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The Lawyer's Duty of Disclosure Ethics and Sarbanes-Oxley the New Conundrum for Patent Lawyers

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I. INTRODUCTION

Lawyers who practice before the United States Patent and Trademark Office ("PTO") understand the duty of disclosure. It is a way of life in the ex-parte nature of those proceedings, commonly called "patent prosecution." Indeed, Rule 56 of the patent code mandates that material information of which a patent applicant, or his representative, is aware, must be disclosed to the PTO during patent prosecution.[1]

Overlaying those obligations in the PTO are the lawyer's ethical duties which are codified in the PTO Code of Professional Responsibility.[2] Those responsibilities do not end at that point, as various state ethical codes play into a lawyer's responsibility to disclose information relating to the representation of a client in certain contexts (either the Rules of Professional Conduct or the Code of Professional Responsibility, depending upon the state where you are admitted to the bar). What's more is that reconciling the ethics rules of the PTO and those of the states can be challenging, at least when it comes to a lawyer's obligations concerning the disclosure of client confidences.

If that were not enough, Congress saw fit add to the complex and sometimes contradictory ethical obligations of the PTO code and state bar ethics rules when it enacted the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley").[3] Enacted as a direct result of corporate scandals starting with the Enron collapse in 2001, it ultimately targeted not only corporate officials, but outside professionals as well – accountants and

1. *See* 37 C.F.R. § 1.56 (2006).
2. 37 C.F.R. § 10.1 et seq. (2006)
3. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

lawyers.[4]

Sarbanes-Oxley, by its express terms, only applies to lawyers "who appear and practice" before the Securities and Exchange Commission. So, do lawyers who practice only intellectual property law (even if they practice only trademark or copyright law) need to worry? Do patent lawyers who carefully limit their practice to the preparation and prosecution of patent applications before the PTO need to worry about Sarbanes-Oxley? Regrettably they do.

The general purpose of this paper is to sensitize intellectual property lawyers to the potential impact on their practice created by Sarbanes-Oxley. At a more detailed level, and because of the unique challenges facing them, this paper addresses Sarbanes-Oxley's potential impact on patent lawyers who practice before the PTO, even when it is the patent lawyer's sole practice. To that end, this paper will highlight relevant portions of Rule 56, the relevant ethical code sections, and the pertinent considerations under Sarbanes-Oxley.

II. 37 CFR § 1.56 (RULE 56) – THE DUTY OF CANDOR AND GOOD FAITH

Patents can be a potent weapon in a company's arsenal. Indeed, by statute, a patent confers upon its owner the right to exclude others from making, using, selling, offering for sale or importing the patented invention.[5] If someone violates this exclusivity, patent owners can collect damages, sometimes equal to or in excess of its lost profits, for acts of infringement.[6] The nature of these benefits flows from the policy underlining patents – to encourage innovation.[7] The federal courts are made available to aggrieved patent owners[8] in order to give substance to this policy. However, the quid pro quo of the right to exclude others is that the patent owner must be entirely forthcoming with the PTO during patent prosecution.[9] In this regard, section 1.56 of the PTO Rules

4. *See generally* JOHN T. BOSTELMAN, THE SARBANES-OXLEY DESKBOOK (Practicing Law Institute) (2006). This two volume treatise is an excellent overview of the Act and the background of its enactment.

5. 35 USC § 271(a) (2006).

6. 35 USC § 284 (2006).

7. U.S. Const. art. I, § 8, cl. 8 ("The Congress shall have power . . . [t]o promote the progress of Science").

8. 28 USC § 1331 (2006) (District Courts) & 28 USC § 1295 (2006) (The Court of Appeals for the Federal Circuit).

9. *See, e.g.*, Enzo Biochem, Inc. v. Gen-Probe Inc., 296 F.3d 1316, 1330 (Fed. Cir. 2002) ("[D]escription is the quid pro quo of the patent system; the public must receive meaningful disclosure in exchange for being excluded from practicing the invention for a limited period of

codified at 37 C.F.R. § 1.56 (2006), provides, in part:

> Duty To Disclose Information Material To Patentability
>
> (a) A patent by its very nature is affected with a public interest. The public interest is best served, and the most effective patent examination occurs when, at the time an application is being examined, the Office is aware of and evaluates the teachings of all information material to patentability. Each individual associated with the filing and prosecution of a patent application has a duty of candor and good faith in dealing with the Office, which includes a duty to disclose to the Office all information known to that individual to be material to patentability as defined in this section[.]

III. THE LAWYER'S ETHICAL DUTY OF DISCLOSURE

A. The Current Rules of Representation of Others Before the Patent and Trademark Office (PTO Code)

The PTO Code has in place a form of the Code of Professional Responsibility[10] which is codified in Part 10 of Title 37 of the Code of Federal Regulations, 37 C.F.R. § 10.1 et seq. (2006).[11] Two relevant portions follow:

> (1) 37 C.F.R. § 10.56: Canon 4.
>
> A practitioner should preserve the confidences and secrets of a client
>
> (2) 37 C.F.R. § 10.57: Preservation of confidences and secrets of a client
>
>> (a) "Confidences" refers to information protected by attorney-client or agent-client privilege under applicable law. "Secret"

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time.").

10. David Hricik, *How Things Snowball: The Ethical Responsibilities and Liability Risks Arising from Representing a Single Client in Multiple Patent-Related Representations*, 18 GEO. J. LEGAL ETHICS 421, 424, 424 n. 19 (observing that the PTO code was directly inspired by the American Bar Associations' Model Code of Professional Responsibility (1969), and as a result, shares many parallel provisions with similar wording and effect).

11. Practice Before the Patent and Trademark Office, 50 Fed. Reg. 5158 (Feb. 6, 1985) (formal notice of adoption).

refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

(b) Except when permitted under paragraph (c) of this section, a practitioner shall not knowingly:

(1) Reveal a confidence or secret of a client.

(2) Use a confidence or secret of a client to the disadvantage of the client.

(3) Use a confidence or secret of a client for the advantage of the practitioner or of a third person, unless the client consents after full disclosure.

(c) A practitioner may reveal:

(1) Confidences of secrets with the consent of the client affected but only after a full disclosure to the client.

(2) Confidences or secrets when permitted under Disciplinary Rules or required by law or court order.

(3) The intention of a client to commit a crime and the information necessary to prevent the crime.

(4) Confidences or secrets necessary to establish or collect the practitioner's fee or to defend the practitioner or the practitioner's employees or associates against an accusation of wrongful conduct.

(d) A practitioner shall exercise reasonable care to prevent the practitioner's employees, associates, and others whose services are utilized by the practitioner from disclosing or using confidences or secrets of a client, except that a practitioner may reveal the information allowed by paragraph (c) of this section through an employee.

B. Proposed Amendments To The PTO Code

On December 12, 2003, the Federal Register published for comment proposed amendments to the ethical guidelines for those representing others before the PTO.[12] The change contemplates a shift from a "Code" format to a "Rules" format.[13] These proposed changes followed several years of debate by the American Bar Association House of Delegates over changes to Model Rules of Professional Conduct. Thereafter, on March 3, 2004, the PTO requested public comment on a number of the proposed rules. [14] While no public announcement has been made as to when the new rules will be enacted, it is likely that by the end of 2007, patent practitioners will have a new set of ethical guides in the PTO.

Two of the proposed rules are worth noting.

(1) § 11.106: Confidentiality of information[15]

> (a) A practitioner, in regard to practice before the Office, shall not:
>
> > (1) Reveal information relating to representation of a client unless the client gives informed consent in writing after full disclosure by the practitioner, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraphs (b), (c), or (d) of this section:
> >
> > (2) Knowingly use information relating to representation of a client to the disadvantage of the client; or
> >
> > (3) Use a confidence or secret of the practitioner's client for the advantage of the practitioner or of a third person.
>
> (b) A practitioner, in regard to practice before the Office, may reveal such information to the extent the practitioner reasonably believes necessary:
>
> > (1) To prevent the client from committing a criminal act that the practitioner believes is likely to result in imminent death or substantial bodily harm; or

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12. Changes to Representation of Others Before the United States Patent and Trademark Office, 68 Fed. Reg. 69442 (Dec. 12, 2003).

13. *Id.* (Summary).

14. Changes to Representation of Others Before the United States Patent and Trademark Office, 69 Fed. Reg. 9986 (Mar. 3, 2004).

15. *Id.; C.f.* Model Rules of Prof'l Conduct R. 1.6 (1983).

(2) To establish a claim or defense on behalf of the practitioner in a controversy between the practitioner and the client, to establish a defense to a criminal charge or civil claim against the practitioner based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the practitioner's representation of a client.

(c) A practitioner, in regard to practice before the Office, shall use or reveal information relating to representation of a client to comply with the provisions of § 1.56 of this subchapter in practice before the Office in patent matters (see 11.303(d));

(d) A practitioner, in regard to practice before the Office may use or reveal information relating to representation of a client to comply:

(1) With the informed consent in writing of the client affected, but only after full disclosure by the practitioner to the client;

(2) With rules, law or court order when permitted by these rules or required by law or court order; or

(3) With the law or regulations of the Office, when permitted or authorized by the law or regulations, in connection with representation before the Office, whether or not the practitioner is employed by the Federal Government.

(e) The client of practitioner employed by the Federal Government is the Department, agency or commission that employs the practitioner unless appropriate law, regulation, or order expressly provides to the contrary.

(f) A practitioner shall exercise reasonable care to prevent the practitioner's employees, associates, and other whose services are utilized by the practitioner from disclosing or using such information of a client, except that such persons may reveal information permitted to be disclosed by paragraphs (c), (d), or (e) of this section.

(g) The practitioner's obligation to preserve in confidence such information continues after termination of the practitioner's employment, except as provide for in § 1.56.

(h) The obligation of a practitioner under paragraph (a) of this section also applies to such information learned prior to becoming a practitioner in the course of providing assistance to another practitioner.

The irony with the proposed amendment is that it allows less of an opportunity for lawyers to disclose wrongdoing by their clients. Section 11.106(b)(1) only allows a lawyer to disclose "a criminal act", which the lawyer believes "is likely to result in imminent death or substantial bodily harm". The American Bar Association amended the version of this rule by allowing lawyers to disclose information "to prevent reasonably certain death or substantial bodily harm" and the intention of a client to commit a crime likely to result in "substantial injury to the financial interests or property of another". Moreover, the existing Rule in the PTO, allows a lawyer to reveal the intention of a client to commit a crime – any crime! When the new rules are finally enacted (by year end 2007) it will not be surprising to see a change in this rule which will allow a practitioner to disclose a crime involving harm to the financial interests of another. It would certainly be more in line with the national standard.

(2) § 11.113 Organization As Client[16]

(a) A practitioner employed or retained by an organization represents the organization, which acts through its duly authorized constituents.

(b) If a practitioner employed or retained by an organization having immediate or prospective business before the Office knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the practitioner shall proceed as is reasonably necessary in the best interest of the organization. In determining how to proceed, the practitioner shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the practitioner's representation, the responsibility to the organization and the apparent motivation of the person involved, the policies of the

16. *Id.; C.f.* Model Rules of Prof'l Conduct R. 1.13 (1983).

organization concerning such matters and any other relevant considerations. Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such measures may include among others:

(1) Asking reconsideration of the matter;

(2) Advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and

(3) Referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.

(c) If, despite the practitioner's efforts in accordance with paragraph (b) of this section, the highest authority that can act on behalf of the organization insists upon acting, or a refusal to act, that is clearly a violation of law and is likely to result in substantial injury to the organization, the practitioner may resign in accordance with § 11.116.

(d) In dealing with an organization's directors, officers, employees, members, shareholders, or other constituents, a practitioner shall explain the identity of the client when it is apparent that the organization's interests may be adverse to those of the constituents with whom the practitioner is dealing.

(e) A practitioner representing an organization may also represent any of its directors, officers, employees, members, shareholders, or other constituents, subject to the provisions of § 11.107. If the organization's consent to the dual representation is required by § 11.107, the consent shall be confirmed in writing by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

The amendment reflects the traditional opportunity to "report up" the corporate hierarchy. If blowing the whistle on wrongdoing proves unsuccessful, the lawyer may resign. As will be elaborated, Sarbanes-Oxley gives the lawyer greater latitude – and a higher mandate – to stop the wrongdoing.

IV. SARBANES-OXLEY'S IMPACT ON LAWYERS' DUTY OF DISCLOSURE

In August 2001, Enron Corporation's downfall began when its CEO Jeffrey Skilling resigned. By December of that year, Enron filed for reorganization with Chapter 11 of the U.S. Bankruptcy Code. The uproar over the Enron debacle was only fueled by a series of corporate scandals all within one year.[17] Arthur Anderson LLP, Enron's auditors, admitted to destroying documents during its Enron engagement, leading to its criminal conviction and collapse. Further post-Enron scandals included financial frauds and accounting restatements at Global Crossings, Adelphia and Tyco. Therefore, it is not surprising that Congress enacted the Sarbanes-Oxley Act of 2002 (the "Act" or "Sarbanes-Oxley").[18] The clear goal of the legislation, was to make financial reporting by public companies more reliable and to hold the management responsible to insure the same. As a safety net, the legislation was broadened to include the outside professionals for such companies - namely its accountants and lawyers.[19]

In Section 307 of the Sarbanes-Oxley Act of 2002, Congress directed the Securities and Exchange Commission (the "SEC" or "Commission") to issue rules establishing standards of professional conduct for attorneys who appear and practice before the Commission on behalf of public companies, including a rule requiring attorneys to report "up-the-ladder" evidence of material violations of securities law, breaches of fiduciary duty or similar violations. Section 307 stated:

> Not later than 180 days after the date of enactment of this Act, the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule-
>
> (1)requiring an attorney to report evidence of a material violation

17. "Within a short period of time, Adelphia Communications Corp.,Global Crossing Ltd., ImClone Systems, Merck & Co., Qwest Communications, Rite Aid Corp., Tyco International Ltd., WorldCom Inc., and Xerox were all accused of accounting improprieties. The accounting practices of other companies[, even] AOL Time Warner [and] General Electric became a topic of everyday conversation . . . Reconsideration of recent years' accounting restatements, particularly those inspired by SEC enforcement actions—suppressed memories of Cedant, MicroStrategy, Sunbeam, Waste Management and others-revealed the ubiquity of what had until recently looked like isolated incidents of accounting fraud." David Westerbrook, *Corporation Law After Enron: The Possibility of a Capitalist Reimagination*, 92 GEO. L.J. 61, 65-67 (2003).

18. *See supra* note 3.

19. *Id.*

> of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and
>
> (2)if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.[20]

On November 21, 2002, the Commission published for comment proposed rules entitled "Standards of Professional Conduct for Attorneys Appearing and Practicing before the Commission in the Representation of an Issuer" (the "Attorney Regulations").[21] Not surprisingly, the proposed Attorney Regulations sparked reactions from all segments of the securities law bar.[22] After considering the comments, the Commission adopted final versions of the Attorney Regulations, which became effective August 5, 2003,[23] and are codified at 17 C.F.R. Part 205.[24]

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20. *Id.*; Codified at 15 U.S.C. § 7245 (2006).

21. Release 33-8150 (Nov. 21, 2002); 2002 SEC LEXIS 3004 (Nov. 21. 2002).

22. *See, e.g.*, Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296 (Feb. 6, 2003) (noting a "total of 167 timely comment letters: 123 from domestic parties and 44 from foreign parties" to the official request for comments).

23. *Id.*

24. 17 CFR §§ 205.1-205.7 (2006). Of course, the lawyer's role cannot be considered in isolation, as the key leaders of a public company have specific duties under the Sarbanes-Oxley Act. The key provisions of Sarbanes-Oxley include:

> **Section 302** - CEOs and CFOs must certify the accuracy of financial information – fairly presenting "in all material respects" the company's financial condition.
>
> **Section 401** - Reports prepared in accordance with GAAP shall reflect all material correcting adjustments identified by the accountant.
>
> **Section 404** - Must document and certify the internal financial reporting procedures and controls.
>
> **Section 409** - Must deliver real-time reports of "material events" affecting company to shareholders or other "stakeholders."
>
> **Section 906** – CEO's and CFO's must also certify that the financial statements comply with Section 13(a) and 15(d) of the Securities Exchange Act of 1934 and that the information presents "in all material respects" the financial condition and operation of the issuer.

The certifications take on significance, as recent federal court opinions demonstrates. *See* In re: Lattice Semiconductor Corporate Securities Litigation, 2006 WL 538756 (D. Or. 2006) (The Sarbanes-Oxley certifications give rise to an inference of "scienter" under the securities laws); Limantour v. Cray, Inc., 432 F.Supp.2d 1129 (W.D. Wash. 2006) (Complaint adequately stated that

Under the Attorney Regulations, an attorney must act reasonably in deciding whether there is credible evidence of a material violation, even if the attorney does not yet "know" with certainty whether a violation has occurred. Ultimately, if the attorney concludes that it is "reasonably likely" that a material violation has occurred, is ongoing or is about to occur, he or she must report. The "reasonably likely" standard means that a violation is "more than a mere possibility," but does not require the violation to be "more likely than not."[25] It is important to note that there is no requirement that the material violation be in any way related to the representation being undertaken by the attorney.

A "material violation" for the purposes of the Attorney Regulations "means a material violation of an applicable federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law."[26] The Attorney Regulations do not define the term "material." The phrase "breach of fiduciary duty" is broadly defined as "any breach of fiduciary or similar duty to the issuer recognized under an applicable federal or state statute or at common law, including but not limited to misfeasance, nonfeasance, abdication of duty, abuse of trust, and approval of unlawful transactions." [27]

Determining whether a material violation has occurred in the context of intellectual property ("IP") is an especially daunting task primarily because of the inherent difficulty in assigning value to intangible assets. Furthermore, some IP is not registered, and as a result, some companies may not be aware of their rights, or the full scope of their rights, to various copyrights and trademarks. Therefore, companies should assess what IP they have, how they monitor it, how they report it, and whether their existing procedures are going to meet the new standards under Sarbanes-Oxley. The challenges with respect to patents and patent applications are particularly acute because of the vast swing of values which may be attributable to them – impacted by conduct in

Forms 10-Q and Sarbanes-Oxley certifications were false or misleading, for purposed of investor's claim of fraud under federal securities law); *But* see Garfield v. HDC Health Corp., et al, 2006 WL 2883238 (11th Cir. 2006) (Officers signed personal certification of corporation's financial statement as required by Sarbanes-Oxley Act, were insufficient to satisfy particularity requirement to plead scienter in securities fraud action against corporation); Zucco Partners, LLC v. Digimarc Corp., 2006 WL 2252557 (D. Or. 2006) (Allegations of scienter based on statements of six confidential witnesses, Sarbanes-Oxley certifications and sales of issuer's stock by the individual defendants during the class period were insufficient to satisfy pleading requirements of PSLRA).

25. Implementation of Standards of Professional Conduct for Attorney, 68 Fed. Reg. 6296, §205(e) n. 47 (Feb. 6, 2003).

26. 17 C.F.R § 205.2(i).

27. *Id.*

the PTO or the marketplace.

V. THE IMPACT OF SARBANES-OXLEY ON IP LAWYERS

The reach of the Attorney Regulations is vast. Although they do not specifically mention intangible assets directly, the Attorney Regulations certainly encompass intellectual property as well.[28]

With IP now comprising substantial portions of corporate assets, many public companies recognize the potential impact of the Act on this increasingly important area in corporate controls and disclosures.[29] While some companies are taking the initiative to begin updating their IP processes, others are cautiously awaiting further direction.[30]

The Attorney Regulations apply to lawyers "appearing and practicing" before the SEC on behalf of issuers of publicly-traded securities, including both in-house and outside counsel. The phrase "appearing and practicing" before the SEC includes:

> (i) transacting any business with the Commission, including any form of communication;
>
> (ii) representing a public company in any Commission administrative proceeding or in connection with any Commission investigation, inquiry, information request or subpoena;
>
> (iii) providing advice about the United States securities laws or the Commission's rules or regulations thereunder regarding any document that the attorney has notice will be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the Commission, including providing such advice in the context of preparing, or participating in the preparation of, any such document; or
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> (iv) advising a public company as to whether certain information or a statement, opinion or other writing is required under United States securities laws or SEC regulations thereunder to be filed with or submitted to, or incorporated into any document that will be filed with

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28. Alison Carpenter, *Sarbanes-Oxley Compliance: Don't Forget IP Valuation*, BNA INTERNATIONAL: WORLD AND TAX LAW REPORT, Apr. 18, 2005, *available at* http://newsweaver.co.uk/bnainternational/e_article000386710.cfm. *See also*, Ira L. Kotel *The Role of the IP Lawyer in Compliance with the Sarbanes-Oxley Act*, 22 THE COMPUTER AND INTERNET LAWYER 8 (August 2005).

29. Carpenter, *supra* note 28.

30. *Id.*

or submitted to, the Commission.[31]

Under the Attorney Regulations, even an IP attorney who does not regularly practice securities law may be deemed to be appearing and practicing before the SEC if he or she drafts, negotiates or otherwise gives advice with respect to any document that he or she has prior notice will be filed by, or incorporated into a document filed by, a public company with the Commission. For example, if an IP lawyer represents a public company in a transaction that must be reported, such as a critical licensing or other intellectual property agreement, the documents related to the reportable transaction must be filed with the Commission or integrated into such a filing. Responses to audit inquiries from accountants for public companies may also come into play. The mere fact that the IP lawyer knows that the documents will be filed with the SEC by the public company, may make him or her liable under the Attorney Regulations because he or she will be deemed to be "appearing and practicing" before the Commission.[32] Similarly, a "supervisory attorney," such as a partner or senior associate, also is deemed to appear and practice" before the Commission if he or she directly oversees a subordinate attorney who is appearing and practicing before the Commission.[33]

Attorneys acting other than in the context of providing legal services to a public company with which the attorney has an attorney-client relationship are not deemed to be "appearing and practicing" before the Commission,[34] nor are most foreign attorneys.[35]

A. *What Must Be Reported*

If a lawyer appearing and practicing before the SEC becomes aware of "evidence of a material violation" by the public company or by any of its "officer[s], director[s], employee[s] or agent[s]," .[36] the Attorney Regulations mandate that the attorney report the evidence of a material violation to the company in an up-the-ladder method.[37] This is similar in some respects with Rule 1.13 of the Rules of Professional Conduct.[38]

"Evidence of a material violation" is "credible evidence, based

31. 17 C.F.R. §§ 205.2(a)(1)(i) – 2(a)(1)(iv).
32. Kotel, *supra* note 28, at 17-18.
33. 17 C.F.R. § 205.4(a).
34. 17 C.F.R. § 205.2(a)(2)(i).
35. 17 C.F.R. § 205.2(a)(2)(ii).
36. 17 C.F.R. § 205.3(b)(1).
37. *See* 17 C.F.R. § 205.3(b).
38. Model Rules of Prof'l Conduct R. 1.13 (1983).

upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing or is about to occur."[39] The SEC intends this to be an objective standard.[40] However, the degree of knowledge and diligence satisfying the "reasonable prudence" test in the context of a company's IP portfolio is nebulous, at best. Each situation turns on its own unique set of facts and circumstances where the more IP means to a business, the more important it is for companies to protect their IP assets.

Experts interviewed for an article in *World Tax and Report*[41] suggest that companies:

- Familiarize CEOs and CFOs with the IP portfolios so they can make accurate and informed certifications;
- Keep board members and other corporate players informed;
- Involve IP counsel in overall IP management; and,
- Implement an effective IP Asset Management Plan.[42]

Each of these tasks will be examined in greater detail.

B. Familiarize CEOs And CFOs With The IP Portfolios So They Can Make Their Certifications

Under Sections 302 and 906, CEOs and CFOs are required to personally certify that the information disclosed in corporate reports accurately represents the financial conditions of their companies.[43] Under Sarbanes-Oxley, these officers are responsible for the execution and maintenance of the required "disclosure controls and procedures." These disclosure controls and procedures must be fashioned to make certain that essential material information is documented, reviewed, understood and reported to the appropriate corporate officials in order to accurately disclose material.

39. 17 C.F.R. § 205(e).

40. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296 (Feb. 6, 2003) ("[T]he triggering standard for reporting evidence of a material violation has been modified to clarify and confirm that an attorney's actions will be evaluated against an objective standard.").

41. Carpenter, *supra* note 28.

42. *Id.*

43. See *supra* note 24.

Accomplishing these goals can be an arduous task in the IP context because IP by its very nature is intangible and difficult to conceptualize. The valuation of IP necessary to make accurate disclosures depends on a plethora of events and circumstances that may or may not occur, which makes forecasting the future value of an IP right complex. However the slightest change in a given market can have monumental consequences in the realm of IP. For example, a patent issuing from an application filed years ago may suddenly become more valuable today because a technology "fad" took years to mature. The same patent may suddenly become worthless two years hence because a minor design around may lead to unabated competition.

The Act is devoid of any mention of "intangible assets," but with IP making up a large part of many companies' assets, it is obvious why it is prudent to familiarize CEOs, CFOs and other senior officers with the company's overall IP portfolio. CEOs and CFOs charged with the task of certifying corporate disclosures must have, at least a cursory, yet working understanding of its company's IP portfolio. This includes understanding "how new IP is developed and identified; [knowing] what claims have been raised and alleged infringements; [knowing] an IP portfolio's value; and being aware of enforcement actions brought by the company against third parties; and third party claims brought *against* the company." [44] Ultimately the key to ensuring that CEOs and CFOs can make accurate certifications is to familiarize them with the company's overall IP portfolio.[45]

C. Keep Board Members And Other Players Informed

A fundamental, but sometimes over-looked component of the Sarbanes-Oxley Act is how it has increased the need for all major corporate players in public companies to take an active role in the control of the company's IP.[46] The experience of in-house patent counsel and even outside counsel notwithstanding, it is important to approach the challenges of IP evaluation from a holistic perspective.[47] Experts underscore the prudence of involving other members of the management team from leaders in marketing and engineering, to research and development, and finance in the strategic decision making

44. Carpenter, *supra* note 28 (quoting Cydney A. Tune, an IP attorney with Pillsbury Winthrop LLP in San Francisco, CA).

45. *Id.*

46. James DeCarlo, *The Board's Responsibilities for Intellectual Property Management,* THE CORPORATE GOVERNANCE ADVISOR, Jan.-Feb. 2005, at 9.

47. *See Id.* at 7.

regarding IP assets. This ensures that any IP decision can be evaluated taking into consideration its impact on the business as a whole.[48]

For instance, as James DeCarlo points out in his article *The Board's Responsibilities for IP Management,*[49] patent counsel may be unaware of significant market plans for the company that may have a bearing on where a patent should be filed, whether existing patents should be researched, or whether new patents should be registered.[50] Without feedback from other members of management, patent counsel may miss an opportunity to seek patent protection in a market, exposing the company to potential liability that may result in financial losses.[51]

Another group integral to making accurate IP disclosures is a company's board of directors. One question currently unanswered and facing directors is whether they can be held personally responsible for damages resulting from insufficient IP portfolio management.[52] In a 2001 case of first impression, In Re RSA,[53] a group of investors brought a shareholder's derivative suit against RSA Security, Inc. (RSA). The investors alleged that the directors had breached their duty of care by neglecting to file for and obtain European patent protection for RSA's core patents.[54] The directors' negligence, according to the shareholders, harmed RSA's stock price constituting because RSA competitors were using RSA's intellectual property without compensation to RSA.[55] They maintain that this constituted a breach of fiduciary duty. The case left little to be gleaned in the form of precedent by ending with a seven-figure settlement.[56]

Traditionally, the ostensible "business judgment rule" has prevented such suits against management for their professional decisions where the questionable action was taken with "due care." [57] Just as standards of conduct change as evidenced by the obligations imposed under Sarbanes-Oxley, however, so has the definition of "due care."[58] A Delaware court has declined to extend the business judgment rule to claims arising from a director's inaction absent a conscious decision not

48. *Id.* at 8.
49. *Id.* at 9.
50. *Id.*
51. *Id*.
52. DeCarlo, *supra* note 46, at 7.
53. *Id.*. *Also see* In Re RSA Security, Consolidated Civil Action No. 18 107-NC (Del. Ch. Filed June 15, 2000), *available at* http://www.legalcasedocs.com/120/240/278.html.
54. DeCarlo, *supra* note 46, at 7.
55. *Id.*
56. *Id.*
57. *Id* at 7-8.
58. *Id.* at 8.

to act.[59] Under this court's reasoning, it may still be prudent for directors and officers to delegate responsibilities regarding the management of a company's intellectual property, but they should do so only after meticulous investigation and communications with IP attorneys.[60]

D. Involve IP Counsel In The Management Of IP

Upper management and directors must involve IP attorneys in all matters even remotely relevant to IP. Though a seemingly basic notion, IP management plans which are devoid of IP attorney support may leave corporate players uninformed regarding IP litigation or the threat of IP litigation affecting the rights of the company.

The existence of material risks relating to the use and protection of a company's IP assets may require disclosure in the risk factors section of the report. A knowledgeable IP attorney may be the only corporate members who can foresee such risks.[61]

Furthermore, material litigation regarding a company's assets must be disclosed in the legal matters section.[62]A failure to adequately disclose any of these threats may violate Sarbanes-Oxley. Of course, IP attorneys are best positioned to analyze the relevant information needed to make informed decisions in response to legal threats to a company's IP portfolio.[63]

For example, as is common when a company is alleged to have committed patent infringement, the company may secure outside counsel to conduct an independent infringement and validity study on the asserted patents. IP disputes may result in injunctions that would materially harm the company and might involve substantial damages (e.g., the threatened injunction in the NTP v. RIM litigation over the ubiquitous "Blackberry"). Therefore, CEOs and CFOs must be aware of potential litigation relating to material IP rights of the company. IP attorneys are often the most capable of drawing legal conclusions and offering legal advice in this context and should be involved in all facets of IP management.

59. Pereira v. Gogan, 2003 WL 21039976 (S.D.N.Y. 2003).

60. *Id.*

61. *See* DeCarlo, *supra* note 46, at 9.

62. Kotel, *supra* note 28, at 15.

63. *Id.* at 16-17 (listing possible factors to consider).

E. Implement An IP Asset Management Plan

The goal of any company's approach to ensuring compliance with the Sarbanes-Oxley Act is to implement an IP asset management plan or revise an existing plan to make it more effective In his article *The Board's Responsibilities for IP Management,* James DeCarlo suggests that IP attorneys and corporate heavyweights should address the following issues in an effective IP asset management plan:

(1) What the company's IP assets are;

(2) How they are valued;

(3) What role IP plays in the company's core business and in the market in which it competes;

(4) Which IP assets are most critical to the company and whether they are adequately protected;

(5) How newly created IP assets of the company are being identified and protected currently;

(6) What areas of the company need more (or less) IP support; and,

(7) The IP position of the company's principal competitors.[64]

This commentator cautions that this list is not exhaustive and should be tailored to reflect the specific IP needs of the individual company.[65] The first step in developing an IP asset management program is to conduct an IP audit to identify current IP.[66] DeCarolo warns that a mere list of patent numbers, though a firm foundation, is not a comprehensive IP inventory.[67] He recommends that an effective IP inventory include "both pending and issued patents, trademarks, trade secrets, copyrights, inventions that have not yet been protected, and license agreements that govern out-licensed or in-licensed technology."[68]

The next step is to assign value to this sometimes extensive portfolio of intangible assets. Herein lies a complex challenge. Traditionally those involved in the valuation of IP have been IT

64. DeCarlo, *supra* note 46, at 10.
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.*

personnel who do not have an "IP-centric focus which is very dangerous because GAAP [generally accepted accounting principles] does not pick up IP well."[69] To extrapolate the general worth of non-liquid assets, companies have to develop a system where they can "make assets more liquid."[70] Traditional valuation processes are virtually useless in the IP domain because the value of IP differs in "not only in time, but also in geography, [and] in what domain space" the company operates.[71] Experts suggest beginning the valuation process by evaluating areas such as mergers and acquisitions where there are already guidelines in place. Ultimately, companies must engage in "abstract thinking" in this area of financial reporting that is "fraught with judgment and subjectivity."[72]

After cataloguing and assigning value to the inventory of IP, a company can begin to develop a formal, comprehensive IP management plan. The key to success, according to experts, is to understand where the intangible assets are from research and development through commercialization because then certain risk factors can be applied to ascertain a sensible value.[73]

VI. SARBANES-OXLEY AND THE PATENT LAWYER

So, what does Sarbanes-Oxley mean to the patent lawyer who prosecutes patent applications? Does such a lawyer have any reporting obligation under Sarbanes-Oxley?

Consider a fledgling public company whose entire business has been built around a blockbuster drug invented by one of its founders. Key claims of the company's patent application on the drug have been allowed by the PTO. However, prosecution of the application remains open in the PTO for other reasons. In any event, the news that the Company will likely obtain the key claims triples the value of the stock. Soon after this news, and while the application is still pending, patent counsel learns about a publication that is clearly material to patentability if it is prior art. Patent counsel has formed a reasonable judgment that, based on the available information, the reference likely does not satisfy the legal standards for prior art, but that, to satisfy Rule 56, he should

69. Carpenter, *supra* note 28 (quoting Robert J. Block, managing director of a Chicago-based risk management firm).

70. *Id.* (quoting Robert J. Block).

71. *Id.* (quoting Nancy Drehwing Edwards, a director at ipCapital Group Inc. in Williston, Vermont).

72. *Id.* (quoting Karen Kincaid Balmer, a partner with Kincaid Consulting LLC in New York)

73. DeCarlo, *supra* note 46, at 8.

disclose all of this to the PTO. He also believes that there is a 40% chance that the PTO will disagree with him. He tells all of this to his immediate supervisor, who has a significant investment in the stock of the company. His supervisor instructs him not to disclose the reference. Does patent counsel have an obligation to report up the ladder? Is failure to report up the ladder a "material violation" of Sarbanes-Oxley?

The possibilities are endless. Suppose outside counsel renders an unfavorable opinion regarding a third party blocking patent to the in-house counsel of his client's company. The subject matter of the opinion is such that, if, in litigation, the third party patent were to be found to be infringed by the company, the company's stock would plummet. Outside counsel learns that his opinion has not been reported to company management. Does outside counsel have any obligation to go around in-house counsel and report up the ladder? Tangential, yet highly important issues of patent valuation and worth, and findings during due diligence, are additionally raised by these hypothetical scenarios.

In the end, resolution of the issue comes down to the "materiality" of the information under the (as yet undefined) Sarbanes-Oxley standard. Compliance with the PTO standard of materiality, or even the PTO or state rules of professional conduct, might not suffice.

VII. CONCLUSION

We are facing uncharted waters on the lawyer's duty of disclosure, particularly as amplified by Sarbanes-Oxley. Presently there is little guidance as to the direct impact Sarbanes-Oxley has on IP.[74] However, with its broad-sweeping guidelines and in light of large corporate scandals centered around inaccurate disclosures, the Act is sure to have

74. To date, other than the opinions cited in *supra* note 24, the reported opinions on Sarbanes-Oxley involve questions of statute of limitations, private rights of actions, the extraterritorial application of the Act and the arbitrability of claims under it. *See, e.g.*, Carnero v. Boston Scientific Corp., 433 F.3d (1st Cir. 2006) (Whistleblower protection provision of Sarbanes –Oxley Act did not have extraterritorial application to extend protection to foreign employee working abroad for foreign subsidiary); Lieberman v. Cambridge Partners, LLC, 432 F3d 482 (3rd Cir. 2005) (Sarbanes Oxley Act's extension of applicable limitations period for private securities fraud claims did not apply retroactively to revive claims already extinguished by the statute of repose before enactment of the extension); Neer v. Pelino, 389 F.Supp.2d 648 (E.D. PA. 2005) (Sarbanes-Oxley Act provision allowing for disgorgement of bonuses and profits by corporate offices did not create a private right of action); In re: Digimarc Corp. Derivative Litigation, 2006 WL 2345497 (D. Or. 2006) (Lack of standing on grounds that there is no private cause of action for a violation of Section 304 of Sarbanes-Oxley); Alliance Bernstein Inv. Research and Management, Inc. v. Schaffran, 445 F.3d 121 (2nd Cir. 2006) (Sarbanes-Oxley claims subject to arbitration).

an impact on IP. To ensure a higher likelihood of compliance with the Attorney Regulations in the Act, companies must familiarize CEOs and CFOs with the IP portfolios so they can make accurate and informed certifications; keep board members and other corporate players informed; involve IP counsel in overall IP management; and, implement an effective IP Asset Management Plan. In light of the serious consequences of violating Sarbanes-Oxley (i.e. criminal penalties), to do less may prove to be imprudent.