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A Practitioner's Perspective on Emerging Legal Trends | 2019 Issue 5

Business Transactions Between Client and Lawyer

Now That's A Great Idea! Or is it?

Small firm lawyers are all too familiar with price sensitive clients—those who may not be accustomed to the varying fees associated with legal services. It can be a drain on the client relationship to report to such a client that further action is required in their transactional or litigation matter, meaning additional attorney's fees will ensue. After all, lawyers can't work for free. But what if the client offers to bring you in as an investor—or better yet, what if the client offers to give you an interest in a transaction? Not only could you recover your ordinary legal fees, but you may quadruple (or more) your investment of time. Analyzing whether such an arrangement is a good idea, or if it's ethical, are two distinct tasks—the latter of which we'll review here.

Partnering with Your Client

As a dutiful practitioner, before even thinking about proceeding, you analyze the relevant conduct rules applicable to the situation. The American Bar Association (ABA) Model Rules are quite clear on the issue as it relates to conflicts: "[a] lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may: (1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and (2) contract with a client for a reasonable contingent fee in a civil case." *See* ABA Model Rule 1.8(i). You likely also analyze the fee rules and find that, among other things: "[a] lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses." *See* ABA Model Rule 1.5(a). But whether the transaction is a "cause of action" or "subject matter of litigation" requires further review.

A Piece of the Pie

In one scenario, the client offers you a small percentage of the company in exchange for assisting with various general legal matters. A quick review of ABA Ethics Opinions leads you to understand that this sort of transaction may actually be ethical, but only after certain steps are followed, including ensuring appropriate terms. *See, e.g.*, Restat 3d of the Law Governing Lawyers, § 36 ("The rule . . . prohibiting acquisition of a proprietary interest in a claim the lawyer is litigating developed from restrictions on purchasing claims under the common law of champerty and maintenance… [t]he prohibition of the Section is limited to matters in litigation."); *see also* ABA Formal Ethics Op. 00-418 (July 7, 2000) ("The Model Rules of Professional Conduct do not prohibit a lawyer from acquiring an ownership interest in a client, either in lieu of a cash fee for providing legal services or as an investment opportunity in connection with such services, as long as the lawyer complies with Rule 1.8(a) governing business transactions with clients, and, when applicable, with Rule 1.5 requiring that a fee for legal services be reasonable.").

After reviewing ABA Model Rule 1.5, you opt for an independent valuation of the company to ensure fairness to the client and find that the 1% stake in the company you propose to acquire is equal to what your otherwise reasonable fee would have been. In analyzing ABA Model Rule 1.8, however, you understand that this is a business transaction with a client. As such, it requires fair written terms, an opportunity for the client to seek independent counsel, and informed consent, confirmed in writing. *See* ABA Model Rule 1.8(a). In other words, while this sort of renumeration may be permitted, it requires the lawyer to thoroughly understand the parameters of the transaction, and similarly explain those terms to the client—in writing.

But what does it mean to have fair written terms? According to the *Restatement of the Law Governing Lawyers*, "[f]airness is determined based on facts that reasonably could be known at the time of the transaction, not as facts later develop." *See* Restat 3d of the Law Governing Lawyers, § 207, cmt e. In other words, practitioners should be mindful that it is always their burden to prove that the transaction was reasonable under the circumstances at the time it was entered into –not in hindsight.

The Patent Exception?

Those practitioners who are registered to practice before the United States Patent Office (USPTO) may also be asked about taking an interest in a specific patent or patent application, rather than the entity itself. Under the traditional interpretation of the ABA Model Rules, it would seem that taking an interest in the "cause of action" or "subject matter of litigation" would be prohibited. *See* ABA Model Rule 1.8(i). However, as a registered patent practitioner, it is important to understand some of the key differences in practice before the USPTO, including the USPTO Rules of Professional Conduct (USPTO Rules). Quite simply, in this instance, the corollary to ABA Model Rule 1.8(i) in the USPTO Rules holds the same prohibition, with an *additional exception* stating that a practitioner may: "[i]n a patent case or a proceeding before the Office, take an interest in the patent or patent application as part or all of his or her fee." *See* 37 CFR § 11.108(i)(3). The preamble to the USPTO's April 3, 2013 rulemaking is more instructive. It is there that the USPTO's disciplinary office, the Office of Enrollment and Discipline (OED), explains that the rule differs from the ABA Model Rule insomuch as there is an exception to the prohibition, which is based upon the prior rule, 37 CFR § 10.64(a)(30)—in existence since 1985. *See* 78 FR 20183. Moreover, the rules clarify that "…practitioners who take an interest in a patent or patent application as part of or all of their fee remain subject to the conflict of interest provisions of § 11.108." *Id.*

Which Rules Apply?

But what about conflicts between the USPTO Rules and state bar rules? According to the definitions section of the USPTO Rules, "[n]othing in this part shall be construed to preempt the authority of each State to regulate the practice of law, except to the extent necessary for the United States Patent and Trademark Office to accomplish its Federal objectives." *See* 37 CFR § 11.1. The Supreme Court has held that "[a] State may not enforce licensing requirements which, though valid in the absence of federal regulation, give 'the State's licensing board a virtual power of review over the federal determination that a person or agency is qualified and entitled to perform certain functions, or which impose upon the performance of activity sanctioned by federal license additional conditions not contemplated by Congress." *See Sperry v. Florida ex rel. Florida Bar*, 373 U.S. 379, 385 (1963). Of course, courts have clarified that registered practitioners may still be subject to their state bar rules for matters related to practice before the USPTO. *See, e.g., Kroll v. Finnerty*, 242 F.3d 1359 (Fed. Cir. 2001). It is likely that both sets of rules apply. While the USPTO Rules and state bar rules may be similar, any differences should carefully be interpreted by the practitioner to understand whether any argument for preemption exists.

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A New York Lesson

The New York Court of Appeals examined the issue of registered practitioners taking an interest in a patent and found that the USPTO's express exception to the prohibition *did not* obviate compliance with state bar rules. *See Buechel v. Bain*, 766 N.E.2d 914 (N.Y. 2001). The facts of *Buechel* are complex and involve multiple additional cases. However, for our purposes, plaintiffs Frederick Buechel and Michael Pappas invented a prosthetic shoulder device and retained defendant Bain, Gilfillan & Rhodes, P.C. to prepare and prosecute the patent application. The fee agreement, which was signed back in 1974, outlined that the defendant firm would receive one-third of all income from the patentable subject matter. What resulted was a new corporation in which each party (the two inventors and the law firm) owned one-third each. After a departure of one of the attorneys from the defendant firm, eventually the assets of the new corporation were transferred to a trust. After litigation involving trust distributions, *Buechel* helped outline the balance between federal and state authority over patent lawyer conduct. Parenthetically, the *Buechel* court noted that another independent conflict appeared to exist, for which the defendant firm failed to advise their clients. Specifically, the court noted that "…converting one-third interest in a single invention into a one-third equity interest in a corporation … would exploit all future inventions." 766 N.E.2d at 916. That apparent additional conflict was an important issue that likely implicated the fee rules, among others.

Significantly, the *Buechel* court cited to the definitions section of the former USPTO Code of Professional Responsibility (now located in 37 CFR § 11.1 of the USPTO Rules) and found that "[f]ederal patent statutes do not preempt State law in this case." 766 N.E.2d at 922. The court, when reviewing the claims noted that "…this case addresses the necessary disclosures attorneys must make and the ethical obligations they must maintain in the course of their interaction with clients. Although Federal patent law recognizes that attorneys may receive an interest in patents in lieu of traditional fee arrangements, the need for disclosure mandated by the [former USPTO] Code of Professional Responsibility governing the practice of law in this State is not obviated." *Id.* The significant implication of *Buechel* is that registered practitioners wishing to take an interest in a patent or patent application must still comply with the disclosure obligation under state law and the USPTO Rules, including the rest of 37 CFR § 11.108.

Risk Management or Mitigation

Business transactions with clients are rife with risk. For example, as an attorney, your client has approached you for your expert advice and counsel. As their fiduciary, we must examine how a lawyer entering into a business transaction with that same client will be affected by his or her own interests. Moreover, even simple ownership of patents (without a transaction with a client) may cause conflicts with clients, including the case of a patent attorney who was forced to resign by his law firm employer because a patent he *formerly* owned was asserted against the firm's then-current client. *See generally*, Ashley R. Presson, Patent-Holding Patent Attorneys: Conflicts of Interests, Confidentiality, and Employment Issues, 40 St. Mary's L.J. 1039 (2009). Therefore, a thorough understanding of the benefits and risks should be examined by each practitioner *prior* to even considering such an arrangement.

And don't forget, for those attorneys practicing in a firm environment who want to avoid *Buechel*-type law firm drama, the temptation to keep the patent for yourself may be high. However, it is probably not worth the hassle. Take the non-patent case of Keith Vanderburg who, as managing partner of a law firm in Ohio, was aware of his firm's representation of a firearms dealer that was behind on bills. In what appeared to be an effort to help the client, Mr. Vanderburg offered to purchase firearms and offset the client's bill. While some of Mr. Vanderburg's partners were aware of his purchases, they believed he was reimbursing the firm as the firm was reducing the client's bill. As it turns out, Mr. Vanderburg was not reimbursing the firm, but did so upon being asked about the situation. The conduct appears to have been self-reported by Mr. Vanderburg and his firm. The Supreme Court of the State of Ohio nevertheless suspended Mr. Vanderburg for violating Rule 8.4(c) (conduct involving dishonesty, fraud, deceit, or misrepresentation). *See Disciplinary Counsel v. Vanderburg*, Slip Op. 2019-Ohio-4227 (O.H. 2019) (fully stayed suspension). Clearly, "side deals" may be tempting, but the consequences of such arrangements may cause further violations and repercussions.

Final Thoughts

For patent litigators, questions still remain regarding the propriety of such an arrangement as it is unclear about how other jurisdictions will react when the proceeding is not "before the Office." *See, e.g.*, Restat 3d of the Law Governing Lawyers, § 36 ("…a lawyer may acquire an ownership or other proprietary interest in a client's patent when retained to file a patent application, while under this Section the lawyer could not acquire such an interest if retained to bring a patent-infringement suit."). Notwithstanding the lack of clarity with regard to district court infringement cases, it appears that proceedings before the Patent Trial and Appeal Board, as well as general patent prosecution matters, would be covered by the exception.

Of course, before proceeding, a practitioner must still comply with the analysis of ABA Model Rule 1.8 (and the USPTO equivalent). As OED further explained in the preamble to the rule: "…practitioners who take an interest in a patent or patent application as part of or all of their fee remain subject to the conflict of interest provisions of §11.108." *See* 78 FR 20183. Therefore, while it is expressly permitted for a registered practitioner to take an interest in a patent, patent application, or proceeding before the USPTO for all or part of a legal fee, practitioners who do so must still comply with the conflict of interest rules of the USPTO Rules, and their own state bar rules.

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