An Attorney's Guide to Ethically Advising Start-Ups: 2020 Update

By: Todd Kulkin
Law Offices of Todd Kulkin, P.C.
60 East 42nd Street, Suite 4600
New York, New York 10017
(212) 485-9884
todd@kulkinlaw.com

LAW OFFICES OF
TODD KULKIN, P.C.

Agenda

- Introduction to Start-up Practice
- Confidentiality
- Conflict Of Interest
- Solicitation & Networking
- No-Contact Rule
- Referral Fees
- Communicating With Unrepresented Persons
- Attorney as third-party neutral
- Trust account issues
- Non-law practice activities
- Should You Take Equity?
- Cryptocurrencies



What is a Start-up?

- A Start-up is ANY business that:

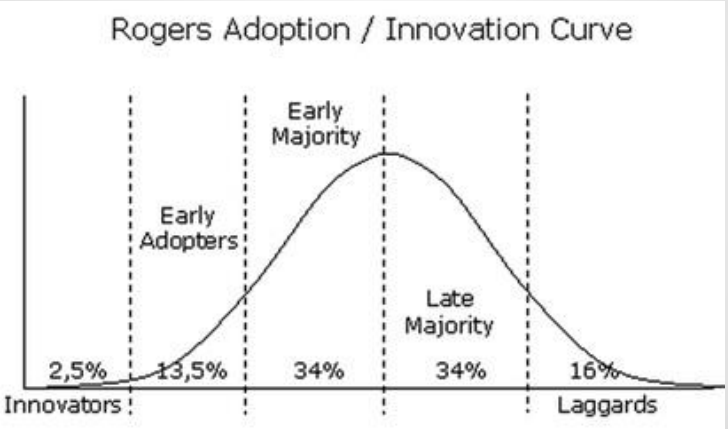
1. Is in its first five years of operation; or
2. Has not fully developed its initial customer base; or
3. Is based on an innovation that is early in the adoption curve.

What does a Start-up Look Like?

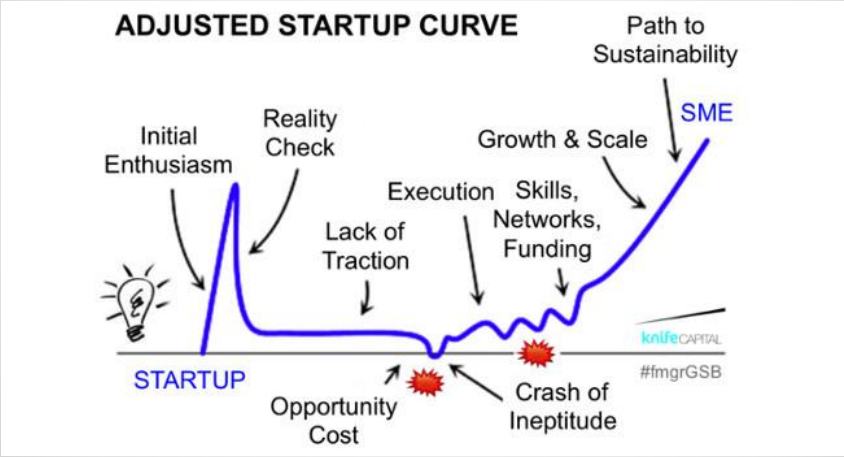




Innovation Curve



The Adjusted Start-up Curve (Paul Graham)



What do Start-up Lawyers Do?

- Entity Formation
- Drafting of Form Contracts
- Negotiate Deals
- Help form partnerships
- Investor Relations
- Determine liability in the business model
- Protect a start-up's intellectual property

Confidentiality

- Model Rule 1.6
- "A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted…"
- Applies to Initial Consult regardless of representation (Rule 1.18)

Start-Up Confidentiality Issues

- Business model information
- Networking on your client's behalf
- Trade secrets
- Patentable items
- Discussing matters with a client in public places

Conflict of Interest

- NY & Model Rules 1.7-1.10
- Definition:

  (1) the representation of one client will be directly adverse to another client;

  or

  (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

Conflict of Interest (Cont.)

- Exceptions:
  (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
  (2) the representation is not prohibited by law;
  (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
  (4) each affected client gives informed consent, confirmed in writing.

Business Conflict Issues

- Representing a client's competition
- Representing a former client's competition
- Negotiating both sides of a transaction
- Sometimes these conflicts can be waived – Sometimes they can't
- The importance of informed consent to waive a conflict

Confidentiality and Venture Capital

- Introductions to VC and "Angel Investors" is not without risk
- One of the highest malpractice risk areas
- Disclosure of business model information
- Non-Disclosure Agreements are key
- What about when you hold equity?

Model Rule 8.4 - Misconduct

- It is professional misconduct for a lawyer to:
  (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;
  (b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;
  (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;
  (d) engage in conduct that is prejudicial to the administration of justice;
  (e) state or imply an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law;
  (f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law; or
  (g) engage in conduct that the lawyer knows or reasonably should know is harassment or discrimination on the basis of race, sex, religion, national origin, ethnicity, disability, age, sexual orientation, gender identity, marital status or socioeconomic status in conduct related to the practice of law. This paragraph does not limit the ability of a lawyer to accept, decline or withdraw from a representation in accordance with Rule 1.16. This paragraph does not preclude legitimate advice or advocacy consistent with these Rules.

NY Rule 8.4 - Misconduct

- A lawyer or law firm shall not:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) engage in illegal conduct that adversely reflects on the lawyer's honesty, trustworthiness or fitness as a lawyer;

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

(d) engage in conduct that is prejudicial to the administration of justice; (e) state or imply an ability:

(1) to influence improperly or upon irrelevant grounds any tribunal, legislative body or public official; or

(2) to achieve results using means that violate these Rules or other law;

NY Rule 8.4 – Misconduct (Cont.)

(f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law;

(g) unlawfully discriminate in the practice of law, including in hiring, promoting or otherwise determining conditions of employment on the basis of age, race, creed, color, national origin, sex, disability, marital status or sexual orientation. Where there is a tribunal with jurisdiction to hear a complaint, if timely brought, other than a Departmental Disciplinary Committee, a complaint based on unlawful discrimination shall be brought before such tribunal in the first instance. A certified -74- copy of a determination by such a tribunal, which has become final and enforceable and as to which the right to judicial or appellate review has been exhausted, finding that the lawyer has engaged in an unlawful discriminatory practice shall constitute prima facie evidence of professional misconduct in a disciplinary proceeding; or

(h) engage in any other conduct that adversely reflects on the lawyer's fitness as a lawyer.

Case Study

- An attorney in Stateasota ("Mr. S") represents both sides of the purchase of privately held stock in a publicly traded company. The consideration for the purchase of stock is a down payment and promissory note. Mr. S. does not obtain a written conflict waiver from either client.
- After one year, the Purchaser misses their payments and Mr. S brings an action against the Purchaser on behalf of the Seller. The Purchaser brings a counterclaim (represented by separate counsel) against the Seller and Mr. S personally for malpractice.
- As the litigation begins, Mr. S advises the Seller to rename himself CEO of the Company and begin operating it again since he knows that Purchaser, the rightful CEO, has no interest in running the company.
- To fund the litigation between Purchaser and Seller; Seller seeks a loan from a third party ("Mr. G") for "operations." Mr. S represents both sides on the loan agreement. The loan agreement stipulates as collateral shares in the Company that Mr. S knows the Seller doesn't own and are the subject of that litigation. Mr. S doesn't inform Mr. G of that fact and places a warranty that the shares belong to Seller in the loan agreement. Mr. S is the notary on the Loan Agreement for both Parties' signatures.

Case Study (Cont.)

- During settlement negotiations, Mr. S. represents the Seller in a purchase of the same shares (the "New Purchase") by Mr. G, who believed until now that the shares were in the Seller's possession. During the negotiation of the New Purchase, Mr. S reveals the truth to Mr. G's attorney: that the original Purchaser owns the shares, that the Seller has been holding himself out as the CEO when he has no legal right to, and that the Shares are subject to a litigation hold.
- When asked about the loan agreement, Mr. S. stated that he drafted it but wasn't aware as to whether it was signed or not.
- To what extent did Mr. S violate the Model Rules of Professional Conduct?
- Confidentiality
- Conflict of Interest
  - Initial transaction
  - Litigation
  - Loan Agreement
  - Negotiating the Final Sale
- Misconduct

Solicitation

- NY and Model Rule 7.3:
- (a) A lawyer shall not by in-person, live telephone or real-time electronic contact solicit professional employment when a significant motive for the lawyer's doing so is the lawyer's pecuniary gain, unless the person contacted:

  (1) is a lawyer; or

  (2) has a family, close personal, or prior professional relationship with the lawyer.
- Networking within the Rules
- Live Seminar Problem

Advertisements & Marketing

- Model Rules 7.1, 7.2, and 7.4
- Rule 7.1 No Misleading
- Rule 7.2 Allows for media advertisements and payment for advertising services
- Rule 7.4 Representations of Practice Areas
- NY Ethics Opinions of Note
  - Social Media Posts - Opinion 1049 (3/2/15)
  - Online Reviews – Opinion 1052 (3/25/15)

An Example to "Check your State"

- NY Rule 7.1 requires more than Model Rule re: Advertising
  - "Prior results do not guarantee similar outcome"
  - Disclosure of "Attorney Advertising"
  - No use of trade names that imply results
  - No use of actors in commercials
  - Rules apply to online advertising as well

The "No Contact" Rule (Model Rule 4.2)

- In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.
- NY Additional rule: Notwithstanding the prohibitions of paragraph (a), and unless otherwise prohibited by law, a lawyer may cause a client to communicate with a represented person unless the represented person is not legally competent, and may counsel the client with respect to those communications, provided the lawyer gives reasonable advance notice to the represented person's counsel that such communications will be taking place.

Referral Fees (Non-Lawyers)

- NY Rule 7.2 (No Model Rule)
- A lawyer shall not compensate or give anything of value to a person or organization to recommend or obtain employment by a client, or as a reward for having made a recommendation resulting in employment by a client, except that:
- a lawyer or law firm may refer clients to a non-legal professional or non-legal professional service firm pursuant to a contractual relationship with such non-legal professional or non-legal professional service firm to provide legal and other professional services on a systematic and continuing basis as permitted by Rule 5.8, provided however that such referral shall not otherwise include any monetary or other tangible consideration or reward for such, or the sharing of legal fees.
- Sharing of legal fees between attorneys is permissible, but make sure that it's a true "co-counsel" type of relationship.

Referral Fees in the Real World

- Other industries and professions give referral incentives
- Sometimes they expect it. What do you do?
  1. Explain the rule as it applies to lawyers;
  2. Explain that "no amount of business is worth my license"
  3. Call it an "exchange of good will"
  4. Don't take the referral fees on the other side (although you could)

Dealing with an Unrepresented Party

Model Rule 4.3:

- A lawyer shall not state or imply that the lawyer is disinterested.
- When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding.
- The lawyer shall not give legal advice to an unrepresented person, other than the advice to secure counsel, if the lawyer knows or reasonably should know that the interests of such a person are or have a reasonable possibility of being in conflict with the interests of the client.

Unrepresented vs. Represented

- Scenario: Company X is founded by two partners: A and B. You are retained to represent A in negotiations with B. How do you handle the negotiations…
  - If B is represented by Counsel?
  - If B isn't represented by Counsel?
  - If B "lawyers up" during the process?

Rule 1.16 - Firing a Client

- ABA Model Rule 1.16 a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:
  - (1) the representation will result in violation of the rules of professional conduct or other law;
  - (2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client; or
  - (3) the lawyer is discharged.
- (b) a lawyer may withdraw from representing a client if:
  - (1) withdrawal can be accomplished without material adverse effect on the interests of the client;
  - (2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;
  - (3) the client has used the lawyer's services to perpetrate a crime or fraud;
  - (4) the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement;
  - (5) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;
  - (6) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or
  - (7) other good cause for withdrawal exists.

Rule 1.16 (Cont.)

- (c) A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.
- (d) Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law.

Rule 2.4 – Client as "third party neutral"

- (a) A lawyer serves as a third-party neutral when the lawyer assists two or more persons who are not clients of the lawyer to reach a resolution of a dispute or other matter that has arisen between them. Service as a third-party neutral may include service as an arbitrator, a mediator or in such other capacity as will enable the lawyer to assist the parties to resolve the matter.
- (b) A lawyer serving as a third-party neutral shall inform unrepresented parties that the lawyer is not representing them. When the lawyer knows or reasonably should know that a party does not understand the lawyer's role in the matter, the lawyer shall explain the difference between the lawyer's role as a third-party neutral and a lawyer's role as one who represents a client.

Trust Account Considerations: Rule 1.15

- Everyone knows not to comingle funds, but there are other pitfalls that you need to avoid which aren't obvious:
- Never take cash out of the escrow account (even to give to a client). Always use a check or wire transfer.
- Keep a ledger that shows the following: Date of Transaction, Name of Client, Transactional Funds, Purpose for transaction, Source of funds, and any other necessary information.
- When using an IOLTA (or IOLA) account, make sure that your escrow agreements have the clients waive interest as that interest belongs to the local pro bono fund.

Non-Legal Services

- An attorney may offer non-legal type services (e.g. consulting) without those activities being subject to the Rules of Professional Responsibility IF AND ONLY IF the client does not reasonably believe that they are being represented by an attorney.
- Some techniques to ensure separation:
  - Open a separate entity for your non-legal type service business;
  - Sign non-disclosure agreement(s) between your non-legal service client and your non-legal service company.
  - Prominently disclaim any attorney-client relationship in any and all contracts between your non-legal services business and their clients.
  - Don't mix your client base, unless you reasonably believe that your independent judgment as an attorney representing that client would be completely unaffected by your non-legal service relationship.

Should You Take Equity?

- Common Practice: equity in a company in exchange for legal services.
- Is there a Conflict of Interest?
- Balance Risk and Reward
- Supplemental Fees
- Is it different if you are not counsel for the Company?
- Phantom Equity Alternative
- NY Weighs in: Opinion 913 (3/2012)

Cryptocurrency Considerations

- As companies begin to undergo ICOs, the question of using cryptocurrency ("coins" or "tokens") to compensate attorneys comes up.
- Unlike equity compensation or phantom equity plans, equity securities aren't in play, so the fiduciary issue isn't the same.
- With that said…ask yourself:
  - Does your advice change the value of the cryptocurrency that you are receiving?
  - Are you handling the company's ICO? If so, then be aware that your advice affects the ICOs viability in addition to when you are getting paid. If not, can you rely on cryptocurrency counsel's analysis?
  - Are there restrictions on the cryptocurrency being offered?
  - How confident are you that the ICO token isn't a security? If it could be considered a security, be wary of potential insider trading related liability.




Questions?




LAW OFFICES OF
TODD KULKIN, P.C.

Todd Kulkin, Attorney at Law
60 East 42nd Street, Suite 4600
New York, New York 10017
(212) 485-9884
todd@kulkinlaw.com