

Negotiation Ethics – Part II

From the Committee on Professional Responsibility, William Freivogel, Chair

Some of you will recall the October 2008 Ethics Corner on negotiation ethics. A key principle contained there is that a lawyer may not lie in a negotiation. A recent Ninth Circuit decision provides a vivid illustration of how that principle applies in federal securities law, *Thompson v. Paul*, 2008 U.S. App. LEXIS 22307 (9th Cir. Oct. 27, 2008). In addition to the truthfulness point, the case will be of interest to members of the Business Law Section on several levels.

First, a warning: the Ninth Circuit's opinion and the district court's decision were in the context of a motion to dismiss a complaint under Rule 12(b)(6) of FRCP. That means both courts took the allegations of the complaint to be true. The "facts" that follow were taken from Ninth Circuit's opinion, which, in turn, came from the complaint. Thus, while the complaint is harsh, plaintiff has, as yet, proven nothing.

Pamela Thompson was CFO of YP.Net until May 2002, when she resigned over the failure of top management to make certain disclosures to the SEC. Upon her resignation she reported her misgivings to the SEC. YP.Net then sued Thompson, and Thompson counterclaimed. That case settled with YP.Net agreeing to give Thompson a considerable amount of YP.Net stock.

Three days after the settlement was signed, the CEO of YP.Net was "indicted on 29 counts of fraud, conspiracy, money laundering, and orchestrating a Ponzi scheme." The indictment had a negative effect on the value of the YP.Net stock Thompson received in the settlement.

Because of her loss in the stock's value, Thompson brought this case against the lawyers ("Lawyers") who had negotiated the settlement on behalf of YP.Net. Thompson claimed that Lawyers had represented to her that the CEO of YP.Net was not under criminal investigation when Lawyers knew that the CEO was, in fact, under investigation. Thompson further claimed that she did not know about the investigation. One of the counts in Thompson's complaint was that the lawyers' misrepresentation about the CEO's troubles violated Section 10(b) of the Securities Exchange Act. Lawyers moved to dismiss the complaint. The trial court granted the motion, holding, among other things, that under Arizona law, Thompson had no right to rely on the representations of YP.Net's lawyers. In this opinion the Ninth Circuit reversed, holding that state law standards do not apply to claims under Section 10(b). The Ninth Circuit acknowledged that at the summary judgment or trial stage it may well develop that Thompson knew much more about the CEO's problems than she claimed in the complaint.

Thompson should be of interest to Business Law Section members for at least two reasons: First, it is strikingly similar to *Dean Foods Co. v. Pappathanasi*, No. 01-2595 BLS, 2004 Mass. Super. LEXIS 571 (Mass. Super. Dec. 3, 2004), which also involved claims of misrepresentations by lawyers about whether a party was under criminal investigation. A difference is that in *Dean Foods* the representations appeared in the lawyers' written opinion and in the representations and warranties. In *Thompson*

Lawyers' representations were oral.

Second, the Ninth Circuit cited with approval *Kline v. First Western Gov't Securities*, 24 F.3d 480 (3d Cir. 1994). *Kline's* greatest significance to Section members involves the Third Circuit's holding that third parties may hold a law firm accountable for statements in an opinion even though the opinion says third parties may not rely on the opinion. This has proven particularly nettlesome to the work of the Section Task Force on Delivery of Document Review Reports to Third Parties, whose work, under the direction of James Rosenhauer, is ongoing. *Kline's* significance to the Ninth Circuit in *Thompson* is *Kline's* holding that when a lawyer makes a misstatement to a non-client, that lawyer can be liable to the non-client under Section 10(b). That is, when a lawyer makes a statement to a non-client in connection with a securities transaction, that lawyer must tell the truth.

It is of interest that the Ninth Circuit did not mention Model Rules 1.4(a) and 8.4(c), which are the core rules on lying to non-clients. But, the court did not have to, because federal securities antifraud principles stand on their own.
