assistance program in which lawyers counsel each other for problems like substance abuse and depression. Information learned there is not reportable, *unless* the lawyer discloses that he intends to commit illegal activity (such as stealing client funds).

Importantly, Rule 8.3(a) does not usually require the lawyer to report *his own* misconduct, except that self-reporting is encouraged. That said, lawyers *must* report their own misappropriation of trust funds, per Rule 1.15-2(p). This reflects how seriously trust fund abuse by lawyers is taken, as discussed further below. As well, per Rule 8(d), if a lawyer is disciplined by a federal or state court for violations of the Rules of Professional Conduct, he must self-report. Note that this appears to only refer to violations of the Rules of Professional Conduct, so judgment again comes into play.

Rule 8.4 – Misconduct: This rule expressly states that it is professional misconduct for a lawyer, among other misdeeds, to “commit a criminal act that reflects adversely on the lawyer’s honesty, trustworthiness or fitness as a lawyer in other respects,” “engage in conduct involving dishonesty, fraud, deceit or misrepresentation that reflects adversely on the lawyer’s fitness as a lawyer,” “engage in conduct that is prejudicial to the administration of justice,” “state or imply an ability to influence improperly a government agency or official,” or “intentionally prejudice or damage his or her client during the course of the professional relationship….” This last requirement will be discussed later in the context of conflicts.

But overall, we see substantial vagueness here, and there are some odd aspects in the language. For instance, if a lawyer shouldn’t “engage in conduct involving dishonesty, fraud, deceit or misrepresentation *that reflects adversely on the lawyer’s fitness as a lawyer*,” can he engage in fraud, deceit, or misrepresentation that does not reflect adversely on his fitness as a lawyer? If so, what kind of fraud, deceit, or misrepresentation might that be? The comments offer some help: “Although a lawyer is personally answerable to the entire criminal law, a lawyer should be professionally answerable only for offenses that indicate lack of those characteristics relevant to law practice.” “Threats, bullying, harassment and other conduct serving no substantial purpose other than to intimidate, humiliate, or embarrass anyone associated with the judicial process” are out. Again, this is very subjective.

Ethics opinions make several interesting clarifications. An attorney’s filing for bankruptcy is not a violation, presumably because while that may affect a lawyer’s fitness, it does not involve deceit, without more.

I mention that a lawyer can notarize documents used in his own legal proceedings simply because that question often arises – it does seem to present a bit of a potential for conflict, though.

Calls with opposing counsel can be recorded without disclosure to the opposing lawyer (North Carolina is a one-party consent jurisdiction). I find this interesting because it seems to potentially involve dishonesty. But perhaps it doesn’t implicate a lawyer’s fitness, the other requirement of that violation. Same goes for an exception allowing lawyers to use excerpts from other lawyers’ pleadings or briefs without consent or attribution.

I pause briefly on 2008 Formal Ethics Opinion 15, which indicates that a settlement with a non-reporting provision “does not constitute the criminal offense of compounding a crime and is not otherwise illegal, and does not contemplate the fabrication, concealment, or destruction of evidence, a lawyer may participate in a settlement agreement of a civil claim that includes a non-reporting provision prohibiting the plaintiff from reporting the defendant’s conduct to law enforcement authorities.” This comes up often in my civil fraud cases, and we will examine the Ethics Opinion further during the CLE.

Finally, Rule 8.5 notes that if you’re practicing in another jurisdiction *pro hac vice* or because you’re licensed there, you need to report any violations in in the non-North Carolina jurisdiction to the Bar.

***CPA Misconduct and Dishonesty***

The AICPA – “the world’s largest member association representing the accounting profession” – has a Code of Professional Conduct, which you can access here: <https://www.aicpa.org/research/standards/codeofconduct.html>. These rules apply both to members in public practice and members in business. The Code contains a number of provisions, similar to attorney rules governing professional conduct, prohibiting misconduct and dishonesty. For instance, Rule 1.100.001 broadly states: “In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.” You’ll note that, as with the attorney rules, judgment plays a central role in guiding how CPAs should use their discretion in interpreting and applying the Code. However, the Code references concrete “interpretations” that offer somewhat more guidance regarding specific predicaments than the attorney rules offer. Thus, CPAs should search for interpretations specific to their problem first.

When a CPA must resort to judgment, the Code offers a “Conceptual Framework”. *See* 1.000.010 (“Thus, in the absence of an interpretation that addresses a particular relationship or circumstance, a member should evaluate whether that relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a threat to the member’s compliance with the rules that is not at an acceptable level. When making that evaluation, the member should apply the conceptual framework approach as outlined in this interpretation.”). In general, under the framework, CPAs should first identify threats, then evaluate how significant it is, and then apply safeguards to either eliminate the threat or reduce it to an acceptable level. Such mitigation of the threat is not always possible, in which case the CPA should disengage if continuing would violate the Code. The Code groups the threats into several general areas: “adverse interest, advocacy, familiarity, management participation, self-interest, self-review, and undue influence.” These categories offer some sense of the ethical challenges that CPAs are likely to confront.

The North Carolina Board of CPAs, as well, has rules offering guidance. *See* [*https://nccpaboard.gov/resources/*](https://nccpaboard.gov/resources/)*.* Subchapter 08N of the North Carolina Administrative Code governs professional ethics and conduct (<https://nccpaboard.gov/welcome/subchapter-08n-professional-ethics-and-conduct/>). 21 NCAC 08N .0202 flatly prohibits deceptive conduct, regardless of whether anyone is actually deceived. “Prohibited conduct… includes deception in: (1) obtaining or maintaining employment; (2) obtaining or keeping clients; (3) obtaining or maintaining certification, inactive status, or exemption from peer review; (4) reporting CPE credits; (5) certifying the character or experience of exam or certificate applicants; (6) implying abilities not supported by education, professional attainments, or licensing recognition; (7) asserting that services or products sold in connection with use of the CPA title are of a particular quality or standard when they are not; (8) creating false or unjustified expectations of favorable results; (9) using or permitting another to use the CPA title in a form of business not permitted by the accountancy statutes or rules; (10) permitting anyone not certified in this State (including one licensed in another jurisdiction) to unlawfully use the CPA title in this State or to unlawfully operate as a CPA firm in this State; or (11) falsifying a review, report, or any required program or checklist of any peer review program.” In addition, North Carolina CPAs must abide by the rules of any other professional or governmental group with which they interact: “CPAs who engage in activities regulated by other federal or state authorities (may include the following agencies: Internal Revenue Service, Department of Revenue, U.S. Securities and Exchange Commission, State Bar, North Carolina Secretary of State, Public Company Accounting Oversight Board, National Association of Securities Dealers, Department of Insurance, Government Accountability Office, U.S. Department of Housing and Urban Development, State Auditor, State Treasurer, or Local Government Commission) shall comply with all such authorities’ ethics laws and rules.” 21 NCAC 08N .0204. The CPA Board has to be notified of any such violations within 30 days.

Both the AICPA and NC CPA Board can investigate and discipline their members. In addition to applying civil penalties for rule violations, “The [NC CPA] Board shall have the power to revoke, either permanently or for a specified period, any certificate issued under the provisions of this Chapter to a certified public accountant or any practice privilege authorized by the provisions of this Chapter or to censure the holder of any such certificate or person exercising the practice privilege authorized by this Chapter.” N.C. Gen. Stat. 93-12(9). The AICPA has a Professional Ethics Division that investigates potential violations. *See* [*https://www.aicpa.org/interestareas/professionalethics/resources/ethicsenforcement.html*](https://www.aicpa.org/interestareas/professionalethics/resources/ethicsenforcement.html)*.* Guidance for how you might respond to an AICPA ethics inquiry can be found here: <https://www.aicpa.org/interestareas/professionalethics/resources/ethicsenforcement/resinv.html>. The guidance encourages subjects of investigations to freely communicate with the investigator (we will discuss how freely and how to handle that), timely respond in writing to the complaint, and to re-acquaint themselves with the rules that have purportedly been violated. Responding to inquiries like this can present many traps for the unwary, and CPAs should consider retaining legal counsel. For example, while CPAs should always be honest and forthcoming with investigators, they should avoid such a familiar relationship with investigators that they inadvertently dig a deeper whole by over-disclosing or by failing to put the facts in proper context.

**C. How Diligent Must You be Regarding the Statements and Declarations of Clients?**

A lawyer cannot “counsel a client to engage…in conduct that the lawyer knows is criminal or fraudulent…” N.C. R. Prof. Conduct 1.2(d). A lawyer must keep client information confidential, of course. N.C. R. Prof. Conduct 1.6. The rules also strictly limit a lawyer’s ability to enter into transactions with clients (Rule 1.8), represent new clients with interests adverse to former clients (Rule 1.8 and 1.9), use information gained from a client against the client (Rule 1.8), and receive gifts from clients (Rule 1.8).

On a related note, “an attorney may be liable for aiding and abetting his client's breach of fiduciary duty if he ‘actively participates’ in the conduct constituting the underlying breach of fiduciary duty.” *Zloop, Inc. v. Parker Poe Adams & Bernstein, LLP*, 2018 NCBC LEXIS 16, \*44, 2018 NCBC 16, 2018 WL 943954 (N.C. Super. Feb. 16, 2018). However, “a lawyer or law firm cannot be liable for the representations of a client, even if the lawyer incorporates the client's misrepresentations into legal documents or agreements necessary for closing the transaction,” and is not liable if he merely performs the role of scrivener. *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991) (“In this case, Weinberg & Green merely “papered the deal,” that is, put into writing the terms on which the Schatzes and Rosenberg agreed and prepared the documents necessary for closing the transactions.”). For instance, if a lawyer input inaccurate client misrepresentations into a financial statement, the lawyer would not be liable to others.

**D.** **How to Avoid Becoming an Unwitting Accomplice to Fraud.**

The guiding principle in the criminal law about not becoming an unwitting accomplice to fraud is the concept of “willful blindness.” “The willful blindness instruction allows the jury to impute the element of knowledge to the defendant if the evidence indicates that he purposely closed his eyes to avoid knowing what was taking place around him.” *United States v. Schnabel*, 939 F.2d 197, 203 (4th Cir. 1991). In other words, to avoid criminal liability for helping your client commit fraud, keep your eyes open and look for red flags of fraud. When you see indirect indicia of fraud, look for more indicators. And start to ask questions of your client and others involved with the scenario.

These, often, may be difficult conversations to have with your client. It is not conducive to a warm professional relationship to accuse your client of committing fraud. So how do you have the discussion with your client when you suspect fraud? The best approach, generally, is to not accuse your client of committing fraud. I like to take the more indirect approach of playing devil’s advocate, suggesting to my client that perhaps what they are doing could look to the authorities or regulators that something might be wrong with what they are doing. I find that I can get a long way by reminding my client that they would never knowingly commit fraud, and that I am seeing red flags that others might misinterpret as fraud. This, generally, can be sufficient to start a discussion that causes the client to rethink their own actions and work with you to proceed in a legal, non-fraudulent manner. It is always helpful, as part of this discussion, to gently remind the client how severe the criminal penalties are for fraud, particularly in the federal context.

What do I mean when I talk about “red flags” indicating possible fraud? What do you look for? In the context of your professional career, you have developed an instinct for what seems authentic and what does not. If you are a tax preparer, for example, if documents that a client is providing to you normally look a certain way, but your client’s documents look different, talk to the client further. Does the letterhead look odd? Does the signature look like it was pasted? Have a discussion.

Finally, as noted above, CPAs and other professionals have to trace a careful path between their loyalty to clients when they suspect fraud. AICPA Rule of Professional Conduct 1.000.020 cautions that, first and foremost, the primary responsibility is to follow the rules. When a CPA is in doubt about what to do when faced with fraud, the best approach under the Code is for the CPA to *talk to others* within their firm or consult others who may be able to advice, and to *document* what they are doing and the reasons for their decision. Again, if departures from the rules cannot be justified – if the fraud cannot be prevented – the CPA must terminate the engagement or client relationship rather than violate the Code by persisting with the ethical conflict.

**E. Competency in Financial Matters.**

***Attorney Competency***

In financial matters, as in all areas, per North Carolina Rule of Professional Conduct 1.1, “A lawyer shall not handle a legal matter that the lawyer knows or should know he or she is not competent to handle without associating with a lawyer who is competent to handle the matter. Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation.”

Comment 1 to Rule 1.1 of the North Carolina Rules of Professional Conduct establishes:

In determining whether a lawyer employs the requisite knowledge and skill in a particular matter, relevant factors include the relative complexity and specialized nature of the matter, the lawyer's general experience, the lawyer's training and experience in the field in question, the preparation and study the lawyer is able to give the matter, and whether it is feasible to refer the matter to, or associate or consult with, a lawyer of established competence in the field in question. In many instances, the required proficiency is that of a general practitioner. Expertise in a particular field of law may be required in some circumstances.

Although a lawyer need be competent, the comments to Rule 1.1 acknowledge that a lawyer need not necessarily have special training or prior experience to handle legal problems of a type with which the lawyer is unfamiliar. A newly admitted lawyer, or a lawyer inexperienced in a particular field, can be as competent as a lawyer with long experience. Important legal skills, such as the analysis of precedent, evaluation of evidence, legal drafting, and determining what kind of legal problems a situation may involve can transcend any particular specialized knowledge. As such competent and adequate representation in a wholly novel field can be achieved through the combination of necessary study and fundamental legal skill.

It is important to note, however, that an error by a lawyer may constitute professional malpractice under the applicable standard of care and subject the lawyer to civil liability without being a violation of the ethical duty to represent a client competently. A lawyer who makes a good-faith effort to be prepared and thorough will not generally be subject to professional discipline. *See* Comment 9 to Rule 1.1. For instance, a single error or omission, made in good faith, absent aggravating circumstances, is not usually indicative of a violation of the duty to represent a client competently.

***Accountant Competency***

Under the North Carolina Administrative Code, a “CPA shall perform professional services competently.” 21 NCAC 08N .0211. The NC Administrative Code is somewhat vague and open to interpretation. Specifically, in competently providing professional services the CPA shall:

(1) undertake only those engagements that the CPA or CPA’s firm can expect to complete with professional competence;

(2) exercise due professional care in the performance of an engagement;

(3) adequately plan and supervise an engagement; and

(4) obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to an engagement.

Under AICPA Rule 1.300.010, competence “means that the member or member’s staff possesses the appropriate technical qualifications to perform professional services and that the member, as required, supervises and evaluates the quality of work performed.” Competence encompasses knowledge of the profession’s standards, the techniques and technical subject matter involved, and the ability to exercise sound judgment in applying such knowledge in the performance of *professional services*. *Id*.

A member’sagreement to perform professional servicesimplies that the memberhas the necessary competence to complete those services according to professional standards and to apply the *member’s* knowledge and skill with reasonable care and diligence. *Id.* “The membermay have the knowledge required to complete the services in accordance with professional standards prior to performance. A normal part of providing professional servicesinvolves performing additional research or consulting with others to gain sufficient competence.” *Id*. If, however, a member cannot gain sufficient competence, the member should suggest in fairness to the client, the engagement of a person to perform the professional services independently or as an associate. *Id*.

**F. Conflicts of Interest.**

***Attorney Conflicts of Interest***

North Carolina Rule of Professional Conduct 1.7 governs how to navigate conflicts of interest with respect to current clients:

Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: (1) the representation of one client will be directly adverse to another client; or (2) the representation of one or more clients may be materially limited by the lawyer's responsibilities to another client, a former client, or a third person, or by a personal interest of the lawyer. (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if: (1) the lawyer reasonably believes that the lawyer 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.

Rule 1.9 addresses conflicts between lawyers and their former clients.

Rule 1.8 prohibits specific conflicts. One is this: Do not enter into a business transaction with a client unless the terms are fair and reasonable to the client, and clearly disclosed in writing; you recommend to the client that they have independent counsel review the deal; and, the client gives informed consent to the transaction, in writing. In my experience, the optics of such transactions are so bad, and the risks to the lawyer and client are so high, that I would almost always advise lawyers to simply refrain. Similarly, the Rule instructs lawyers not to accept substantial gifts from clients.

In addition, do not use information gained during a representation to a client’s disadvantage unless the client gives written informed consent.

One subpart of Rule 1.8 that arises fairly often is the prohibition from allowing someone other than your client to pay their fees. This situation is often unavoidable. When it occurs, the client must give consent, the compensation arrangement cannot affect your judgment, and you cannot share confidential information as defined in Rule 1.6 with the person paying the bill (or with anyone else, except in a manner that complies with Rule 1.6).

***CPA Conflicts of Interest***

The North Carolina Administrative Code expressly identifies circumstances that may give rise to CPA conflicts of interest. For instances, the contemplated potential circumstances giving rise to a conflict of interest include: CPA personal financial interest in the advice; acceptance of a commission or referral fee; and acceptance of a contingency fee. 21 NCAC 08N .0303. As related to each of these, in offering accounting or financial related advice, a CPA shall be objective and shall not place the CPA’s own financial interests nor the financial interests of a third party ahead of the legitimate financial interests of the CPA’s client or the public. 21 NCAC 08N .0303(a). Concerning a commission or referral fee or acceptance of a contingency fee, a “CPA shall communicate in advance to a client the scope of services or products to be rendered or referred for which the CPA will receive a commission, referral, or contingent fee. A CPA shall provide disclosure in a written statement within ten business days of the service or product to be rendered or referred with the commission, referral, or contingent fee to be charged or received by the CPA.” 21 NCAC 08N .0303(e).

The AICPA rules also acknowledge that a “member or his or her firm may be faced with a conflict of interest when performing a professional service.” AICPA Rule 1.110.010. “In determining whether a professional service, relationship or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.” *Id*. The AICPA Rules list examples of situations in which conflicts may arise, which include:

* Providing corporate finance services to a client seeking to acquire an audit client of the firm, when the firm has obtained confidential information during the course of the audit that may be relevant to the transaction;
* Advising two clients at the same time who are competing to acquire the same company when the advice might be relevant to the parties’ competitive positions;
* Providing services to both a vendor and a purchaser who are clients of the firm in relation to the same transaction;
* Preparing valuations of assets for two clients who are in an adversarial position with respect to the same assets;
* Representing two clients at the same time regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership;
* Providing a report for a licensor on royalties due under a license agreement while at the same time advising the licensee of the correctness of the amounts payable under the same license agreement;
* Advising a client to invest in a business in which, for example, the immediate family member of the member has a financial interest in the business;
* Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a competitor of the client
* Advising a client on the acquisition of a business which the firm is also interested in acquiring;
* Advising a client on the purchase of a product or service while having a royalty or commission agreement with one of the potential vendors of that product or service;
* Providing forensic investigation services to a client for the purpose of evaluating or supporting contemplated litigation against another client of the firm;
* Providing tax or personal financial planning services for several members of a family whom the member knows to have opposing interests  
  m. Referring a personal financial planning or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement;
* A client asks the member to provide tax or personal financial planning services to its executives, and the services could result in the member recommending to the executives actions that may be adverse to the company;
* A member serves as a director or an officer of a local United Way or similar organization that operates as a federated fund-raising organization from which local charities receive funds. Some of those charities are clients of the member’s firm;
* A member who is an officer, a director, or a shareholder of an entity has significant influence over the entity, and that entity has a loan to or from a client of the firm.

Before accepting a new client relationship, engagement, or business relationship the CCPA should take reasonable steps to identify if there is a potential conflict. *Id.* If an actual conflict has been identified, the CPA should “evaluate the significance of the threat created by the conflict of interest to determine if the threat is at an acceptable level.” *Id. “*If the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level.” *Id*. Examples of safeguards that can be used to eliminate a threat or reduce it to an acceptable level include:

* using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality;
* creating separate areas of practice for specialty functions within the *firm*, which may act as a barrier to the passing of *confidential client information* from one practice area to another within a *firm*;
* establishing policies and procedures to limit access to *client* files, the use of confidentiality agreements signed by employees and *partners* of the *firm* and the physical and electronic separation of confidential information.

When a conflict of interest exists, the member should disclose the nature of the conflict of interest to clients and other appropriate parties affected by the conflict and obtain their consent to perform the professional services. In cases where an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the member should (a) decline to perform or discontinue the professional services that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level.

**G. Attorney Fees.**

North Carolina Rule of Professional Conduct 1.5 governs how to handle fees. They should not be excessive, considering time and effort required, how difficult the work is, whether accepting the work precludes other employment by the lawyer, fee customarily charged in the locality for similar services, amount involved and results achieved, experience of the lawyer, and other factors. The practical effect of these factors appears to be to allow the lawyer to justify any reasonable fee, and my opinion is that the multitude of factors swallows the purpose of the rule.

The Rule also provides guidance regarding contingent fee arrangements, chief among which is that a contingent fee agreement should always be in writing signed by the client. As a practice pointer (that I’m sure most of you already apply), I take care to have an engagement letter for every client and matter, not just for contingent fee cases. We will discuss the reasons for this.

The North Carolina Rules of Professional Conduct also address an attorney accepting property in payment for legal services. *See* Comment 4 to Rule 1.5. Such an arrangement may include ownership interest in an enterprise, or the transfer of real property to the lawyer. *Id*. While a lawyer may accept such property in payment for services, provided it does not involve acquisition of a proprietary interest in the ause of action or subject matter of the litigation contrary to Rule 1.8(i), a fee paid in property should be considered carefully. A fee paid in property or ownership interest instead of money can have the essential qualities of a business transaction with the client.

Finally, the Rule provides for a dispute resolution procedure when the attorney disagrees with a client about a fee. Although the Rule contemplates that a lawyer can initiate legal proceedings to collect a fee after following the steps in the Rule, the conventional wisdom is that lawyers generally should not sue clients for fees because of the likelihood of a retaliatory malpractice counterclaim. As time allows, we will discuss the value of this practical wisdom when weighed against the inevitable lost fees it entails.

**H. Handling Client Finances and Trust Accounts.**

Last but far from least, as you already know, do not play games with funds received from clients. The guidance on this is in North Carolina Rule of Professional Conduct 1.15. The rule speaks for itself, and you probably have heard from day one of law school that you will lose your license and go to prison if you misappropriate your client’s money. I have represented several attorney clients who have learned this the hard way. Loss of license *and* federal prosecution with active prison time are a given if you do this.

Thus, this is an area where I advise people not simply to follow the letter of Rule 1.15, but to go beyond it and establish very strong practices, keep excellent documentation (over-document), supervise any employees involved with the trust account very carefully, and over-communicate with clients about what you are doing with any funds you hold in trust for them. And do all of this in writing. Anything you do with trust money, send an email about. This may be overkill for real estate lawyers, but for the rest of us who are holding money for fees, larger transactions, or whatever, I like to send many emails to clients and be extremely transparent about what I am doing with their money. Keep your money separate from the client’s money!

As far as complying with the letter of Rule 1.15, please do at least that. We will walk through the rule during our discussion, but read it carefully. It is fairly nuanced and detailed – much more so than most of the other Rules of Professional Conduct – and requires some study and regular review.

In addition, I recommend you thoroughly review – and we will discuss – the Lawyer’s Trust Account Handbook that is published by the North Carolina State Bar (here: <https://www.ncbar.gov/media/283992/trust-account-handbook.pdf>). This provides additional, helpful background regarding how to properly keep trust account records and safeguard your client funds. Much of this guidance is also contained in a mandatory trust accounting CLE video, which you can access online. *See* https://www.nccle.org/about-us/news-publications/2016/06/cle-required-in-2017-to-satisfy-new-trust-account-check-signature-requirement/.

1. The author acknowledges, with thanks, the research and drafting assistance of Gregory D. Whitaker, Esq., associate at Terpening Law. [↑](#footnote-ref-1)
2. Part 205 of Title 17 of the Code of Federal Regulations. See generally Implementation of Standards of Professional Conduct for Attorneys (Final Rule), Securities Act Release No. 33-8185, Exchange Act Release No. 34-47276 (Jan 29, 2003) (Final Part 205 Rule Release). [↑](#footnote-ref-2)