Ethical Issues in Contract Drafting/Negotiation

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Agenda

- Conflicts
- Negotiations
- Backdating
- Drafting
- Anti-Contact Rule

Conflicts—Parent/Subsidiary

- You represent Parent in drafting and negotiating an intercompany services/license agreement with 90% owned Sub. Sub doesn't have its own counsel. What do you need to do?
- Q #1: Who is your client?
- Are you concurrently representing Sub in this transaction?
  - If yes
    - Need Rule 1.7(a) (or Rule 1.9) waivers
    - May need Rule 1.8(f) waiver
  - If no
    - Might send no-engagement letter/recommend that Sub get independent counsel
    - Can't claim to be disinterested (Rule 4.3)
- Does the answer change if Sub is 100% owned?

Conflicts—Company Formation

- Joe and Karen plan to start Newco together. They need help with:
  - Entity selection
  - Entity formation
  - Financing transaction with outside investor
  - IP contributions to Newco
  - Restricted stock purchase agreements
  - Buy-sell agreement
  - Voting agreement
- What do you need to do?

Conflicts—Company Formation

- Step 1: Clarify who you're representing
  - J or K only
  - K and J jointly
  - Newco only
  - K, J and Newco jointly
- Step 2: Get engagement letter with your client(s) and get any required waivers
- Step 3: Confirm non-clients don't think you are representing them
  - No legal work for non-clients
- Step 4: Each client gets equal treatment

Conflicts—M&A

- You represent Seller in acquisition. Buyer requires employment agreements (with non-competes) from Seller's key employees. Can you advise the employees on the employment agreements?
  - Argument for: Buyer's counsel represents "company's" interests
  - Argument against: thicket of divided loyalties and confidential information may make conflict too fundamental
- If you represent Seller and key employees concurrently
  - Need engagement letters with key employees
  - Need Rule 1.7 waivers (and perhaps Rule 1.8(f) waivers)
- If you don't represent key employees, make sure employees understand that! (Rule 1.13(e))
  - Send no-engagement letters
  - Strongly advise employees to get their own attorneys
  - Don't want "confidential" information from employees

Conflicts Practice Pointers

- “Who is my client?”
- Deal waits until conflicts are checked/cleared
- Conflict checks aren’t a one-and-done process
- Conflict actually waived only when signed waiver is filed

Negotiation—Telling the Truth

- You represent seller in acquisition. Buyer demands "impossible" rep that will not be true on signing or closing
- Options
  - Weaken the rep
  - Gut it in disclosure schedule
- What if those efforts fail?
  - You can't endorse the rep if it's "material" (Rule 4.1(a))
  - You may need to tell the buyer that the rep is untrue (Rule 4.1(b))
  - If misrepresentation is fraudulent, you may need to withdraw (Rule 1.2(d))

Negotiation—Tricky Drafting

- Buyer and Seller handshake on key terms. Seller's lawyer Rachel offers to prepare the first draft. In doing so, Rachel:
  - Makes most provisions wildly client-favorable to increase Buyer's negotiation costs
  - Includes client-favorable provisions that are void hoping Buyer won't know that
  - Makes broad R&Ws but buries catch-all exclusions in the exceptions schedule
  - "Hides" important provisions in unexpected parts of the contract
  - Deliberately chooses ambiguous language for some sections to minimize effect of client's concessions

Negotiation—Tricky Drafting

- Has Rachel done anything wrong from a legal standpoint?
  - Rule 4.4(a): “In representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person”
  - Attorney can’t lie or sandbag (Rule 4.1 and others)
  - May jeopardize contract enforceability
    - Construed against drafter
    - Unconscionable
    - Statutes prohibiting void clauses
- Has Rachel done anything wrong from other perspectives?
  - Could damage business relationship with Buyer
  - Could damage relationship with client
  - Could damage her own professional reputation
- Practice pointers
  - Not every client wants tricky drafting
  - Clients need to “own” drafts before drafts delivered to other side

Backdating

- Ex 1: Vendor's salesperson wants to backdate contract to increase his commission under bonus plan
- Ex 2: Jen hired April 1. Jen's option grant mistakenly omitted from April stock option grants submitted to board. Omission discovered June 15, and price has increased in interim.
  - Ex 2A: Can you, with board approval, replace the list of April grant approvals to add Jen?
  - Ex 2B: Can you draft action by uniform consent dated April 1 and get board approval?
- Ex 3: Acme and Smith reach oral agreement on March 30 with understanding that agreement will be reduced to writing. Written agreement prepared April 15. Can the written agreement be dated March 30?

Backdating

- Rule 8.4(c): “It is professional misconduct for a lawyer to engage in conduct involving dishonesty, fraud, deceit or misrepresentation”
- Backdating can be fraudulent or even criminal
- My vote: Only Option #3 is permissible, and only if the agreement was enforceable March 30
  - But maybe no Q1 revenue recognition
- Lessons
  - Tell the truth, even if it hurts
  - Backdating scandals have reinforced attorney’s role as gatekeeper
  - Attorneys can “cross the line” from facilitators to principals

Drafting—Redlines

- Jessica prepares inaccurate redline but claims it is accurate
- Risks
  - Bad etiquette
    - Loss of drafting privileges
    - Degradation of parties' trust
    - Personal reputation loss
  - Legal consequences
    - Contract reformation
    - Rule 8.4(c)
- Practice pointers
  - QA redlines you send
  - Be careful trusting the other side's redlines!

Drafting—Metadata

- Joe drafts acquisition agreement. Joe exchanges file with client Ted, and each edits the file using Word's "track changes" tool. Joe "accepts all" and emails the file to opposing lawyer Karen. Karen easily uncovers Joe's and Ted's prior comments.
- Metadata = "data about data." Examples:
  - Author name/affiliation
  - Revision history
  - Timestamping of all activity

Drafting—Metadata

- Did Joe do anything wrong?
  - Risk of Rule 1.6(a) violation
    - NYSBA Opinion #782 (Dec. 2004): “Lawyers must exercise reasonable care to prevent the disclosure of confidences and secrets contained in ‘metadata’ in documents they transmit electronically to opposing counsel or other third parties.”
  - Risk of malpractice
    - Disclosure of confidential information
    - Loss of attorney-client privilege
  - *Guaranteed embarrassment*
- Practice pointers
  - Never use native Word redlining tool
  - Use “paste special” instead of clone-‘n’-revise
  - PDF (or TIFF) solves most metadata problems (but raises other issues)
- Lesson: every procedural step in “manufacturing” contracts may have substantive significance

Drafting—Metadata

- Did Karen do anything wrong?
  - Norm #1: All's fair in love and war—caveat sender!
  - Norm #2: Hidden data is ill-gotten benefit/trap for unwary
- Split authorities
  - NYSBA Opinion #749 (Dec. 2001): "A lawyer may not make use of computer software applications to surreptitiously 'get behind' visible documents"
  - ABA Formal Opinion 06-442 (Aug. 2006): MRPC doesn't restrict reviewing/using third party metadata
- Practice pointers
  - Intentional snooping could be problematic
    - But ABA Opinion: intentional looking ≠ dishonest
  - Accidental discovery might prompt professional courtesy like misdirected fax (see Rule 4.4(b))

Anti-Contact Rule

- Opposing businessperson emails contract draft to you, your client and her lawyer. Can you "reply to all"?
- Rule 4.2: "In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order."

Anti-Contact Rule

- Client schedules “4 way” conference call to negotiate contract. At appointed hour, everyone but opposing lawyer dials in. What should you do?
- Practice pointers
  - Get permissions from opposing counsel early in relationship
  - Educate client about Rule 4.2