SUPREME COURT 2009–2010 PROFESSIONAL LIABILITY CASES

By Thomas W. Curvin and Tracey K. Ledbetter

A number of cases on the Supreme Court's docket this term address issues related to the regulation of attorneys, accountants, and other professionals. The Court's decisions in these cases could have far-reaching ramifications.

Constitutional Challenge to the PCAOB

Perhaps the most significant of these cases is the constitutional challenge to the Public Company Accounting Oversight Board (PCAOB), presented in *Free Enterprise Fund v. Public Co. Accounting Oversight Board*, Docket No. 08-861. The PCAOB was created pursuant to the Sarbanes-Oxley Act of 2002, and it regulates auditors of public companies. Such firms are required to register with the PCAOB, which can impose sanctions for violation of securities laws.

The case before the Court raises the issue of whether the method of appointing PCAOB members violates separation of powers or the Appointments Clause. Petitioners argue that the Sarbanes-Oxley Act violates separation of powers because members of the PCAOB are vested with far-reaching executive power, but the President does not have authority to appoint or remove those members or otherwise supervise or control their exercise of the executive power; the court of appeals had held that Congress can restrict the President's removal authority in any way it "deems best for the public interest." Petitioners also contend that the Sarbanes-Oxley Act violates the Appointments Clause because members of the PCAOB are not appointed by the President and confirmed by the Senate, nor can they be appointed by the "Head" of a "Department" as is required for inferior officers.

If the Court finds that the PCAOB is unconstitutional, its decision could limit the SEC's ability to take actions against accounting firms for violations of the securities laws. In the absence of the PCAOB, state boards of accountancy would be responsible for oversight of accounting firms, but at present, the state boards often rely on PCAOB resources and standards.[1] Some observers believe that a decision holding the PCAOB unconstitutional jeopardizes the Sarbanes-Oxley Act as a whole, because the act lacks a severability clause.[2] Of course, if the PCAOB or the Sarbanes-Oxley Act is held unconstitutional, Congress will likely move to reenact the legislation in a way that comports with the Constitution, thereby lessening the long-term impact of such a ruling. In the short term, however, a finding that the PCAOB is unconstitutional could create a great deal of uncertainty for accounting firms.

No Immediate Appeal of Attorney-Client Privilege Rulings

A closely watched case by attorneys and corporate legal officers was one of the earliest cases to be decided this term, *Mohawk Industries, Inc. v. Carpenter*, Docket No. 08-678. There, the Court held that trial court orders rejecting claims of attorney-client privilege are not immediately appealable under the collateral order doctrine. In the *Mohawk* case, a former employee suing for wrongful termination sought to discover information related to a meeting he had with the company's attorney before he was fired. The company contended that information from the meeting, which was part of an internal investigation, was privileged. The district court ordered the company to disclose the information, finding that the company had waived the privilege by putting the attorney's actions at issue in a separate class action case. The district court also refused to certify its ruling for immediate appeal under 28 U.S.C. § 1292(b).

On appeal, the Eleventh Circuit held that it did not have jurisdiction to review the district court's order. The question raised before the Supreme Court was whether a party may immediately appeal an order rejecting a privilege claim, or whether such an appeal had to wait until final judgment.

The Supreme Court unanimously held that "the collateral order doctrine does not extend to disclosure orders adverse to the attorney-client privilege."[3] The Court found that immediate appeals under the collateral order doctrine are not necessary to ensure effective review of district court orders adverse to the attorney-client privilege, and therefore such orders did not meet the third prong of the collateral order doctrine, which requires that a district court order be effectively unreviewable.[4] In response to the petitioner's argument that post-judgment appeal is inadequate to protect the attorney-client privilege, the Court noted that "[t]he breadth of the privilege and the narrowness of its exceptions" would affect the relationship of clients and counsel more than "the small risk that the law will be misapplied," and that litigants facing an adverse privilege ruling have several potential avenues of review other than a collateral order appeal.[5] The Court therefore concluded that "sufficiently effective review of adverse attorney-client privilege rulings can be had without resort to the [collateral appeal] doctrine."[6]

The Court's ruling forecloses immediate appeals of privilege rulings under the collateral order doctrine. As the Court noted, in the face of such adverse rulings, litigants must weigh other options, including pursuing an interlocutory appeal under 28 U.S.C. § 1292(b), pursuing a writ of mandamus against the trial court, or, perhaps the most extreme option, disobeying the order to produce on pain of contempt, and then immediately appealing the contempt finding.

Defining "Honest Services Fraud"

In its review of the criminal convictions of Conrad Black (the former chair and CEO of Hollinger) and Jeffrey Skilling (the former Enron CEO), the Court will address the duties of corporate officers and other professionals toward their companies, customers, and clients. *Black v. United States*, Docket No. 08-876; *Skilling v. United States*, Docket No. 08-1394. Both Black and Skilling were convicted of violating the "honest services fraud" statute, 18 U.S.C. § 1346. Black was convicted of taking money from the company for his own gain and, apparently, without board approval or shareholder disclosure. Black argued that his goal was to reduce his tax liabilities, not to cause financial harm to the company or its investors. Skilling was convicted on a number of counts arising from Enron's collapse, including the charge that he lied about the company's financial condition in violation of the honest services fraud statute. Skilling contends that his actions were intended to advance Enron's interests, not his own.

In *Black*, the Court will consider whether the honest services fraud statute applies to the conduct of a private individual whose alleged "scheme to defraud" did not contemplate economic or other property harm to the private party to whom honest services were owed (i.e., the corporation itself). One of the questions presented in *Skilling* is whether the honest services fraud statute requires the government to prove that the defendant's conduct was intended to achieve "private gain" rather than to advance the employer's interests, and, if not, whether the statute is unconstitutionally vague.

The honest services fraud statute itself merely defines "scheme or artifice to defraud," as used in the mail fraud statute, to include "a scheme or artifice to deprive another of the intangible right of honest services." Critics have long argued that the honest services fraud statute is subject to abuse because it is so vague that it can be applied to a wide swath of behavior. *The New York Times*, discussing the issue, wrote:

> The bottom line, Justice Scalia said in February, is that the courts have not been able to define what separates "the criminal breaches, conflicts and misstatements from the obnoxious but lawful ones." The honest services law, he said, "invites abuse by headline-grabbing prosecutors in pursuit of local officials, state legislators and corporate C.E.O.'s who engage in any manner of unappealing or ethically questionable conduct."[7]

The *Black* and *Skilling* cases are likely to be of particular interest to directors and officers of corporations, as the Court will probably use them to define the contours of the honest services fraud statute and to clarify what actions may be subject to prosecution as honest services fraud. As *Business Week* has noted, the *Black* ruling "could have a major impact on how broadly frauds are defined in court and punished upon conviction."[8] (Indeed, many observers believe that the Court's questioning during oral argument suggested skepticism about the honest services fraud statute.[9]) Similarly, the *Skilling* case will give the Court the opportunity to determine whether private gain is necessary or sufficient to support conviction under the honest services fraud statute.

Triggering the Securities Fraud Statute of Limitations

Professionals at risk of securities fraud lawsuits are following *Merck & Co. v. Reynolds*, Docket No. 08-905, a case involving the statute of limitations in securities actions. Investors in Merck filed a class action in 2003, alleging that the company had provided misleading information about the risks of Vioxx. (The drug was withdrawn from the market in 2004.) The district court dismissed, noting that because of publicity regarding FDA concerns about Vioxx, the investors were on inquiry notice of the alleged misrepresentations more than two years before bringing suit.

At issue in *Merck* is a circuit split regarding whether, under the "inquiry notice" standard applicable to federal securities fraud claims, an investor must receive evidence of scienter without the benefit of any investigation before the statute of limitations will begin to run. Most circuits hold that the statute of limitations may begin to run before the investor has evidence that the alleged fraud was intentional, but the rule applied by the Third Circuit below was more lenient, which meant that investors had more time to bring suit.

By clarifying what triggers the statute of limitations for a securities fraud claim, the decision in *Merck* will affect the potential exposure of accountants and other professionals to such claims. The Court is also likely to create a uniform standard for all circuits, which may simplify statute of limitations calculations for defendants subject to suit in multiple jurisdictions.

Allowing Bankruptcy Advertising and Advice

Attorneys' First Amendment rights in advising their clients are at issue in a pair of consolidated cases, *Milavetz, Gallop & Milavetz, P.A. v. United States*, Docket No. 08-1119, and *United States v. Milavetz, Gallop & Milavetz, P.A.*, Docket No. 08-1225. In these cases, a bankruptcy law firm sought a declaratory judgment, arguing that the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) relating to "debt relief agencies" did not apply to law firms and was unconstitutional if it did. Noting that a provision in the law, 11 U.S.C. § 526(a)(4), appeared to bar attorneys from advising their clients to take on more debt if they were considering bankruptcy, the firm argued that the law also violated the First Amendment.

There are several questions presented in these consolidated cases:

- whether the interpretation of attorneys as "debt relief agencies" is contrary to the plain meaning of BAPCPA
- whether 11 U.S.C. § 528 (requiring debt relief agencies to identify themselves as such in advertising), as applied to attorneys, violates the First Amendment free speech guarantee of the Constitution by restraining commercial speech by requiring mandatory deceptive disclosures in attorney advertisements
- whether Section 528 violates due process under the Fifth Amendment
- whether 11 U.S.C. § 526(a)(4) precludes only advice to incur

more debt with a purpose to abuse the bankruptcy system
- whether Section 526(a)(4), construed with due regard for the principle of constitutional avoidance, violates the First Amendment

Insofar as these cases interpret the bankruptcy laws, they may be of limited application to attorneys outside the bankruptcy context. Nonetheless, the Court's decision in these cases could have significant effects on attorneys counseling clients who are approaching bankruptcy. As the ABA has argued, the effect of applying the BAPCPA provisions to attorneys will be to create new exceptions to the attorney-client privilege by directly limiting the communications between attorney and client and by making those communications discoverable.[10]

Limiting Prosecutorial Immunity

Prosecutors ought to pay careful attention to the Court's treatment of prosecutorial immunity in *Pottawattamie County, Iowa v. McGhee*, Docket No. 08-1065. The case involved two men who were wrongfully convicted of a murder and imprisoned for 26 years. The men brought a Section 1983 suit against prosecutors and police, alleging that the prosecutors coerced a government witness and provided him with information about the murder—even though he had no independent knowledge of it—so that his testimony would be more convincing. The prosecutors also failed to disclose evidence of a possible other suspect, in violation of *Brady v. Maryland*; this *Brady* violation led to the convictions being overturned.

The question before the Court is whether a prosecutor may be subjected to a civil trial and potential damages for a wrongful conviction and incarceration where the prosecutor allegedly violated a criminal defendant's due process rights by procuring false testimony during the criminal investigation, and then introduced that same testimony against the criminal defendant at trial.

If the Court determines that prosecutorial immunity is not absolute, this case could subject prosecutors to civil actions, potentially involving high damages, based on allegations of wrongdoing in preparing for trial. Respondents note in their brief that "most prosecutors adhere to the highest standards of professional conduct and would not engage in any conduct that looks remotely like the misconduct at issue here," and contend that the limitation of prosecutorial immunity they seek should only apply to the "truly extreme" misconduct such as that at issue in the case.[11]

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1. *See* Brief of National Ass'n of State Boards of Accountancy as *Amicus Curiae* in Support of Respondents at 28–31, Free Enter. Fund v. Pub. Co. Accounting Oversight Board, No. 08-861 (U.S. Oct. 20, 2009), www.abanet.org/publiced/preview/briefs/pdfs/09-10/08-861_RespondentAmCuNASBA.pdf.
2. *See* Professor Bainbridge.com, www.professorbainbridge.com/professorbainbridge com/2009/05/supreme-court-grants-cert-on-pcaob-challenge.html (May 18, 2009, 14:05 PST).
3. Mohawk Indus., Inc. v. Carpenter, No. 08-678, slip op. at 13 (U.S. Dec. 8, 2009). Justice Thomas concurred in part and concurred in the judgment.
4. *Id.* at 6.
5. *Id.* at 8–12.
6. *Id.* at 12.
7. Adam Liptak, *A Question of When Dishonesty Becomes Criminal*, N.Y. Times, Oct. 13, 2009, at A14, www.nytimes.com/2009/10/13/us/13bar.html?_r=1.
8. Posting of Brian Burnsed to Business Week Money & Politics Blog, www.businessweek.com/blogs/money_politics/archives/2009/09/it_looks_to_be.html (Sept. 24, 2009).
9. *See, e.g.*, Jess Bravin, *Justices Question Antifraud Law*, Wall St. J., Dec. 9, 2009, at A3, http://online.wsj.com/article/SB126028995066582097.html.
10. *See* Brief for *Amicus Curiae* the American Bar Association Supporting Petitioners at 16–18, Milavetz, Gallop & Milavetz, P.A. v. United States, No. 08-1119 (U.S. Sept. 1, 2009), www.abanet.org/publiced/preview/briefs/pdfs/07-08/08-1119_PetitionerAmCuABA.pdf.
11. Brief of Respondent at 50–55, Pottawattamie County, Iowa v. McGhee, No. 08-1065 (U.S. Sept. 11, 2009), www.abanet.org/publiced/preview/briefs/pdfs/07-08/08-1065_Respondent.pdf.