The Lawyers' Lawyer Newsletter

Recent Developments in Risk Management

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Conflicts of Interest – Advance Waivers – Sufficiency of Disclosure – Who Is a "Sophisticated Client"

***Galderma Laboratories, L.P. v. Actavis Mid Atlantic LLC* (N.D. Tex. Feb. 21, 2013)**

Risk Management Issue: When are advance waivers of conflicts of interest valid and binding on clients, and what are the requirements that lawyers must meet in order for them to be enforceable?

The Case: Before Judge Ed Kinkeade of the U.S. District Court for the Northern District of Texas was the motion of plaintiff client to disqualify the law firm from representing the defendants in the underlying litigation. Important to the decision is Judge Kinkeade's description of the client:

> [It] is a worldwide leader in the research, development, and manufacturing of branded dermatological products… headquartered in [Texas]. [The client] and its affiliates have operations around the world, employing thousands of people and reporting worldwide sales of 1.4 billion euros for the year 2011 alone. As a complex, global company, [the client] routinely encounters legal issues and the legal system. [The client] has its own legal department to address these issues. The legal department is headed by its Vice President and General Counsel . . . [The Vice President and General Counsel] is a lawyer who has practiced law for over 20 years and has been general counsel for [the client] for over 10 of those years. In addition to an in-house legal department, [the client], through [the Vice President and General Counsel], frequently engages outside counsel to assist with a wide range of issues. Over the past 10 years, [the client] has been represented by large law firms including [the law firm and two other law firms]. [The client] also engages smaller law firms as needed.

In 2003, when the client became a client of the law firm, the law firm sent the client an engagement letter, which included a broad waiver of future conflicts of interest:

> We understand and agree that this is not an exclusive agreement, and you are free to retain any other counsel of your choosing. We recognize that we shall be disqualified from representing any other client with interest materially and directly adverse to yours (i) in any matter which is substantially related to our representation of you and (ii) with respect to any matter where there is a reasonable probability that confidential information you furnished to us could be used to your disadvantage. You understand and agree that, with those exceptions, we are free to represent other clients, including clients whose interests may conflict with ours [*sic*] in litigation, business transactions, or other legal matters. You agree that our representing you in this matter will not prevent or disqualify us from representing clients adverse to you in other matters and that you consent in advance to our undertaking such adverse representations.

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The Vice President and General Counsel signed that he understood and, on behalf of the client, agreed to the terms and conditions of engaging the law firm, including the waiver of future conflicts of interest.

Between 2003 and 2012, the law firm provided employment and benefits advice to the client. In 2012 the client, represented by other law firms, initiated intellectual property litigation against a second company. The second company, already a client of the law firm, engaged the law firm to represent it in the litigation. When the client received a copy of the second company's answer and counterclaims, and became aware that the law firm was representing the second company, the client asked the law firm to withdraw from representing the second company. Instead, the law firm chose to terminate its attorney-client relationship with the client and informed the client that it would not withdraw from representing the second company, because the client had consented to the law firm representing adverse parties in litigation when it signed the waiver of future conflicts in the 2003 engagement letter. The client moved to disqualify.

Judge Kinkeade summarized the issue to be resolved, and the parties' arguments, as follows: "whether or not [the client], a sophisticated client, represented by in-house counsel gave informed consent when it agreed to a general, open-ended waiver of future conflicts of interest in [the law firm's] 2003 engagement letter."

On the one hand, the client argued that its consent was not "informed consent" when its in-house lawyer signed the agreement on its behalf, because the law firm did not advise the client of any specifics with regards to what future conflicts the client might be waiving. On the other hand, the law firm argued that because the client was a highly sophisticated client, a regular user of legal services, and was represented by its own counsel, the waiver language was reasonably adequate to advise the client of the material risks of waiving future conflicts, despite being general and open-ended.

Judge Kinkeade's decision includes extensive consideration of both the Texas and the Model Rules of Professional Conduct, as well as applicable Fifth Circuit case law. In addition, Judge Kinkeade compared the sufficiency of the law firm's waiver with the similar waiver considered in *Celgene Corp.,* 2008 WL 2937415, at *8 (July 29, 2008 D.N.J.) (*Celgene*). [***Editors' Note:*** the Celgene case was the subject of a Note in the November 2008 *The Lawyers' Lawyer Newsletter*.] In particular, Judge Kinkeade noted that "[i]n holding that the waiver language was not reasonably adequate, the *Celgene* court reasoned that the attorneys seeking the waiver of future conflicts needed to further identify risks to Celgene, such as particularizing generic pharmaceutical companies as a potentially conflicted client and identifying patent disputes as a potential matter where the attorneys may represent a client with conflicting interests. . . . The [*Celgene*] court also reasoned that the attorneys needed to further explain alternatives such as defining substantially related matters or considering broader limitations such as refraining from representing all general drug companies." But he concluded that "[t]his type of language is not always necessary for a client to give informed consent," and that "[i]f such language was always required, general and open-ended consent would never be valid."

Accordingly, Judge Kinkeade found that "the waiver in the 2003 engagement letter is reasonably adequate to allow clients in some circumstances to understand the material risk of waiving future conflicts of interest. The language disclosed a course of conduct for determining when [the law firm] will be disqualified, explains the material risk that [the law firm] may be directly adverse to the client, and explains an alternative, that the client need not hire [the law firm] if it does not wish to consent."

The court then examined whether or not the disclosure provided by the law firm was reasonably adequate to allow the client to understand the material risks of waiving future conflicts, in the light of its degree of sophistication, and also whether the client was independently represented in making the waiver. Distinguishing *Celgene* as based on different standards in place in the Third Circuit and New Jersey, Judge Kinkeade, applying the language of the relevant ABA Model Rules, held that in the Fifth Circuit:

> "the test for informed consent is whether the client understands the material risks involved in waiving the future conflict . . . Additional consultation outside of the waiver is not a requirement to obtain informed consent. A lawyer need not inform the client through additional consultation of

> facts or implications already known to the client. . . Accordingly, under the national standard, as opposed to the New Jersey standard, additional consultation is not required for a client to give informed consent when, without it, the client is aware of sufficient information reasonably adequate to make an informed decision."

Similarly, with respect to the client's sophistication, Judge Kinkeade held that:

> "[w]hen a client has their own lawyer who reviews the waiver, the client does not need the same type of explanation from the lawyer seeking a waiver because the client's own lawyer can review what the language of the waiver plainly says and advise the client accordingly. The court cannot agree with the *Celgene* court because to do so would ignore the knowledge and advantage that clients gain by employing their own counsel to advise them, and the national ethical standards clearly compel the court to consider a client's use of independent counsel."

Accordingly, Judge Kinkeade's holding in this case was "that [the client] gave informed consent to [the law firm's] representation of clients directly adverse to [the client] in substantially unrelated litigation. Because [the law firm's] representation of [the second company] falls within the scope of that informed consent, [the law firm] is not disqualified from representing [the second company]."

Comment: Whether and when law firms should be able to rely on advance waivers of conflicts of interest involves the resolution of competing paradigms of legal ethics. On the one hand, the rules governing conflicts of interest are premised on the fiduciary duties of loyalty and the protection of client confidences. On the other, the law governing lawyers recognizes the principles that clients should normally be free to select counsel of their choice, free from outside interference, and that client consent can, in appropriate circumstances, form a proper basis for overcoming prohibitions on conduct that would otherwise be impermissible.

This decision vindicates our comment regarding the opposite conclusion reached in *Celegene* that, based on ethics opinions and case law, if the similar facts had been presented in a jurisdiction other than the Third Circuit and New Jersey, the law firm may well have survived a motion to disqualify it, as did the law firm here. More importantly, the case sets out with great clarity the elements that firms will need to establish if they are going to be successful in relying on broad advance waivers of conflicts involving direct adversity to current clients.

Risk Management Solution: Whether or not the same advance waiver would have been enforced against a similarly sophisticated client in other jurisdictions, some useful lessons can be drawn from this decision, and the contrast between this case and *Celgene*.

- As to existing or presently identifiable potential conflicts, in order for a waiver to have the greatest likelihood of being upheld, disclosure of both the specific facts and the potential adverse consequences should be made.
- As to advance or blanket waivers of potential future conflicts, the disclosure should be as comprehensive and detailed as is possible, laying out the foreseeable types of adversity and the nature of the potential negative consequences for the client.
- As to waivers of both existing and future conflicts, these should be obtained in circumstances that — as far as possible — preclude the client from later averring that the client did not understand the meaning or implications of the waiver. Waivers standing the greatest likelihood of being upheld are those where the client actually received independent legal advice with respect to the waiver — but a very significant element of the decision in this case is that in-house counsel for a corporation can serve that independent function.

Accordingly, the ideal signatory of a conflict waiver letter is a client's independent counsel — whether in-house, or outside. At a minimum, lawyers should advise clients to obtain the advice of independent

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counsel before signing waivers of conflicts, and, preferably, clients should be required to do so before lawyers proceed based on the waiver. Generally, this is easier where an in-house counsel is available. But when there is not, if the law firm believes that there is any likelihood that it will later need to rely on the waiver, the case is even stronger for requiring the affected client to have another lawyer review the waiver letter before signing it.

Legal Fees – Suing for Fees – Engagement Letters – Account Stated

***Pryor Cashman LLP v. U.S. Coal Corporation*, 651908/11, NYLJ 1202588022493, at *1 (Sup. Ct. N.Y. Feb. 4, 2013)**

Risk Management Issues: Are engagement letters enforceable if not countersigned by the client? Is a client's failure to make a timely objection to a lawyer's bill a sound basis for suing the client for fees?

The Case: In July 2006, plaintiff client hired defendant law firm to perform the legal work in connection with the acquisition of numerous coal companies. The law firm provided an engagement letter containing the terms of their agreement, including: (1) the specific scope of the legal services; (2) a list of billing rates for the law firm's attorneys, law clerks and paralegals; (3) expenses that may be incurred, to be reimbursed by the client; (4) an explanation of the firm's billing practices, such as sending a monthly invoice containing the fees and expenses incurred during the previous month, and the firm's right to impose interest on balances outstanding for more than 30 days; (5) an explanation that the client was free to terminate the attorney-client relationship at any time, and that the law firm would withdraw in compliance with applicable law; and (6) an agreement to waive certain conflicts of interest. The client verbally acknowledged and agreed to these terms. From July 2006 through June 2011, the law firm performed legal services in accordance with the terms of the engagement letter. It regularly sent the client invoices, and, after receiving each invoice, the client never raised an objection, nor requested a reduction of the billed amount. The client periodically paid the invoices, though not in full.

From March 2008 through December 31, 2009, the client repeatedly assured the law firm that it would pay the outstanding balance on its invoices. According to its executives, the client was in the process of obtaining financing for acquisitions of other coal companies, or refinancing its then-existing debt obligations. Afterwards, it would have enough money to pay the outstanding fees and expenses. Based on those representations, the law firm continued to perform legal services on the client's behalf. As of June 2011, the law firm was owed $2,455,478.86. The client declined to pay, and the law firm sued. The complaint contained two causes of action — for breach of contract, and for an account stated.

The client answered, alleging that the firm had engaged in misconduct in that the firm had conflicts of interest relating to various business transactions between partners of the firm and the client, none of which had been properly disclosed or waived, and that the firm had engaged in "questionable billing practices," such as billing for 14-hour-plus days and billing entries that were repeated word for word. The client asserted three counterclaims based on the same allegations.

In granting the firm's motion for summary judgement on its claims, and dismissing the client's counterclaims, the court found that at no time did the client object to the invoices it had received over the course of the five years of representation. The court held that "[b]ecause of the failure to object, the challenges to the reasonableness of the charges fail." Nevertheless, the court noted that "even if the court were to review the quality of the invoices, they appear to be adequate, at least in the context of the client's failure to contemporaneously object – they identify the attorneys to perform the services, the date of the service, a description of the work performed, the hours billed,

and the fee assessed for each block of time charged." Similarly, the court held that "[a]s for the conflict of interest defense, the valid accounts stated bars [the client's] breach of contract counterclaim." In addition, the court held that the firm was entitled to judgement on its breach of contract claim, specifically finding that the failure to obtain the client's countersignature to the engagement letter would not constitute a violation of New York's requirement for a written engagement letter, and that even if that requirement had not been met "that, by itself would not preclude [the firm] from seeking recovery of legal fees under such theories as services rendered, *quantum meruit* and account stated." Finally, in dismissing the counterclaims, the court held that it was fatal to those claims that the client neither alleged nor proved that it had been damaged in any way by the alleged conflicts of interest.

Risk Management Solution: This case is the exception that proves the rule: "never sue a client for fees." The case demonstrates the critical importance of using well-crafted engagement letters for all — even very sophisticated — clients. In addition, the case reinforces the importance of the account stated cause of action in states whose substantive law permits them. In this case, the court noted the length of time, the number of bills and the partial payments in determining that the client had had an opportunity to object and had failed to do so. Law firms can assist in creating support for the "failure-to-object" element of account stated claims by accompanying each bill with a cover letter requesting that the client notify the firm promptly if it has any questions or concerns with respect to the bill. In addition, in any matter where the outcome of the engagement involves anything less than the complete attainment of the client's objectives, it is vitally important, before commencing litigation to collect the fee, to review the file to determine the likelihood of success of any counterclaim for malpractice that may be asserted. Finally, the recent and highly publicized case of another law firm suing for unpaid fees demonstrates that there is an additional and equally critical step that firms should take before commencing fee suits, namely thoroughly reviewing the file (including the email file) relating to the engagement, as well as all of the bills and the underlying time records.

Regulation of Advertising – Meaning of Confidential Information – "Blogging" About Client Matters – Need for Client Consent

***Hunter v. Virginia State Bar, Ex Rel. Third District Committee*, --- S.E.2d ---, 2013 WL 749494 (Va. Feb. 28, 2013)**

Risk Management Issue: May a lawyer write a blog post discussing public information relating to a client without the client's consent? If a lawyer blogs about cases he won, is this regulated attorney advertising requiring a disclaimer?

Case: A Virginia attorney created and posted in a trademarked blog, which was accessible from his law firm's website. The blog, which was not interactive, contained posts discussing legal issues and cases, but the overwhelming majority were posts about cases in which the lawyer obtained favorable results for his clients. The posts contained his clients' names and publicly available information about their cases. He did not ask for his clients' consent before blogging about their matters, nor did he include a disclaimer anywhere on the blog that his posts constituted attorney advertising or that prior victories do not guarantee future results.

Based on the attorney's blog posts, the Virginia State Bar charged the lawyer with violating several Rules of Professional Conduct relating to attorney advertising as well as Rule 1.6, which prohibits revealing client confidential information. After a hearing, the Bar found that the lawyer violated Rule 1.6 by "disseminating client confidences" obtained in the course of representation without consent to post. Specifically, the Bar found that the information in the attorney's blog posts "would be embarrassing or be likely to be detrimental" to clients. The Bar further held that the lawyer violated Rule 7.1 by failing to state on the blog that it contained legal advertising, and also Rule 7.2 by "disseminating case results in advertising without the required disclaimer [that past case results

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do not guarantee or predict a similar result].” The Bar imposed a public admonition with terms including a requirement that the lawyer remove case-specific content for which he has not received consent and post a disclaimer that complies with Rule 7.2 on all case-related posts.

The lawyer appealed to a three-judge panel of the circuit court and the court heard argument. The court ruled that the Bar’s interpretation of Rule 1.6 violated the First Amendment and dismissed that charge, but upheld the Bar’s findings with respect to Rules 7.1 and 7.2.

The Virginia Supreme Court affirmed. With respect to Rule 1.6, the Court found that the state may not prohibit an attorney from discussing public information about a client or former client, even if that information is embarrassing or likely to be detrimental to the client. The Court emphasized that all of the lawyer’s blog posts involved cases that had been concluded, and therefore his posts could not prejudice a pending case. The Court also made the broad assertion, “State action that punishes the publication of truthful information can rarely survive constitutional scrutiny.”

Regarding the advertising rules, the Court first determined that the lawyer’s blog posts were commercial speech, specifically lawyer advertising. The attorney argued that his posts were political speech and thus entitled to a higher degree of constitutional scrutiny, but the Court disagreed, noting that the blog posts were predominately about cases where the lawyer received a favorable result for his client, were located on his law firm’s commercial website rather than on an independent site, and did not allow for discourse about the cases by allowing readers to post comments. Thus, the Court reached its conclusion even though, “[The attorney] chose to commingle sporadic political statements within his self-promoting blog posts in an attempt to camouflage the true commercial nature of his blog.” Although the Court disagreed with the Bar’s argument that the posts were inherently misleading, it did find that they had the potential to be misleading. Because the Bar has a substantial governmental interest in protecting the public from potentially misleading attorney advertising, and that the regulations are no more restrictive than necessary, the Court determined that Rules 7.1 and 7.2 do not violate the First Amendment, and the lawyer was required to include a disclaimer on his blog posts that complies with Rule 7.2.

Comment: The Virginia Supreme Court’s striking down as unconstitutional that part of Rule 1.6 prohibiting attorneys from disclosing public information about clients may have potentially far-reaching consequences. Many states have previously disciplined attorneys under Rule 1.6 for failing to secure consent of their clients before revealing potentially embarrassing public information about clients. It bears watching to see if this case starts a trend, or whether it is seen as an outlier.

Risk Management Solution: Lawyers’ and law firms’ free speech rights are subject to constitutionally permissible regulation of commercial speech by professional regulators. States’ appetites for enforcing advertising rules vary widely. As a result, it continues to be important for law firms to take care to monitor all publicly accessible postings involving the firm, its lawyers and their clients.