



Negotiation Ethics

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Meet the Speakers



Jayme Partridge
Principal



Christina Brown-Marshall
Principal



General Considerations

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- **What rules govern attorney conduct in negotiations?**
- **What do those rules permit?**
- **What do those rules prohibit?**
- **What laws apply to attorney conduct in negotiations?**
- **What are consequences of unethical behavior?**
- **What is the benefit of behaving ethically in negotiations?**

Why Be Ethical In Negotiations

- **The law imposes penalties for dishonesty**
- **Lawyers have professional obligations**
- **Corporations have codes of conduct**
- **Your reputation depends on it**

Legal Basis: Tort Law

- **Restatement (Second) of Torts §525:**

One who **fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it**, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.

Legal Basis: Contract Law

- **Restatement (Second) of Contracts Chapter 7; key provisions:**
 - §161. When Non-Disclosure Is Equivalent to an Assertion
 - §162. When a Misrepresentation Is Fraudulent or Material
 - §164. When a Misrepresentation Makes a Contract Voidable

Legal Basis: Contract Law

§161. When Non-Disclosure Is Equivalent to an Assertion

“A person's **non-disclosure of a fact** known to him is equivalent to an assertion that the fact does not exist ...

where he knows that **disclosure of the fact would correct a mistake of the other party as to a basic assumption** on which that party is making the contract and

if **non-disclosure of the fact amounts to a failure to act in good faith** and in accordance with reasonable standards of fair dealing....”

Legal Basis: Contract Law

§162. When a Misrepresentation Is Fraudulent or Material

- (1) A misrepresentation is fraudulent if the maker **intends** his assertion to induce a party to manifest his assent and the maker
 - (a) **knows or believes that the assertion is not in accord with the facts**, or
 - (b) **does not have the confidence that he states or implies in the truth** of the assertion, or
 - (c) **knows that he does not have the basis that he states or implies** for the assertion.
- (2) A misrepresentation is **material** if it would be **likely to induce a reasonable person** to manifest his assent, or if the maker knows that it would be likely to induce the recipient to do so.

Legal Basis: Contract Law

§164. When a Misrepresentation Makes a Contract Voidable

"If a party's manifestation of assent is induced by either a **fraudulent or a material misrepresentation** by the other party upon which the recipient is **justified in relying**, the contract is voidable by the recipient...."

Corporate Codes of Conduct: Examples

Levi Strauss & Co:

"**HONESTY**: We will not say things that are false. We will never deliberately mislead. We will be as candid as possible, openly and freely sharing information, as appropriate to the relationship."

ADP LLC:

"Associates are expected to be **honest and ethical** in dealing with each other, clients, vendors and all other third parties. Doing the right thing means doing it right every time."

"There is zero tolerance of non-compliance and/or retaliation. Any violations will result in swift progressive discipline, including possible termination of employment from ADP."

Reputation: Yours and Your Employer's

In a relatively small community such as the legal field, a reputation for “sharp practice” can impact:

- Ongoing relationships between companies
- Terms of follow-on deals
- Job opportunities
- Ability to create new business relationships



Professional Obligations of Lawyers

ABA Model Rules of Prof. Conduct

Rule 4.1 Truthfulness In Statements To Others

In the course of representing a client a lawyer shall not knowingly:

- (a) make a false statement of **material fact** or law to a third person; or
- (b) fail to disclose a **material fact** to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

Rule 4.1: Not “Material Fact”

ABA Formal Opinion 06-439 (2006):

“a party’s negotiating goals or its willingness to compromise, as well as ... negotiation ‘puffing,’ ordinarily are not considered ‘false statements of material fact’”

Rule 4.1: Considered “Material Fact”

Examples of unacceptable false statements of material fact include:

- A lawyer representing to the other side that a benefit will cost the company money when it does not.
- Declaring as a fact that your authority to settle is limited to a certain amount when it is not.

Rule 4.1: Duty to Disclose (Omission)

Rule 4.1, cmt. 1:

“Although a lawyer is required to be truthful when dealing with others, a lawyer generally has no affirmative duty to inform an opposing party of relevant facts.”

For example:

- No duty to inform an opposing party about things such as settlement authority limits.

Courts Lean Toward Disclosure

- Death of a client (*Virzi v. Grand Truck Warehouse & Cold Storage Co.*, 571 F.Supp. 507 (E.D. Mich. 1983))
- Insurance policies (*Ex rel Nebraska State Bar Ass'n v. Addison*, 412 N.W.2d 855 (Neb. 1987); *contra*, NY County Ethics Opinion 731 (2003))
- Misrepresenting settlement terms (*In re Eadie*, 36 P.3d 468 (Ore. 2001))
- Changes to the terms of a contract or settlement agreement (*In re Rothwell*, 296 S.E.2d 870 (S.C. 1982))
- Statements that were true when made but are now false (*In re Williams*, 840 P.2d 1280 (Ore. 1992))
- Side deal with party's lawyer (*In re Zaruba*, 177 N.J. 564 (2003))
- Procuring sham transaction (*In re Hiller*, 694 P.2d 540 (Ore. 1985))
- Concealing financing terms (*Vega v. Jones Day*, 121 Cal. App. 4th 282 (Cal. App. 2004))

ABA Model Rules of Prof. Conduct

Rule 1.0(f) – “knowingly” denotes actual knowledge and the lawyer’s “actual knowledge” may be inferred from the circumstances.

- “Evil intent or bad purpose” not required.
- If lawyer makes innocent misrepresentation he/she believes true and later learns it is false, he/she must correct the statement by notifying the person the misrepresentation was made to, even if opposing counsel.

ABA Model Rules of Prof. Conduct

Rule 1.6 Confidentiality of Information

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

1. to prevent reasonably certain death or substantial bodily harm
2. to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's service

ABA Model Rules of Prof. Conduct

Rule 8.4 Misconduct:

It is professional misconduct for a lawyer to

...

(c) Engage in conduct involving dishonesty, fraud, deceit or misrepresentation



Hypotheticals

Hypothetical 1

- Your counterpart in a negotiation tells you from its own research it has determined that a continuation patent was never disclosed to a standards organization.
- You know this to be false because under the SSO's disclosure rules, disclosure of one patent is deemed disclosure of the family.

Tactically, you may want to correct this mistake. But are you required to do so?

Hypothetical 2

- You are about to close the sale of one of your client's properties to the local church for its construction of a new elementary school.
- The business person on the transaction calls you to congratulate you on working out a great deal.
- She then adds that it is a good thing that the company is selling the property because the internal compliance unit informed her that unknown to corporate HQ or the public, for the last five years large quantities of highly toxic chemicals have been dumped on a regular basis on the property.

Is it a material fact? Would your client be committing misrepresentation by omission? If your client refuses to let you disclose this fact, what would you do?

Hypothetical 3

- You are negotiating settlement of a breach of contract action your company brought against a supplier.
- You say, truthfully “five major customers cancelled their purchase contracts after the defendant’s breach.”
- But you know they cancelled for reasons unrelated to the breach.

Is disclosure required?

Hypothetical 4

- While reviewing documents to produce in response to plaintiff's discovery requests in a fraud case, you find emails between the sales representatives joking about the lies they told the plaintiff.
- Before you produce the emails, plaintiff's counsel calls you to say that his or her elderly client has no real recollection of the sale and would be willing to go away for nuisance value.

Is disclosure required?

Hypothetical 5

- The adversary serves you with notices of deposition for every board member.
- You know that one member's testimony will almost definitely establish liability.
- You negotiate a deal with your adversary where he or she agrees to one specific board member's testimony (not the one you were concerned about) in lieu of the other discovery concessions.

Is disclosure required?

Hypothetical 6: Sale of a Business 1

- Key component of the business is a proprietary manufacturing process
- Under the deal, all IP is being provided on an "as is" basis
- Seller's attorney knows that the proprietary manufacturing process has been licensed to a key competitor of the business

Is disclosure required?

Hypothetical 7: Sale of a Business 2

- Company A is selling a business to Company B. Both are large sophisticated companies.
- Company A is unsure if a license they have for certain technology which is a large component of the sale will transfer to Company B.
- Company A knows that Company B is very concerned about other issues and has not asked about licenses necessary to conduct the business they are purchasing.

Does Company A have an obligation to disclose the fact that Company B may have to pay to get the license they need?

Hypothetical 8: Technology License 1

- Royalty-bearing technology license, non-exclusive
- Agreed royalty is 3% of product revenue; there is no MFN provision
- Licensor has licensed the same technology to a competitor for 2%

Is disclosure required?

Hypothetical 9: Technology License 2

- Licenser enters into agreement with Licensee for license of its trade secret, and license fee obligation continues for 10 years.
- Licenser has previously disclosed the technology to a third party under an NDA whose confidentiality period expires in 5 years.

Is disclosure required?

Hypothetical 10: Contract Suit

- Party A has accused B of breach of contract and has demanded payment.
- A's management, which is dealing with too many lawsuits already, has instructed the negotiating team to settle the dispute without litigation. Party B has made a settlement offer below Party A's "walk" number.
- Party A responds by saying if Party B doesn't agree to pay at least X by Friday, Party A will file suit.

Any ethical issues here?

Hypothetical 11: Sale of IP Rights

- Party A wishes to divest IP rights in certain technology
- A has contacted many suitors over 2 year period, but only B has expressed interest
- A's management has told team to close for at least \$1M or move on to other projects
- A's negotiation team opened with an offer of \$3M; B countered with \$1.5M
- In an attempt to obtain the best possible price, A's negotiators tell B:
 - It does not have authority to close a deal for less than \$2M
 - B needs to move quickly because A is expecting an offer soon from another potential acquirer

Any ethical issues here? If these statements are problematic, how could they be tweaked?



Conclusion

Red Flags

Balance of power

- Sophistication
- Degree of disadvantage
- Pattern

Common Elements

The deal reflects a serious misunderstanding

AND

- Lawyer's "fingerprints"
- Either by action or inaction
- The lawyer's services were used

Tactics

- Non-reliance clause
- Merger clause
- Add conspicuous clauses on topic
- Written offer to inspect

Conclusion

- Negotiators are presumed to know the rules, but err on the side of disclosure and honesty.
- Lawyers will be held to a higher standard and courts are not forgiving of dishonesty and deceit.

Questions?



Thank You!



Jayme Partridge
partridge@fr.com



Christina Brown-Marshall
brown-marshall@fr.com

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