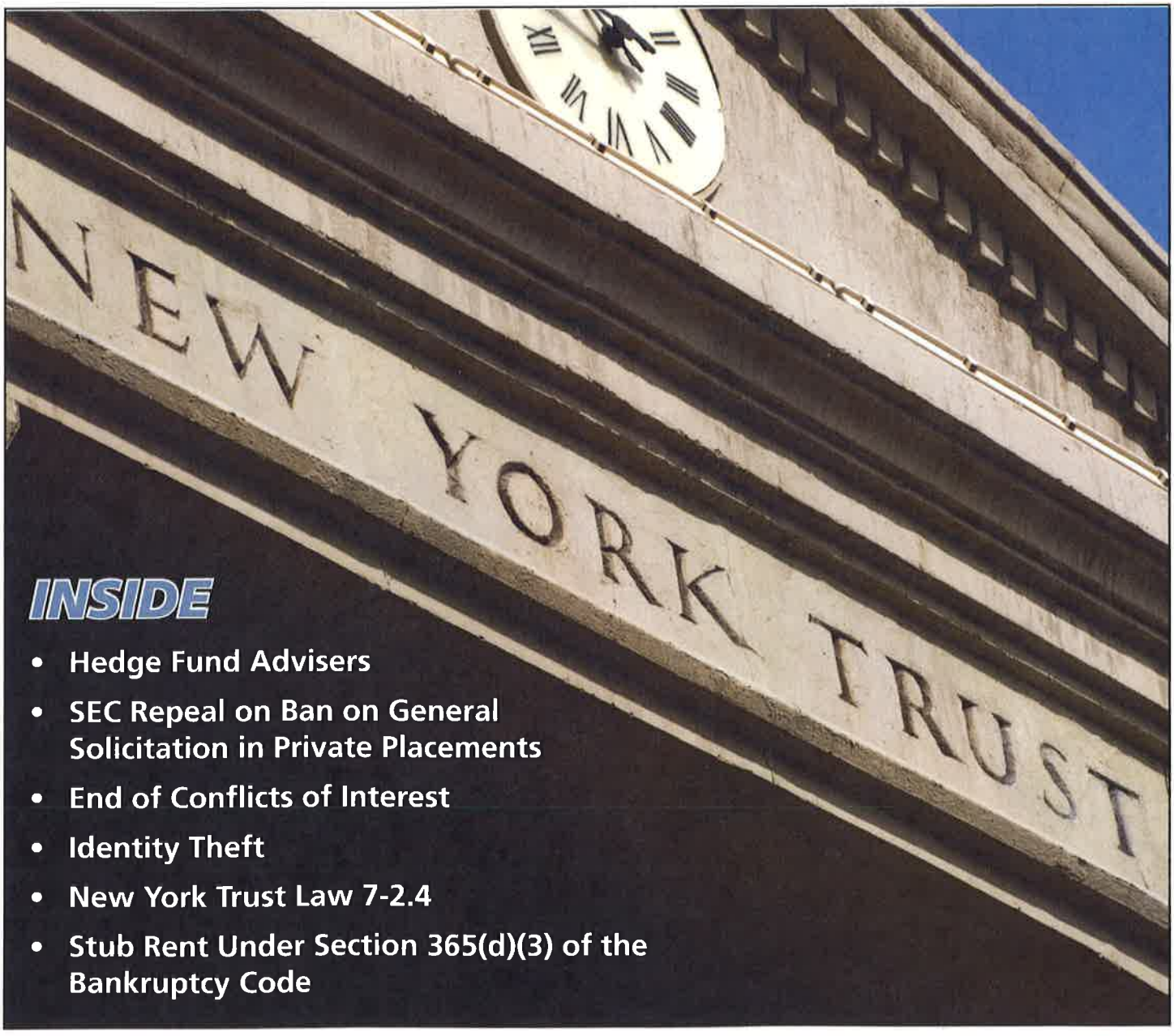
NYSBA WINTER 2013 | VOL. 17 | NO. 2

NY Business Law Journal

A publication of the Business Law Section
of the New York State Bar Association



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HeadNotes

As this issue was going to press, the Congress had just brokered a temporary deal to raise the debt ceiling and reopen the government. But the battle over Obamacare continues, and the well-publicized problems with the health care website may presage issues down the road for businesses and their lawyers. As H.L. Mencken observed, "Under democracy one party always devotes its chief energies to trying to prove that the other party is unfit to rule—and both commonly succeed, and are right." Stay tuned.

One of the most gratifying developments during my tenure as Editor-in-Chief of the *NY Business Law Journal* has been the increasing awareness of our *Journal* outside New York, and our concomitant ability to attract quality contributions from non-New York practitioners, academics and law students, as well as from the unparalleled legal community in our State. Case in point: Our lead article, contributed by Bryan Morben, a law student at the University of Minnesota. Mr. Morben addresses an issue that has become as timely as today's headlines, given the volatility in the markets and the ability of the media to make "rock stars" out of successful investment managers.

In December 2012, a hedge fund manager known for his success in short selling (i.e., selling borrowed stock in the hope that it will decline in value and can be repurchased at a lower price) went public with an attack on Herbalife Inc., the multi-level marketing company, alleging that it was a fraudulent Ponzi scheme. The stock declined precipitously over the next few days, creating substantial profits for the hedge fund. Then came a counter-attack from another well-known investor who was "long" (owned) the stock. The stock rose in response. These events create troubling questions under the securities laws regarding the ability of hedge fund managers to influence stock prices to their own advantage. In "The Ability of Hedge Fund Advisers to Manipulate the Market and Make Millions Doing It: The Battle Over Herbalife and the Need to Extend the Investment Advisers Act," Mr. Morben tells the compelling story of how this controversy has played out over the past year. He also cogently summarizes the applicable antifraud provisions of the securities laws, highlighting why they may not be adequate to address this type of market manipulation, and proposes enhancements to the Investment Advisers Act aimed at giving the Securities & Exchange Commission (SEC) the tools to address it.

In other securities law developments, the SEC has now amended its rules to liberalize the use of private placements in securities offerings. In "SEC Repeals Ban on General Solicitation in Private Placements, Adds a Disqualification for Bad Actors and Proposes New Reg. D Requirements," former Business Law Section Chair Guy P. Lander and his colleagues at Carter Ledyard & Milburn discuss changes to SEC rules aimed at implementing requirements imposed by both the Dodd-Frank Wall Street Reform Act of 2010 and the Jumpstart Our Business Startups (JOBS) Act of 2012. The former requires the SEC to prohibit certain "bad actors" from participating in private placements of securities under SEC Rule 506. Mr. Lander et al. summarize and explain the criteria for who is a "bad actor," and the predicate acts giving rise to this determination. The JOBS Act was passed to encourage new business formations by, among other things, making it easier for business start-ups to raise capital. Toward this end, the SEC has now eliminated the ban on general solicitation in connection with private placements. Previously, only limited solicitation could take place. The article explains that the new rule preserves the existing safe harbors, while adding the additional solicitation approach sanctioned by the JOBS Act.

Given the increasing complexity of business law, and the size and diverse practices of law firms that represent businesses, lawyers are loathe to commit to engagements that may preclude them from taking more lucrative engagements down the road due to conflicts of interest. Over the years lawyers have attempted to deal with this by using "waiver" clauses in their engagement agreements, in effect asking the client to waive in advance potential but unknown conflicts that may develop down the road. These were sometimes thought to be unenforceable, but several recent cases may suggest otherwise. In "The End of Conflicts of Interest? Courts Warm Up to Advance Waivers," our legal ethics guru, Evan Stewart of Cohen & Gresser LLP, discusses two recent, and eye-opening, cases that may presage broad changes in the approach of the courts to these waivers. In his usual clear and engaging style, Mr. Stewart explains the significance of these cases and offers practical guidance for lawyers, while casting a jaundiced eye on the reasoning behind these decisions. And he also debunks your Editor's long-held belief that Gracie Allen, when told by George Burns to "Say goodnight, Gracie," replied, "Goodnight, Gracie."

A popular ongoing feature of the *Journal* is "Inside the Courts," a compendium of current securities litigation prepared by the attorneys of Skadden Arps in New York City. As concise as it is comprehensive, "Inside the Courts" is an invaluable way for business practitioners to stay on top of key litigation developments that could

The End of Conflicts of Interest?: Courts Warm Up to Advance Waivers

By C. Evan Stewart

One of the greatest comedic teams of the 20th Century was George Burns and Gracie Allen. Their television show, which came after a long career in vaudeville and radio, ran from October 12, 1950 until September 22, 1958; it was (and is) a classic. Burns, the straightman, would end each show with "Say goodnight, Gracie." Allen's response: "Goodnight."[1] Pretty simple, huh?

We lawyers, of course, love the opposite: complexity. And no part of lawyers' ethical obligations seems quite as complex as that of conflicts of interest; and within that field itself, the most puzzling set of issues tends to relate to the doctrine of advance waivers.

The "Good" Old Days?

Once upon a time, advance waivers were looked upon with a high level of suspicion, at best.[2] After all, the notion of a lawyer asking her client to agree to the lawyer being adverse to it at some point in the future does seem to run counter to the historical, laser-like beam of undivided (and zealous) loyalty that is at the bedrock of our profession.[3]

But the American Bar Association seemed eager to change all that in 2002, when it enacted the current version of Model Rule 1.7; advance waivers were now to be countenanced, so long as the client gives "informed" consent. According to the ABA, informed consent requires that a waiving client must "reasonably understand[ ] the material risk that the waiver entails."[4] The criteria for such an understanding include, *inter alia*: (i) a (more) detailed statement of the type of engagements that might be undertaken; (ii) a (more) detailed statement of the "reasonably foreseeable adverse consequences" of said engagements; (iii) whether the "particular type of conflict" is one with which the waiving client is familiar; (iv) whether the waiving client is "an experienced user of the legal services" at issue; (v) whether the waiving client is represented by other counsel for purposes of giving consent; and (vi) whether the consent is limited to prospective engagements unrelated to the current representation.[5]

In the years that followed the 2002 version of ABA Model Rule 1.7, courts took dramatically different approaches to advance waivers,[6] and even practitioners that routinely used advance waivers in client retainer agreements doubted their efficacy.[7] Two new cases, however, would suggest that the future has arrived, big time.

A "Brave" New World?

The first case is *Galderma Laboratories v. Actavis Mid Atlantic*.[8] There, a federal judge in the Northern District of Texas ruled that a general, open-ended advance waiver with a sophisticated corporate client represented by in-house counsel made it permissible for Vinson & Elkins to represent the client's opponent in unrelated litigation.

The client that sought Vinson's disqualification was Galderma Laboratories (and two of its affiliates). Galderma had first retained Vinson in 2003 for advice on employment and H.R. issues. At that time, the company's general counsel executed Vinson's retainer agreement, which included the following provision:

> We [Vinson] understand and agree that this is not an exclusive agreement, and you [Galderma] are free to retain any other counsel of your choosing. We recognize that we shall be disqualified from representing any other client with interests 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 yours 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*. (emphasis added).

Fast forward to 2012, when Galderma brought a patent infringement case against Actavis Mid Atlantic. Vinson, which had previously represented Actavis on intellectual property matters, was retained to defend the company. Galderma asked Vinson to stand down. Vinson instead terminated its attorney-client relationship with Galderma. Galderma's motion to disqualify followed shortly thereafter.

Interestingly, Judge Ed Kinkeade did not apply Texas state ethics rules in ruling on the disqualification motion

(Texas allows lawyers to oppose current clients in most unrelated matters *without* getting the client's informed consent). Rather, he looked to the ABA's Model Rule 1.7 because he wanted to apply the "national" standard. Judge Kinkeade then broke down the informed consent issue into two questions: (i) did Vinson give reasonably adequate disclosure for a generic client; and (ii) was such disclosure adequate for *this* client. He answered yes to both questions and then denied Galderma's motion.

The key to Judge Kinkeade's ruling appears to have been his focus on the sophistication of the company, the top-flight law firms the company regularly retains (beyond Vinson), and (most particularly) the expertise and experience of Galderma's general counsel—who was the signatory to the 2003 retainer agreement. In reaching his decision, Judge Kinkeade recognized that he was doing so in the face of a prior federal court decision on very similar facts: *Celgene Corp. v. KV Pharm Co.*[9] Taking that decision head on, the judge found it inapposite for several reasons: (i) he noted that New Jersey has a different, stricter standard of what constitutes "full disclosure and consultation;" (ii) he found that the *Celgene* court's looking to whether the waiver identified particular risks (e.g., potential classes of adversaries or disputes) was no longer important in light of the ABA's 2002 action; and (iii) he disagreed that having "independent" counsel judge the advance waiver was important (following *Celgene* "would ignore the knowledge and advantage that clients gain by employing their own counsel to advise them").

Judge Kinkeade did acknowledge that Vinson's general waiver language might not work in all cases.[10] But in this one, and for Galderma, he ruled that it did.

Even more recently, New York's First Department upheld an advance waiver in *Macy's Inc. v. J.C. Penney Corp.*[11] There, the court affirmed a lower court's ruling that allowed the Jones Day law firm to represent Macy's in a bitter contract dispute with J.C. Penney over the use of Martha Stewart's products.

In 2008, Jones Day had been retained by J.C. Penney to represent the company with respect to Asian trademark matters. The law firm's engagement letter included a very broad advance waiver provision:

> Jones Day represents and in the future will represent many other clients. Some may be direct competitors of J.C. Penney or otherwise may have business interests that are contrary to J.C. Penney's interests. It is even possible that, during the time we are working for you, an existing or future client may seek to engage us in connection with an actual or potential transaction or pending or potential litigation or other dispute resolution proceeding in which such client's interests are or potentially may become adverse to J.C. Penney's interests.
>
> Jones Day cannot enter into this engagement if it could interfere with our ability to represent existing or future clients who develop relationships or interests adverse to J.C. Penney. We therefore ask J.C. Penney to confirm that Jones Day may continue to represent or may undertake in the future to represent any existing or future client in any matter (including but not limited to transactions, litigation or other dispute resolutions), even if the interests of that client in that other matter are directly adverse to Jones Day's representation of J.C. Penney, as long as that other matter is not substantially related to this or our other engagements on behalf of J.C. Penney. In the event of our representation of another client in a matter directly adverse to J. C. Penney, however, Jones Day lawyers or other service providers who have worked with J.C. Penney will not work for such other client, and appropriate measures will be taken to assure that proprietary or other confidential information of a non-public nature concerning J.C. Penney acquired by Jones Day as a result of our representation of J.C. Penney will not be transmitted to our lawyers or others in the Firm involved in such matter.
>
> In other words, we request that J.C. Penney confirm that (1) no engagement that we have undertaken or may undertake on behalf of J.C. Penney will be asserted by J.C. Penney either as a conflict or interest with respect to, or as a basis to preclude, challenge or otherwise disqualify Jones Day from, any current or future representation of any client in any matter, including without limitation any representations in negotiations, transactions, counseling or litigation adverse to J.C. Penney, as long as that other matter is not substantially related to any of our engagements on behalf of J.C. Penney, (2) *J.C. Penney hereby waives any conflict of interest that exists or might be asserted to exist and any other basis that might be asserted to preclude, challenge or otherwise disqualify Jones Day in any representation of any other client with respect to any such matter,* (3) J.C. Penney has been advised by Jones Day, and has had the opportunity to consult with other counsel, with respect to

> the terms and conditions of these provisions and its prospective waiver, (4) J.C. Penney's consent to these provisions is both voluntary and fully informed, and (5) J.C. Penney intends for its consent to be effective and fully enforceable, and to be relied upon by Jones Day.
>
> ***
>
> Please sign and return to us the enclosed copy of this letter in order to confirm that it accurately reflects the scope, terms and conditions with respect to this engagement. However, please note that your instructing us or continuing to instruct us on this matter will constitute your full acceptance of the terms set out above and attached. If you would like to discuss any of these matters, please give me a call. (emphasis added).

J.C. Penney never signed the retainer letter. Notwithstanding, Jones Day went forward with representing the company, and several years later it also sued J.C. Penney on behalf of Macy's.

In the litigation with Macy's, J.C. Penney sought Jones Day's disqualification, arguing that this was the broadest, most open-ended advance waiver provision, with no attempt whatsoever to identify the types of possible future adverse representations, clients, or matters.[12] Not surprisingly, the company also contended that it had never agreed to such a waiver, noting that it did not execute the retainer agreement.

Neither argument was persuasive, however. The First Department emphasized the clear and unambiguous language of the waiver; clearly the Macy's case is subsumed under that language. As for the non-execution issue, the court ruled that J.C. Penney's conduct constituted a contractual "yes," given that the retainer agreement had an express negative consent provision (which is highlighted above); thus, the fact that Jones Day actually did the Asian trademark work equaled the client's complete assent to all the contractual terms of the retainer agreement.

Lessons to Be Learned

As we watch the dust settle, the quick and dirty lessons from these two decisions are at least the following. The first is: make sure what law applies to the retainer agreement. That Judge Kinkeade blithely brushed aside (seemingly applicable) Texas law to apply instead ABA Model Rule 1.7 is troubling; the ABA's Model Rules, after all, are not the "national" standard of anything—they are merely an aspirational set of rules which bind **no one** (each state is free to follow, amend, or reject each and every ABA Model Rule).[13] Given the continuing disparity in states' rules, as well as court rulings (*e.g.*, *Galderma v. Celgene*), making clear what law governs the attorney-client relationship is an important and necessary first step in this process.[14]

Next up would be for clients to take retainer agreements a little more seriously. Given the clear trend lines (disturbing as they are) to allow lawyers to bend and twist like pretzels in order to search for the deepest pocketed client, often at the expense of less well-heeled clients,[15] all clients need to think about pushing back on these advance waiver provisions. Once thought to be unenforceable (even by the lawyers who drafted them), a blind man can see that this is not where the case law is developing. Here is an area where in-house counsel can really earn their pay, or not (*e.g.*, the Galderma general counsel) because after the agreement is inked, it will be too late.[16]

And that leads to the last lesson: it would appear that sometimes a one-sided contract (drafted by one party) which is **not** executed **can** be an enforceable agreement. The First Department's decision in *Macy's* seems quite troublesome; indeed, it would have come as a big surprise to my very distinguished professor of contracts at law school! Whether the decision is good law outside of New York is unknown; but it is obviously good law (at least) in the First Department. Clearly, clients faced with this precedent cannot just say "no" silently or to themselves only.[17]

Conclusion

Chico Marx once famously remarked in *Duck Soup*, "Well, who you gonna believe, me or your own eyes?"[18] Prior to the *Galderma* and *Macy's* decisions, I would not have believed that the law with respect to advance waivers would today be where it appears to be. And given lawyers' desires to be on all sides of conflicted clients, it is just possible that the law in this area will get even whackier.[19] Stay tuned!

Endnotes

1. Contrary to legend, Allen never responded "Goodnight, Gracie." Burns was once asked why they did not use what he acknowledged would have been a funny line. His response: "Incredibly enough, no one ever thought of it."
2. *See, e.g.*, ABA Formal Op. 93-372 (1993); Richard W. Painter, *Advance Waiver of Conflicts*, 13 GEO. J. LEGAL ETHICS 289 (2000).
3. *See* S. Rifkind, *The Lawyer's Role and Responsibility in Modern Society*, 30 THE RECORD 534 (1975).
4. MODEL RULES OF PROF'L CONUDCT R. 1.7 cmt. 22 (2011).
5. *Id.* These criteria differ from the prior criteria, which required a pretty specific identification of the nature of the likely future matter and the potential party or class of parties likely to be adverse. See ABA Formal Op. 05-436 (2005) (withdrawing ABA Formal Op. 93-372 and endorsing "open-ended" waivers where the waiving client is sophisticated or represented by counsel).
6. Compare Bringham Young Univ. v. Pfizer, Inc., 2010 WL 3855347 (D. Utah Sept. 29, 2010); Concat LP v. Unilever, PLC, 350 F. Supp.

2d 796 (N.D. Cal. 2004); McKesson Info. Solutions v. Duane Morris, No. 2006 CV 12110 (Fult. Super. GA 2006); Avocent Redmond Corp. v. Rose Electronics, 491 F. Supp. 2d 1000 (W.D. Wash. 2007); Colene Corp. v. KV Pharmaceutical Co., 2008 WL 2937415 (D.N.J. July 28, 2008) (all rejecting advance waivers) with Visa, U.S.A., Inc. v. First Data Corp., 241 F. Supp. 2d 1100 (N.D. Cal. 2003); St. Barnabas Hosp. v. New York City Health & Hosp. Corp., 7 A.D.3d 83, 775 N.Y.S.2d 9 (1st Dept. 2004); In re Shared Memory Graphics LLC, 659 F.3d 1336 (Fed. Cir. 2011); Gen. Cigar Holdings, Inc. v. Altadis, S.A., 54 F. App'x 492 (11th Cir. 2002) (all okaying advance waivers).

7. *See, e.g., ABA/BNA Lawyers' Manual on Professional Conduct*, 21 ABA/BNA LAW, MANUAL ON PROF. CONDUCT 96, 96–97 (Feb. 23, 2005) ("Advance consents are uniformly being used in large law firms, even though lawyers are doubtful that they'll hold up.") (Comment of Diane Karpman); *see also* Samson Habte, *In-House and Outside Counsel Often Divided on Issue of Advance Waivers, Panelists Say*, 29 ABA/BNA LAW, MANUAL ON PROF. CONDUCT 2, 2–3 (June 15, 2013).
8. Galderma Labs. v. Actavis Mid Atlantic, LLC, 927 F. Supp. 2d 390 (N.D. Tex. 2013).
9. 2008 WL 2937415 (D.N.J. July 29, 2008).
10. *See, e.g.*, GSI Commerce Solutions, Inc. v. Baby-Center, LLC, 618 F.3d 204 (2d Cir. 2010) (applying, *inter alia*, Model Rule 1.7 to bar advance waiver with respect to a corporate affiliate).
11. 107 A.D.3d 616 (1st Dept. June 27, 2013), *reported in* ABA/BNA Lawyer's Manual on Professional Conduct 393 (July 3, 2013).
12. *See supra* note 4.
13. See C. E. Stewart, *Lawyers and the Border Patrol: The Challenge of Multi-Jurisdictional Practice*, NY BUSINESS LAW JOURNAL 17 (Summer 2011).
14. Importantly, the ABA has recently "tweaked" ABA Model Rule 8.5 to allow for lawyers and clients to enter into a written agreement that specifies which jurisdiction's law will govern disputes with respect to conflicts of interest. See MODEL RULES OF PROF'L CONDUCT R. 8.5 cmt. 5 (2011) ("With respect to conflicts of interest, in determining a lawyer's reasonable belief under paragraph (b)(2), a written agreement between the lawyer and client that reasonably specifies a particular jurisdiction as within the scope of that paragraph may be considered if the agreement was obtained with the client's informed consent confirmed in the agreement.").
15. See *supra* note 13.
16. Obviously, the maximum point of client leverage on this point is *before* the outside firm is retained.
17. Unfortunately, this is not the first idiosyncratic (and troubling) decision by the state courts of New York recently. *See* C.E. Stewart, *Ohio Takes a Bite Out of the Big Apple*, NEW YORK BUSINESS LAW JOURNAL (Fall 2012); C. E. Stewart, *Just When Lawyers Thought It Was Safe to Go Back Into the Water*, NEW YORK BUSINESS LAW JOURNAL (Fall 2011).
18. This famous line is frequently attributed to Chico's brother Groucho. In fact, it is delivered by Chico's character, Chicolini, who at that point in the movie is impersonating Rufus T. Firefly (Groucho). *Duck Soup* (Paramount 1933) is generally considered the Marx Brothers' best film.
19. My "favorite" example of this—thus far—is Pioneer-Standard Electronics Inc. v. Cape Gemini America Inc., 2002 WL 553460 (N.D. Ohio 2002) (court rejected Shearman & Sterling's attempt to drop a client like a "hot potato," instead allowing the firm to represent adverse clients in separate cases "with equal vigor").

C. Evan Stewart is a partner in the New York City office of Cohen & Gresser LLP, focusing on business and commercial litigation. He has published over 200 articles on various legal topics and is a frequent contributor to the *New York Law Journal* and this publication.