Lawyers for the Profession®

The Lawyers' Lawyer Newsletter

Recent Developments in Risk Management

May 2016 | Volume 21 | Issue 2

Conflicts of Interest — Subject Matter Conflicts — Can IP Attorneys Simultaneously Represent Two Clients That Are Prosecuting Patents for Similar Inventions?

Maling v. Finnegan, Henderson, Farabow, Garrett & Dunner, LLP, 473 Mass. 336, 42 N.E.3d 199 (2015)

Risk Management Issue: What constitutes an adequate conflicts check where two clients may be pursuing intellectual property in similar inventions (sometimes referred to as a "subject matter conflict")?

The Case: The Massachusetts Supreme Court considered claims by an inventor against his attorneys for legal malpractice and breach of fiduciary duty for simultaneously representing a competing company in prosecuting a patent for a similar invention without informing him or obtaining his consent to the concurrent representation.

Plaintiff Chris Marling retained lawyers in the Boston, office of Finnegan, Henderson, Farabow, Garrett & Dunner, LLP to represent him in obtaining a patent for a new screwless eyeglass frame. After the Firm obtained the patent, Marling learned that lawyers in the firm's Washington, D.C. office had simultaneously represented a competitor, Masunaga Optical Manufacturing Co., Ltd., in the prosecution of a patent in connection with screwless eyeglass technology.

Marling claimed that the Firm had a conflict of interest in violation of Mass. R. Prof. C. 1.7 by simultaneously representing Masunaga in obtaining a patent in the same technology area. He alleged that the Firm's failure to disclose the potential conflict resulted in "tremendous financial hardship" for Marling and that his invention was not commercially viable after learning that a competitor had a head start in the market.

A number of IP law firms filed *amicus curiae* briefs in the case. They asserted that representing two clients obtaining patents for similar inventions does not create a conflict of interest except where the claims of two patent applications are identical or obvious variants of each other. A contrary rule would effectively restrict IP firms to representing one client in each field of technology and would result in them favoring larger clients who generate more work.

The Massachusetts Supreme Court concluded that Finnegan's simultaneous representation of two competing clients in prosecuting patents in the same technology area for similar inventions was not a per se violation of Rule 1.7. Further, because the Firm successfully obtained a patent for Marling's screwless eyeglass frame, Marling failed to state a claim for relief.

The court reasoned that Marling and Masunaga were not adversaries in the traditional sense as they did not appear on opposite sides of litigation. It treated a conflict arising from representation of competitors as permissible economic adversity. Moreover, Marling did not allege that the Firm's judgment was impaired, that confidences were disclosed, or that Marling had obtained a less robust patent than had he been represented by "conflict free" counsel. Thus, Marling could identify no damages stemming from the Firm's representation.

Comment: At the conclusion of the opinion, the Massachusetts Supreme Court noted that what constitutes an adequate conflicts check is a complex question given lateral transfers, firm mergers, and the rise of giant international law firms. As *Marling* illustrates, economic adversity between two clients can be difficult to detect, particularly where a law firm has multiple offices. Although it affirmed the dismissal of Marling's action, the Court warned, "law firms run significant risks, financial and reputational, if they do not avail themselves of a robust conflict system adequate to the nature of their practice."

Conflicts of Interest, continued on page 2

HINSHAW & CULBERTSON LLP

Hinshaw & Culbertson LLP
222 North LaSalle Street
Suite 300, Chicago, IL 60601
312-704-3000
www.hinshawlaw.com
www.lawyeringlaw.com

Editors:
Anthony E. Davis and Noah D. Fiedler

Contributors:
Cassidy I. Chivers, Matthew R. Henderson and Linda L. Streeter

Economic adversity generally does not constitute a conflict of interest that would require an attorney to obtain the affected clients' informed consent. Model Rule 1.7, Comment 6 ("[S]imultaneous representation in unrelated matters of clients whose interests are only economically adverse, such as representation of competing economic enterprises in unrelated litigation, does not ordinarily constitute a conflict of interest and thus may not require consent of the respective clients").

However, *Marling* establishes only the minimum conflict screening protocols for IP attorneys under Rule 1.7. Indeed, the Court emphasized that nothing in the decision should be construed to absolve law firms from the obligation to implement robust processes to detect potential conflicts. It emphasized that the misuse of client confidences or the preferential treatment of one client over another constitute serious ethical violations. Further, the decision should not be seen as a carte blanche to engage in true "subject matter conflicts," where the technology is actually identical.

Risk Management Solution: Law firms need to adopt comprehensive conflicts screening protocols that include more complete client intake information beyond the mere names of the parties, including, in intellectual property prosecution matters, sufficient detail about the actual technology or invention involved to enable firms to identify true subject matter conflicts. These procedures will help avoid possible disqualification and claims.

Strategic Decisions During Litigation Leads to Law Firm's Disqualification

In re RSR Corp., No. 13-0499, 2015 WL 7792871, at *3 (Tex. Dec. 4, 2015)

Risk Management Issue: What can law firms do to manage the risk of disqualification when they seek to consult with or engage a former employee of an opposing party?

The Case: In 2003, a mining company entered into a licensing agreement with an anode manufacturing company, under which the mining company agreed to license its anode-production information to the manufacturing company. In return, the manufacturing company promised to pay the mining company a fee for every anode sold. In 2008, the mining company sued the manufacturing company for breach of contract and misappropriation of trade secrets. Firm 1 represented the mining company. Firm 2 represented the manufacturing company.

In 2010, the manufacturing company's financial manager resigned his position. While employed, his job duties included ensuring cash flow and financing, as well as calculating the payments to the mining company under the 2003 agreement. He had access to data regarding the manufacturing company's financial statements, foreign trading and government reports. He gathered financial information in response to the mining company's audit request in 2009, and discussed the audit and litigation strategy with his employer's officers and lawyers. His employment contract stated that all information he gathered during his employment was confidential and could not be disclosed to third parties, even after his employment ended. After he left, he took with him about 15,000 to 17,000 emails, which included communications with the lawyers and officers.

Firm 1 contacted the manufacturing company's former finance manager in connection with the lawsuit. Eventually, they had several meetings, often including Firm 2. The finance manager "supplied significant information regarding [the manufacturing company], accusing [it] of underpaying [the mining company] under the 2003 agreement." The finance manager insisted that both firms pay for his time, which he charged at $1,600 per day (four times his normal salary). Ultimately, in May 2011, the finance manager formalized a consulting agreement with Firm 2, though the court found that Firm 1 "also participated in the decision to retain him." The agreement guaranteed the finance manager $1 million for a 3-year contract. However, another provision of the contract stated that Firm 2 "had no obligation to use [the finance manager's] services and would pay [him] only for work actually performed." Two months after signing the agreement, he quit consulting with both firms and signed an affidavit recanting his accusations against the manufacturing company — his former employer. The manufacturing company then moved to disqualify Firm 1.

The trial court granted the motion, holding that under the analytical framework of *In re Am. Home Products Corp.*, 985 S.W.2d 68, 76 (Tex. 1998), which involved disqualification of counsel for hiring the other side's former paralegal or legal assistant. In this scenario, two presumptions — that the paralegal/legal assistant (1) received confidential information and (2) shared it — ensure that any law firm hiring a side-switching paralegal is disqualified unless it has demonstrative screening measures in place. However, the appellate court declined to extend *American Home Products* to the circumstances to the case before it. Instead the court applied the more flexible standard under *In re Meador*, 968 S.W.2d 346 (Tex. 1998).

Meador applies when attorneys "receive[ ] an opponent's privileged materials outside the normal course of discovery," such as where a former employee communicates such information to the lawyer of former employer's adversary. The court distinguished between nonlawyers whose core duties were litigation related and employees who may have had contact with the legal department, and performed litigated-related tasks, but were not hired for the purpose of assisting with litigation. The court held that the finance manager fell under this latter category. Thus, the court did not decide whether Firm 1 should be disqualified, but directed the trial court to analyze the question under the "variety of fact-specific factors" explained in *Meador*: (1) whether the attorney knew or should have known that the material was privileged; (2) the promptness with which the attorney notifies the opposing side that he or she has received its privileged information; (3) the extent to which the attorney reviews and digests the privileged information; (4) the significance of the privileged information (i.e., the extent to which its disclosure may prejudice the movant's claim or defense, and the extent to which return of the documents will mitigate that prejudice); (5) the extent to which the movant may be at fault for the unauthorized disclosure; (6) the extent to which the nonmovant will suffer prejudice from the disqualification of his or her attorney.

Comment: Two important court of appeals decisions discuss whether and when lawyers may interview former high-level employees of adverse parties, *Neisig v. Team 1*, 76 N.Y.2d 363, 558 N.E.2d 1030, 559 N.Y.S.2d 493 (1990) and *Muriel Siebert & Co., Inc. v. Intuit Inc.*, 8 N.Y.3d 506, 32 A.D.3d 284, 820 N.Y.S.2d 54 (2007). In *Siebert* the court held that lawyers seeking to interview former high-level employees of represented parties may do so, provided that they take care to direct such individuals not to divulge communications with the former employer's attorneys that involve legal advice or information that is proprietary to the former employer unless the information is already in issue in the matter.

Risk Management Solution: One of a lawyer's duties is to not only identify key witnesses in his or her client's case, but also understand how to manage the problem that exists when former employees of an adverse party have knowledge of facts pertaining to the dispute that will likely include privileged and confidential information. The lawyer should assess the circumstances of the employee's departure and the extent of his knowledge of privileged and confidential information, and then contact the former employee. Although opposing counsel has every right to contact the former employee, only the former employee should be told that he or she has no obligation to talk absent a subpoena, and (per *Siebert*) should be directed *not* to divulge confidential and privileged information.

Failure to Follow Structure of Engagement Agreement Leads to Corporate Counsel's Disqualification

M'Guinness v. Johnson et al., 243 Cal. App. 4th 602 (2015)

Risk Management Issue: What can counsel for a closely held corporation do to avoid disqualification in the event of shareholder disputes?

The Case: The law firm was corporate counsel for a small construction company, Think It, Love It, Construct It, Inc. (TLC), which had three shareholders: James M'Guinness, Steven Johnson, and Scott Stuart. TLC was incorporated in 2002. In May 2006, it retained the law firm. The client agreement provided that the nature of the legal representation was "[a]dvice and representation concerning [TLC] and other general legal work directed by you from time to time." The agreement also advised TLC that it may "terminate" the relationship "at any time," and "at the conclusion of [the] engagement, at your request and at your cost for any file review, copy and delivery charges, we will review and deliver your files to you, along with any of your funds or property in our possession, charged at our hourly rate." A retainer of $2,500 was deposited into the firm's client trust account. Over the next six years, the law firm performed approximately 25 hours of legal work for TLC. In October 2012, the firm's accounting records showed a balance of $1,417 in the client trust account. The firm sent monthly invoices, which sometimes contained a carry-forward balance, but no charges for new legal services during the invoicing period.

On January 23, 2013, M'Guinness sued Johnson and TLC alleging that Johnson mismanaged the company and misappropriated control of it. M'Guinness sought involuntary dissolution of TLC. The law firm appeared and answered on behalf of Johnson, and filed a cross-complaint against M'Guinness, Stuart and TLC. M'Guinness, Stuart and TLC moved to disqualify the law firm, arguing that it had impermissible conflicts of interest based on its concurrent and prior representation of TLC. Johnson and the firm argued that the representation ended in early March 2012 and that the prior representation did not create a conflict of interest because it was unrelated to the issues involved in the litigation.

The trial court denied the motion, holding that "the evidence was insufficient to warrant automatic disqualification based upon concurrent representation because 'disqualification is a drastic measure, it is generally disfavored and should only be imposed when absolutely necessary.'"

The appellate court reversed, holding that the trial court abused its discretion:

> "The undisputed facts demonstrate that the Law Firm continued to represent TLC through the time the lawsuit was instituted. If a party moving to disqualify an attorney establishes concurrent representation, the court is required, 'in all but a few instances,' to automatically disqualify the attorney without regard to whether the subject matter of the representation of one client relates to the representation of a second client in the lawsuit."

The finding of concurrent representation was based on: (1) the "open-ended nature" of the client agreement; (2) the firm's retention of the funds in the trust account, which indicated that the relationship was not "terminated" in accordance with the client agreement; (3) the actions of a firm partner (an "old football buddy" of Johnson's) up through April 2013 in which the partner exerted control over corporate property and sent emails to M'Guinness' counsel shortly after the lawsuit was filed, which created the implication that he still represented TLC; (4) the law firm's billing practices; and (5) "as a matter of corporate law, the Firm's ongoing duty to TLC precluded its representation of Johnson in a lawsuit involving allegations in which the interests of the corporation diverged from those of shareholder litigants."

Comment: The court found that it was critical that the firm had agreed to act as all-purpose corporate counsel for TLC, and that the termination of that relationship could only be effected "by specific methods described in the agreement and under conditions that included the Firm's return of all property and funds to the client," which did not happen. It is also noteworthy that the court's holding rested in part on the law firm partner's guarded email response to M'Guinness' counsel's question "when, if ever, [did] your firm stop [] representing TLC[?]" The partner said, "I have not yet looked at the possibility of representing TLC Builders in this case. I will do so today." The court reasoned that the response "could be viewed as having implied that his Firm still represented TLC" because he did not say when the representation ended, but did indicate he might be representing TLC "*in this case*" (emphasis in opinion).

Risk Management Solution: This case highlights the importance of crafting engagement agreements in order to define in detail the structure and scope of the representation. A lawyer's eagerness to be a "jack of all trades" for a single client may appear to be good for business, but it could also expand the scope of duties owed to the client and thus the lawyer's malpractice exposure. Or, as in this case, it could lead to subsequent conflicts of interest and disqualification. Engagement letters need to be crystal clear about the scope of the representation, including the identity of the client and the method of termination, and abide by those terms. *See also*, Cal. Bus. & Prof. Code § 6147 (governing contingency fee agreements) and § 6148 (governing noncontingency fee agreements).

Alleged Existence of Attorney-Client Relationship — Negotiations Affecting Client and Indemnifying Party

George Makhoul, etc. v. Watt, Tieder, Hoffar & Fitzgerald, LLP, et al., 11-CV-5108 (PKC) (E.D.N.Y. 2015)

Risk Management Issue: What must law firms do to avoid establishing attorney-client relationships when communicating during the course of an engagement with persons or entities that may be allied in interest to their actual clients?

The Case: Plaintiff filed a legal malpractice action against defendant law firm — the law firm retained by its bonding company to negotiate with a governmental agency — alleging that the firm jointly represented both the bonding company and plaintiff in its negotiations. The Law Firm moved for summary judgment on the basis that it had no attorney-client relationship with plaintiff.

Plaintiff had been awarded contracts with a governmental agency for several federally funded projects. Performance and payment bonds for the projects were issued by Insurance Company. Plaintiff signed indemnity agreements in favor of Ins. Co. for any losses Ins. Co. incurred to fulfill plaintiff's obligations for three of the projects bonded by Ins. Co. After the Agency issued default notices against plaintiff and demands on Ins. Co. to complete the projects, Ins. Co. hired the Law Firm to advise and represent Ins. Co. regarding a response to the bond demands and negotiations with the Agency.

The Law Firm met with plaintiff and Ins. Co. together to "discuss the default, project status and a path forward." Plaintiff alleged that in this meeting it was advised that the Law Firm could simultaneously represent both parties in the negotiations with the Agency and that at that time it verbally retained the Law Firm. The Law Firm denied making any representations that it would represent plaintiff. The parties agreed that there was no written retainer or other writing confirming that plaintiff had retained the Law Firm as its counsel.

Plaintiff alleged that over the course of approximately one year it relied exclusively on the Law Firm for advice and representation in all negotiations with the Agency. It further alleged that it met with the Law Firm more than a dozen times without having any other attorney present, and relied on the Law Firm to prepare the written agreements negotiated with the Agency on behalf of both plaintiff and Ins. Co. Plaintiff acknowledged that during this period it was represented by other attorneys regarding other matters, but alleged that those attorneys did not represent it in negotiations with the Agency.

The court considered the following factors to determine whether an attorney-client relationship existed: (1) whether a fee arrangement was entered into or a fee paid; (2) whether a written contract or retainer agreement existed indicating that the attorneys accepted the representation; (3) whether there was an informal relationship whereby the attorneys performed the legal services gratuitously; (4) whether the attorneys actually represented the individual in a particular aspect of the matter (e.g. at a deposition); (5) whether the attorneys excluded the individual from some aspect of the matter in order to protect another client's interest; and (6) whether the purported client believed that the attorneys were representing him and whether this belief was reasonable.

In weighing these factors the court considered, among other things, the lack of any documents, such as written retainer agreement, letter of engagement, or payment of fees to the Law Firm by plaintiff. It examined: plaintiff's relationship with and reference to other attorneys during the pertinent time frame; the communications between Ins. Co. and plaintiff in which Ins. Co. requested that plaintiff engage its own counsel; and the fact that plaintiff and Ins. Co. had an adversary relationship regarding the negotiations.

The court determined that plaintiff failed to demonstrate the existence of an attorney-client relationship with the Law Firm and granted summary judgment for the Law Firm.

Risk Management Solution: Determining who is — and who is not — the client through a written retainer agreement may be as important from a risk management perspective as establishing the scope and terms of engagement. Avoiding the implication of an attorney-client relationship requires a clear delineation of who is and who is not represented by the law firm. Here, the court looked to the absence of a written retainer, the lack of billing and payment, the relationships between the parties and attorneys, and the course of communications. The law firm could have protected itself from the claim of joint representation by sending a letter of nonrepresentation to plaintiff at the outset of the negotiations when it chose to participate in meetings without having separate counsel present.

Hinshaw & Culbertson LLP prepares this newsletter to provide information on recent legal developments of interest to our readers. This publication is not intended to provide legal advice for a specific situation or to create an attorney-client relationship.

The Lawyers' Lawyer Newsletter is published by Hinshaw & Culbertson LLP. Hinshaw is a full-service national law firm providing coordinated legal services across the United States, as well as regionally and locally. Hinshaw lawyers represent businesses, governmental entities and individuals in complex litigation, regulatory and transactional matters. Founded in 1934, the firm has approximately 525 attorneys with offices in Arizona, California, Florida, Illinois, Indiana, Massachusetts, Minnesota, Missouri, New York, Rhode Island, Wisconsin and London. For more information, please visit us at www.hinshawlaw.com.