

Ethical Issues in Contract Drafting/Negotiation
Professor Eric Goldman

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**Summary of Model Rules of Professional Conduct
Applicable to Contract Drafting/Negotiation**

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Note: this document references the Model Rules of Professional Conduct [http://www.abanet.org/cpr/mrpc/mrpc_toc.html]. As always, each jurisdiction's rules differ.

1. Lawyer's Involvement in Fraud. Knowingly helping a client commit fraud violates the Rules. Rules 1.2(d) and 8.4(c). When an attorney represents an organization engaged in fraud, or where the client contact is engaged in self-dealing, the attorney is expected to escalate the matter internally. Rules 1.13(b) and (c). Should an internal escalation fail (or where the client is an individual) and the client persist in fraudulent conduct, the attorney may be required to withdraw. Rule 1.6(b)/Rule 1.2(d).

2. Conduct in Negotiations. An attorney cannot knowingly make misrepresentations during negotiations. An attorney may have an affirmative duty to disclose information to avoid client crime or fraud. Rules 4.1 and 8.4(c).

An attorney cannot communicate with the other party's principal if the other party is represented by counsel (unless the other party's *attorney* permits that communication). Rule 4.2. This can come up in places like conference calls and replies to emails. Most attorneys do not even know this rule exists, but adhering to this rule can help both the client and your professional standing.

Where your client is dealing with an unrepresented party, you need to proceed with special care. Rule 4.3. This can especially come up in negotiations between you, your client and the other principal, where your statements can be misinterpreted.

3. Identity of Party Problems. Watch out for conflicts that can arise when you represent and negotiate contracts between interrelated parties. Rule 1.7. This can arise when representing a parent and its subsidiary, a founder or employee and the company, a corporate investor and the corporation, or a partnership and one or more of its partners. Always make sure you know who your client is!

If you are representing a party in contract negotiations, but someone other than that party is paying the bill, you need to jump through some special hoops. Rule 1.8(f). This can arise in situations like insurance settlements and parent/subsidiary negotiations. Keep track of who your client is!

4. Jurisdiction. If you are negotiating a contract, you can run into some tricky problems about practicing in another jurisdiction. Rule 5.5(a). Are you practicing law in another state when you specify that the contract will be governed by the governing law of that other state? If you conduct negotiations there by telephone? If you conduct negotiations there in person?

Multi-Jurisdictional Practice

By Eric Goldman

The scenario: You are a lawyer licensed in Wisconsin practicing in Milwaukee. An Illinois-based company wants you to represent them in drafting and negotiating contracts that will be governed by Illinois law. When contracts go sour, the client wants you to represent it in court wherever the business partner is located. You will need to meet with the client occasionally at its Illinois headquarters. Can you represent this client?

As a starting proposition, you cannot practice law in Illinois without an Illinois license. Rule 5.5(a): “A lawyer shall not practice law in a jurisdiction where doing so violates the regulation of the legal profession in that jurisdiction.” But it’s not 100% clear where you will be practicing law during this representation. As a result, you have a variety of options, each with their own disadvantages:

Option #1: Obtain an Illinois license.

- Option #1A: take the Illinois bar exam
- Option #1B: waive into Illinois. Requirements:
 - JD from ABA-accredited school
 - Actively practice law at least 5 years out of last 7
 - Character & Fitness
 - MPRE
 - Affidavit that you will annually practice at least 500 hours of Illinois law physically in the state.
 - \$800
 - Other administrative requirements

This is the most conservative option, but even then it does not completely solve the situations where you perform legal work outside Wisconsin and Illinois.

Option #2: Admission Pro Hac Vice (Pro hac vice = “for the occasion”).

- Permission to appear before a court located in a state where you are not licensed.
- May be required to hire local co-counsel

This option helps with court appearances, but it does not provide any coverage for transactional work.

Option #3: Constrain the scope of representation only to places where you are licensed

- Option #3A: Affiliate with local counsel

This option is fairly conservative and ultimately limits your utility to your client. Affiliating with local counsel usually cures all problems, but it increases the cost and complexity to the client, making it impractical in many situations (especially fast-moving transactions).

Option #4: Take the position that you do not need Illinois license for the representation because you are licensed in the state where you will physically perform most of the work (Wisconsin), even though you will travel to Illinois for some meetings. Even if you

choose this option, you will still need pro hac vice admissions for out-of-Wisconsin court appearances.

The current rules involving geography and licensing may be evolving to provide more support for Option #4. For example, Restatement of Law Governing Lawyers § 3 says that “A lawyer currently admitted in a jurisdiction may provide legal services to a client...at a place within a jurisdiction in which the lawyer is not admitted to the extent that the lawyer’s activities arise out of or are otherwise reasonably related to the lawyer’s practice [in the jurisdiction where admitted].”

Also, Ethics 2000 Model Rule 5.5 suggests a more flexible attitude about geography:

- An unlicensed lawyer shall not establish law office, have systematic/continuous presence for law practice, or represent that the lawyer is licensed in jurisdiction, except:
 - In-house/government attorneys
 - Services authorized by federal law
- Lawyer may provide legal services on a temporary basis elsewhere if he/she:
 - Associates with local counsel
 - Legally authorized to appear in proceeding
 - Provides services connected to ADR (where pro hac vice not available)
 - As “reasonably related to the lawyer’s practice” in licensed jurisdiction

However, it remains unclear if any of these rules authorize an attorney to undertake an ongoing transactional relationship with an out-of-state client.

How to Review and Comment on a Contract

By Eric Goldman

In a transactional practice, procedural choices can substantively affect the ultimate deal. In particular, a poor procedural choice can lead to the loss of future procedural privileges in ways that disadvantage the client; and in extreme cases, a lawyer's poor procedural choice can tank the deal altogether.

Despite this, many lawyers transgress basic norms when generating and delivering feedback on a transaction. Most such transgressions are unintentional, so to help cure that information gap, this document mechanically details the steps that a lawyer should follow when receiving a document from the other side.

Step 1: Make sure you have the right documents that were meant for your review. I can't count the number of times I've received the wrong draft of a document, such as a draft that hasn't actually changed from a previous iteration or that was used for internal comments (so, for example, it contains comments between the other side and his/her lawyer). Few things are more irritating than to spend significant time reviewing the wrong document, especially when the transaction is on a fast track.

Step 2: Make sure that the other side did the redlining accurately. This should be self-explanatory, but far too often, the redlining is botched (usually unintentionally), and that can lead to a big waste of time—or worse, missed changes.

Step 3: Read the document from top to bottom. Unless time is critical, I usually read the document in its entirety and not just the redlines, because it's easy to forget how the redlined changes might affect other aspects of the contract that aren't changed.

Step 4: Mark all of your desired changes and comments. I know it's a little silly, but I have developed a color-coding system for making notes—blue pen reflects my internal notes, red pen reflects any changes agreed upon with the other side. This color-coding speeds up my subsequent review of the document circulated by the other side or my editing when I'm making the changes (I just look for my red notes). Further, because I use these colors consistently, I can revisit transactions from months or years ago and still sort through my notes.

Step 5: Cross-check old notes/documents to make sure all prior feedback was addressed.

Step 6: THINK ABOUT WHAT IS MISSING. If I have time, I usually set the document aside for a little while to get some space, then I come back to it with a clear head to see what should have been in the document but isn't. Identifying missing provisions is one of our toughest jobs as lawyers (there is plenty of psychological literature explaining why), but we must look beyond the other side's text.

Step 7: Talk with your client about issues before speaking with other side. Ultimately, lawyer and client should speak with a single voice, and this requires you to coordinate your feedback with your client's feedback.

Step 8: Where appropriate, schedule a conversation with the other side.

- At the beginning of the conversation, clarify who will prepare the next draft
 - Usually, the person who received the prior draft will prepare the next draft
- Then, before getting into substance, ask the other side if anything has changed on their end. Not infrequently, things have changed since they sent the draft to you, and it's best to hear about these changes before you start delivering your comments.
- If you are preparing the next draft
 - When circulating the draft, include a cover sheet explaining any deviations from the discussions and outlining all open issues. Not only does this provide a helpful instruction manual for the other side, but it makes it easier for you to pick up the transaction when it comes back (especially if the deal goes on hold for a while)
 - Prepare a clean redline. Always accept all redlined changes before editing it. Never edit a document that already has redlining in it.
 - Watch out for metadata
- Never forget that you are both a representative of your client and an agent of your client. Your actions and words can affect your client's reputation and economic prospects. If your client wants you to pound the table and act intransigently, then go ahead (so long as it otherwise comports with the Rules of Professional Conduct). But if not, your behavior may harm the client both in this deal and for subsequent deals. Further, in many cases, your words can legally bind your client, so make sure your client can stand behind everything you say.

Contract Signing Protocol

By Eric Goldman

We focus so much on deal substance and style that we often lose sight of the problems that can arise at the most critical time of all—when pen is hitting paper. If a lawyer mishandles contract execution, it can lead to a malpractice claim, professional discipline and a very angry client (or, more likely, former client). Therefore, this document proposes a step-by-step protocol to make sure that the contract signing stage is handled correctly.

Step 1: **MAKE SURE YOU GET THE RIGHT VERSION OF THE CONTRACT.** This can be particularly challenging when a number of drafts were swapped at the 11th hour; it may not be entirely clear which draft everyone is officially blessing.

Step 2: If you haven't had drafting control over the last version, read the version to make sure it reflects all changes accurately. If you are the lawyer presenting the contract to the client for signature, everyone expects to ensure that the client is signing the right version with all negotiated changes. Stated differently, I don't think a lawyer can credibly blame the other side if the draft has errors, even if those errors didn't show up on the redlines. As a result, when I was in-house counsel, I typically read the agreement from top-to-bottom to make sure that the draft didn't have any unexpected changes that didn't show up on the redline. This was time-consuming and usually a little painful, but I did occasionally mistakes in the supposedly execution-ready draft.

Step 3: Make sure all internal signoffs have been procured and ensure availability of person with signing authority. This is especially critical when the parties are rushing to get the deal completed by a fast-approaching deadline. It can be embarrassing at best, and deal-killing at worst, to find that the proper signatory or internal gatekeeper cannot be found by the stated deadline.

Step 4: Prepare a clean version.

Step 5: Decide which side is going to sign first. Of course, this is unnecessary if the agreement is being executed in counterparts.

Step 6: One approach: send 2 copies of the final version to the other side

- include a cover letter with instructions
- include visual cues (such as flags) indicating where they need to sign
- include return envelope if you want an original back

Originating the signature copy has the advantage of ensuring that the right version is prepared for signature. Otherwise, you may need to reread the half-executed agreement you get from the other side before blessing for signature.

Step 7: When returned, get your client to sign and return one copy to the other side.

A DEAL ISN'T "DONE" UNTIL YOU SEE A FULLY SIGNED AGREEMENT
(or, better yet, cash in the bank)

As a great example of this, see *International Telemeter v. Teleprompter*, 592 F.2d 49 (2d Cir. 1979). Kirsch's client told Kirsch that it had signed a settlement agreement, but Kirsch didn't get the signed copy into his possession. Kirsch then relayed the alleged good news to the other side. However, Kirsch's client had a management change before delivering the signed copy, and the new management balked at the settlement. This left Kirsch in the middle—he had told the other side that the agreement was done (and had authority to do so), but his client had reversed course and was saying the deal was never signed. Not only did Kirsch's eagerness cost Kirsch a client (he resigned), but he has very few defenses if his former client sues him for malpractice based on being committed to a deal they didn't want.

This issue also comes up with press releases—no public announcements of a completed deal until you see the fully signed contract.

Step 8: Make sure the signed version gets filed properly. A signed contract that can't be found when needed isn't very useful. I can't tell you how many times I looked in the files for a signed contract and instead found a mess—signature pages with no contract attached; a contract with only one signature; or contract drafts without any signature at all. I've even had a couple of situations where *both sides* could not find a signed contract—posing a fascinating ontological problem as well as some intensely practical ones. As outside counsel, you may not always see the final signed contract (though I would usually ask for one, if for no other reason than to confirm that no further work was required on my part), but if you do, it should be stored for easy retrieval. As inside counsel, it's essential to maintain comprehensive files of all binding contracts.

Step 9: Do a post-mortem with your client to see what you learned from the deal. If you and your client are likely to do future similar deals, it may be worth investing some time after the first transaction to recap any lessons learned.

Step 10: Send a congratulatory note to other side/attorneys. Often, in the course of working on a deal, a lawyer develops a rapport with opposing counsel. The lawyer can reinforce the good feelings and extend his/her network by celebrating a successful closure to the deal. Good professional relationships can also help if and when the parties renegotiate the deal post-signing.

Step 11: Get client to calendar significant dates and develop implementation plan. Often there are post-signing obligations to the contract, and the lawyer may need to help the client understand and implement those obligations to avoid breaching the contract.

Step 12: If deal has subsequent conditional dates, make sure those conditional activities get documented when they occur. For example, in web development and hosting agreements, usually some contract obligations are triggered upon "launch" of the website, such as hosting might run 12 months from the website launch. Unless the parties

document the launch date, in the future it will be difficult to determine when the contract expires. Therefore, when reaching a milestone contemplated by the contract, the lawyer should (if involved at that point) record the event in the files (and, as applicable, the contract tracking software) to make sure the contract can be interpreted properly in the future.

Doing Business with Your Clients

By Eric Goldman

Many transactional lawyers have opportunities to do transactions with their clients. In the 1990s, this issue reached a zenith as lawyers scrambled to obtain equity in clients, either as part of undertaking the representation or as directed shares when clients were lining up for an IPO. Seeking big payoffs, some lawyers took pretty aggressive interpretations of the rules to engage in these transactions, but it would be a mistake to relegate this behavior to the dot-com boom. Instead, doing business with clients occurs in all aspects of the legal profession, and it poses significant risks in every format.

Typology of Deals with Clients

- Buying/getting stock or taking options in clients
 - If taken as a fee, Rule 1.5 *also* applies
- Loaning money to clients or getting loans from clients
- Co-investing with clients in assets or stock
- Asset purchase/sale from clients
- Providing compensated non-legal services to clients
 - Especially when a lawyer owns a business and refers clients to it or invests client money in it

Downsides of Doing Business with Clients

- Transacting with clients creates the opportunity for unfair advantage
 - Attorney has position of trust and confidence
 - Attorney may be more sophisticated
 - Attorney may have inside knowledge
- Risks
 - Bar discipline
 - Malpractice
 - Rescission of transaction
 - Termination of representation

Ethics 2000 Rules

- Rule 1.8(a): “A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:
 - (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
 - (2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and
 - (3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer’s role in the transaction, including whether the lawyer is representing the client in the transaction.”

- Rule 1.8(b): “A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules”
- Rule 1.8(d): “Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation”
- Rule 1.7(a)(2): “A concurrent conflict of interest exists if there is a significant risk that the representation of one or more clients will 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.”

Other Regulations Beyond the Professional Responsibility Rules

- Contract law
 - Some jurisdictions treat lawyer/client transactions as presumptively fraudulent or impose heightened risk disclosure obligations on the attorney
 - Lawyer may have burden of proof
 - If anything goes wrong, clients may be able to rescind, effectively putting all of the economic risk on the lawyer’s shoulders—giving the client risk-free upside
- Securities law
 - Insider trading laws

Case Study: Mershon [316 N.W.2d 895 (1982)]

- Mershon is Miller’s tax lawyer for 19 years
- Mershon, Miller and Schenk form a corporation to develop land
 - Miller contributes land
 - Mershon had undocumented understanding that land would be returned to Miller if deal didn’t go through
 - Schenk contributes engineering services
 - Mershon contributes legal services
 - Structured as interest-free promissory note to purchase stock, with note paid back as legal services are performed
 - Not clear if Mershon properly addressed the issues associated with concurrently representing both company and investor
- Company goes bust without developing the land, and later Miller dies
 - Mershon returns stock but Schenk retains 50% interest in company/land
- Mershon’s failings
 - Did not advise Miller to get independent counsel
 - Did not make adequate disclosures
 - Business terms were too favorable to Mershon
 - Did not document side deal about returning land
 - Miller inadequately protected upon a death of a party
- Consequences
 - Public reprimand by state bar
 - Loses \$6,900 of time and advanced costs

- Malpractice?

Solutions?

- The lesson: attorneys enter into business deals with clients at their risk
 - All facts will be construed against attorney and in favor of clients
- Possible solutions
 - Very conservative practice: no business deals with clients
 - Conservative practice: Deal with client only if client gets independent legal advice
 - Managed risk practice: Transact carefully
 - Disclose all terms in understandable language
 - Only agree to fair and reasonable terms (best to get reputable third party to set valuations)
 - Disclose all possible risks of the deal going sour
 - Recommend independent legal counsel (and give adequate time to get it)
 - Provide legal advice as you would a stranger (and document all deal terms)
 - Disclose the lawyer's role in the deal
 - Obtain consent to the terms and the lawyer's role
 - *Get everything in writing*
 - Very risky practice: Let each attorney decide for themselves
 - Bad practice: Handle deals with clients more sloppily than market-driven deals