

Patenting Legal Methods: Patently Unethical?

BY ROY SIMON

A few months ago, an article in the Wall Street Journal reported that some lawyers had applied for patents on complex estate planning techniques. See, Rachel Emma Silverman, *The Patented Tax Shelter*, Wall St. J., June 24, 2004, at D1. The article outlined three developments in recent years that have propelled some lawyers to seek patent protection for estate planning strategies. First, lawyers have been devising increasingly sophisticated estate planning strategies, and lawyers who devise these complex methods want to be the only lawyers in town entitled to implement them. Second, lawyers used to try to keep these complex methods secret by insisting their clients sign confidentiality agreements, but the IRS scuttled this tactic in late 2003 by requiring clients to disclose the transactions on their tax returns. Third - and most important - in 1998 the courts began to recognize patents for "business methods," a category broad enough to include estate planning strategies.

The notion that other lawyers can obtain business method patents upsets many lawyers. The day that the Wall Street Journal article appeared, a New York tax lawyer wrote a letter to Chief Judge Judith Kaye. He expressed alarm that patents could spread from the tax and estate planning area to other areas of law. He suggested that this presented "serious ethical issues" and "may adversely affect the long term best interests of the public." He then raised a series of questions:

- If a lawyer develops a new technique for structuring a real estate partnership, would no one be able to structure a partnership in a similar way without using that lawyer?
- If another lawyer comes up with a similar technique and doesn't know that the first lawyer has patented it, will he be subject to a patent infringement lawsuit?
- Is the public interest served if a lawyer who drafts a unique will clause dealing with charitable bequests has a monopoly on his language and can prohibit other lawyers from using it?

The letter asked "whether the courts and other bodies charged with overseeing the legal profession should permit this."

The letter found its way to Kenneth Standard, the new President of the New York State Bar Association. He sent the letter and the Wall Street Journal article to the Chairs of the State Bar's Intellectual Property Law Section, the Committee on Standards of Attorney Conduct (which is reviewing the New York Code of Professional Responsibility), and the Committee on Professional Ethics.

This article explores the issues that may arise under the New York Code of Professional Responsibility when lawyers obtain patents on legal methods, and the options open to the courts and the New York State Bar Association for responding to the dangers and opportunities created under patent law.

Business Methods Patents

Section 101 of the patent law, the gateway to all patent rights, provides:

Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent thereof, subject to the conditions and requirements of this title.

Under the general notion that patents are not available for abstract ideas, the courts had held that "business methods" were not patentable. In the leading case, *Security Checking Co. v. Lorraine Co.*, 160 F. 467 (2nd Cir.1908), the Second Circuit said: "Though seemingly within the category of process or method, a method of doing business can be rejected as not being within the statutory classes." But in the landmark case of *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998) the Federal Circuit held that business methods were indeed patentable if they met all of the criteria set forth by the patent laws.

The *State Street* case opened the door for lawyers to patent various legal strategies. The Wall Street Journal article mentioned that lawyers have patented or applied for patents on (a) a method for gaining tax advantages when transferring stock options to a trust, (b) a way to preserve benefits for heirs when donating artwork to charities, and (c) a method for turning future social security benefits into current cash. Can patents on other legal strategies be far behind? Could someone have patented the "poison pill" defense to a hostile takeover, or the use of sale and lease back transactions in real estate deals?

I am not a patent lawyer, so I cannot assess what legal strategies can be patented. But let us assume that complex tax and estate planning strategies are patentable, and that other legal strategies may also be patentable. How should the legal profession react to this new reality?

Two Possible Responses

We can readily imagine at least two responses against the desire of some lawyers to patent their legal "inventions."

1. *Adopt an ethics rule prohibiting lawyers from obtaining patents for legal strategies.* The New York courts could adopt a provision of the Code of Professional Responsibility prohibiting lawyers from applying for, obtaining, or enforcing patents for legal strategies. That might encounter Supremacy Clause problems because the right to obtain patents is granted by federal law. But not everything that is legal is ethical. For example, it is legal for a lawyer to tape record a witness interview without the knowledge and consent of the witness, but several bar association ethics opinions have said that it's unethical to secretly tape record conversations. See N.Y. City Bar Op. 20032 (2003); N.Y. State Bar Op. 328 (1974).
2. *Lobby Congress to outlaw patents for legal strategies.* A more effective approach would be for the legal profession to lobby Congress to abolish patents for legal strategies. But this response has several drawbacks. At best, it would take many months, or perhaps even years, to get Congress to act. Moreover, the legal profession may not have the political clout to justify a different treatment for legal strategies than for other business methods.

In fact, patents for legal strategies may be a positive rather than a negative development. The general theory of patents is that they encourage innovators to develop new ideas by permitting innovators to reap the fruits of their creativity. Why is that theory any less true in the marketplace of legal ideas than in the marketplace for machines or chemical compounds or manufacturing processes? We should keep in mind that a patent application is a public document. Legal strategies that have previously been kept secret will come to light, and others will be able to build on those ideas. Instead of one method of transferring stock options to a grantor controlled trust, for example, we may see fifty or a hundred such methods. The more patents lawyers obtain, the more innovative other lawyers will become. All of this innovation and competition will benefit the public and the legal profession.

In any event, whether patents for legal strategies are good or bad for society, we are stuck with them until Congress outlaws them or the courts hold that legal strategies (as opposed to other business methods) are not patentable. Until something radically changes, therefore, we need to consider the ethical problems that lawyers will face in this new world of patented strategies. Both those who hold patents on legal strategies and those who want to use those strategies will face problems. I will address patent holders first, then lawyers who do not hold patents.

Problems Facing Patent Holders

Lawyer patent holders face potential problems with conflicts of interest, compensation, and confidentiality. Suppose an affluent client needs estate planning advice from a tax lawyer who has patented a tax saving technique. The client says, "I'm coming to you because you hold the patent to the famed Taxless Transfer Technique (TTT). Because you are the only lawyer in town who can use this technique, I want to retain you." This scenario raises two possible conflicts of interest under DR 5101, which guards against conflicts that arise when a lawyer's "exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own financial, business, property, or personal interests" First, the lawyer may find that the patented TTT is not suitable for this particular prospective client. Does the lawyer have to disclose this to the prospective client in the initial interview? Second, the patent enables the lawyer to charge a fee for its use that is well above the fees the same lawyer charges for other, unpatented techniques and above those that can be charged by competing lawyers without the benefit of TTT. Does the lawyer have to tell a client that the lawyer has a strong financial interest in recommending the famous TTT because of the premium fee?

I think the answer to both of these questions is "no." Consider an analogy. A client comes to a topnotch antitrust litigator and says, "I want you to sue Mega Corp. for antitrust violations!" The lawyer knows that filing a lawsuit will generate a lot of premium legal fees. But the lawyer also realizes that filing an antitrust suit is not the best approach in the client's particular circumstances. A better approach would be to contact the Federal Trade Commission and persuade it to put pressure on Mega Corp. Lots of lawyers, some with more experience than our litigator, know how to do that. Does DR 5101 require our star litigator to say to the client, "You don't really need someone with my expertise in trying antitrust cases. You just need someone familiar with the FTC, and lots of lawyers can do that"? No. If that were true, many lawyers would have to advise a prospective client that other lawyers are just as well suited to handle the client's problem. That is not the custom of the profession or the intent of DR 5101.

Compensation issues. Patented legal strategies also raise questions about excessive fees. This issue divides into two parts. What if the patented technique is not necessary to solve the client's problem? Is the lawyer charging an "excessive fee" in violation of DR 2106 if the lawyer provides the client with the patented technique even though a less expensive technique would serve the client's interests adequately. The answer to that question may well be "yes," especially if the patented technique is far more expensive than a nonpatented technique that is equally effective, or nearly so. But what if the patented technique is the best solution for the client. How high may the lawyer set the fee for the patented technique without violating DR 2106?

That is a difficult question because the twelve factors for measuring whether a fee is excessive (DR 2-106(B)) do not neatly fit the patent situation. If the patented TTT device will save the client \$10 million in estate taxes, may the lawyer charge the client \$9 million for the technique? My gut tells me that \$9 million is excessive. Suppose a lawyer with an unpatented technique will save the client \$5 million and charge only \$100,000 in legal fees. Does that cap the fees for the patented technique at \$4.9 million, since that is the most the client can save by using the patented technique?

Other questions also enter the mix. How much may the patent holder charge to cover any uncompensated research and development time the lawyer incurred while inventing the patented technique? Suppose the patent was developed in the representation of a client who paid for the work by the hour? For example, if a wealthy client paid \$200,000 in fees for the lawyer to develop TTT, may the lawyer charge the next client \$200,000 for the same product?

In the ordinary free market world, a patent holder may charge what the traffic will bear. But lawyers are not part of the ordinary free market world; they are professionals bound by the disciplinary codes. That means that lawyers will probably have to set their fees for patented techniques below the rates that would maximize profits. Unfortunately, how much lower is anybody's guess. The higher the fee, the greater the risk that someone will find it excessive. But the same rule applies to all legal service, patented or not.

Confidentiality. Another set of issues center on confidentiality. Suppose, as before, that a wealthy client paid a lawyer by the hour to create TTT. Concluding that TTT is an original, nonobvious product that can trim millions off the estate tax bills of affluent clients, the lawyer decides to patent the technique. May the lawyer apply for a patent without the client's consent? In other words, may the lawyer disclose the final product to the United States Patent Office without violating DR 4101 or DR 5108(A)(2)?

Under DR 4101(C), a lawyer may not disclose a client "secret" unless the client consents after full disclosure. Information gained in the professional relationship is a "secret" if the client has requested that it be "held inviolate," and we should assume that most wealthy clients would instruct their lawyers to keep the product secret. Under DR 5108(A)(2), a lawyer who has formerly represented a client may not reveal information protected by DR 4101 unless the information has become "generally known," and we may safely assume that patentable legal strategies are not generally known. Yet a strong case can be made that legal strategies are not "secrets" within the meaning of DR 4101 and therefore are not protected by DR 4101. As I have argued in my own book, *SIMON'S NEW YORK CODE OF PROFESSIONAL RESPONSIBILITY ANNOTATED* 440 (Thomson West 2004 ed.), the word "information" in DR 4101(A) "should be read to refer only to factual information, not legal information." (Emphasis in original.) For example, if a lawyer files a complaint against Merck for injuries to a client arising out of the client's use of

Vioxx, the lawyer may use the same complaint on behalf of a second client who wants to sue Merck for similar injuries, and may also use his knowledge of Vioxx on behalf of the second client without obtaining the first client's consent, even though the lawyer acquired the information about Vioxx while investigating a possible suit on behalf of the first client. I believe that the entire legal profession operates in that way, and ought to operate that way.

Are highly complex legal strategies different? I want to say "yes," but the difference between a highly complex, patentable legal strategy for saving on taxes is different only in degree from a simple will or trust. Yet at some point, differences of degree become differences in kind. The New York Yankees are not just stronger and taller than Sunday morning softball players. Perhaps we could bootstrap complex legal strategies into the zone protected by DR 4101 by saying that if a legal strategy is sufficiently complex and original to qualify for a patent, then it also qualifies as a "secret" under DR 4101. But that is just reasoning by tautology. Until a court or ethics committee says so, a legal strategy - even one that was made at the request of a particular client - is not the kind of "information" that DR 4101 protects. Of course, a wise client may insist in the retainer agreement that the lawyer keep the final product confidential. But how many clients will do that?

If a client does contract to keep a legal strategy confidential, or if courts hold that a legal strategy is a "secret" under DR 4101, then a lawyer will be prohibited from submitting a legal strategy to the USPTO without the client's consent after full disclosure. Recognizing the profit potential, some clients will say, "I'll consent, but only if you cut me in on the action." In that case, other ethical issues arise because this has become a business transaction between lawyer and client. Business transactions between lawyers and clients are highly risky for lawyers, and can lead to costly litigation and professional discipline.

Other clients may say, "Go to hell! I paid for it, and I'm going to patent it myself!" May the lawyer apply for a patent if the client objects?

The problems of confidentiality disappear if a lawyer invents a legal strategy on his own, independent of the legal services for any client. In that instance, the lawyer owns the product and will presumably make clear in the letter of engagement (see 22 NYCRR Part 1215) that the lawyer owns the patent on the legal strategy, that the strategy is not protected by the duty of confidentiality, and that the lawyer reserves the right to use the same legal strategy on behalf of other clients.

Problems For NonPatent Holders

Now let's look at the situation from the perspective of a lawyer who does not hold the patent. Suppose a client comes to a lawyer for estate planning advice. From reading various press accounts about TTT, the lawyer knows that TTT would be perfect for this client. Does the lawyer have a conflict of interest under DR 5101 if he retains the client even though his professional judgment tells him that the client would be better off going to the lawyer with the TTT patent? Does DR 5101 require the lawyer to tell the client that TTT's holder is the best lawyer for the job? Again, I do not think so. If DR 5101 required such notice in the patent situation, it would by analogy require such notice in every situation where the client could obtain better service from another lawyer.

Of course, many lawyers may be happy to refer clients to patent holders in exchange for a referral fee. That is perfectly ethical under DR 2107(A) as long as the client does not object to the involvement of the

other lawyer, the total fee is reasonable, and the lawyer receiving a referral fee accepts "joint responsibility" for the matter or is paid in proportion to services actually rendered to the client. See *generally*, Roy Simon, *Joint Responsibility Under DR 2107(A)*, NYPRR Dec. 2002.

Those are the main ethical questions that occur to me regarding patented legal techniques. In my view, these are not serious ethical problems. Some judges or disciplinary authorities may disagree with me, but I think that patent holders who develop patentable legal strategies at their own expense and who then charge reasonable fees for their patented techniques will be on safe ethical ground.

Preventing Possible Abuses

Even if lawyers may ethically patent certain legal strategies and may ethically sell patented strategies to their clients, abuses may arise. Some lawyers may seek to patent legal strategies that are plainly not patentable solely so that they can threaten infringement suits against competing lawyers. Other lawyers may obtain legitimate patents but then threaten infringement suits against lawyers who plainly are not infringing the patents. Conduct of this kind may have a strong *terrorem* effect that will chill lawyers from offering appropriate legal services to their clients. We should be prepared to combat these abuses with our current sanctions rules (Rule 11 of the Federal Rules of Civil Procedure in federal courts, and 22 NYCRR Part 130 in state courts) and with DR 1102(A)(5), which prohibits lawyers from engaging in conduct "prejudicial to the administration of justice."

Some lawyers who obtain legitimate patents may refuse to license the technique to other lawyers on reasonable terms. The patent laws do not require patent holders to license their products, but perhaps the Code of Professional Responsibility ought to make it unethical to refuse to license a patented legal strategy on reasonable terms. That may encounter resistance under the Supremacy Clause, but the patent laws arguably do not preempt all state regulation in the field, especially where professional ethics are at stake.

Finally, as regards lawyers who obtain legitimate patents and overcharge for their patented products, the courts and ethics committees could anticipate this problem by offering better guidance about the limits of permissible fees for patented products. Drafting that guidance will not be easy, but the State Bar should take the lead in attempting to do so before patents proliferate and the problem gets out of hand.

Conclusion: Proceed with Caution

In most areas of commerce, the patent system is viewed as a positive force that provides strong incentives to creative minds to develop and market new products. The same may be true in the legal profession, but many lawyers - like the lawyer who wrote to Chief Judge Kaye - have a strong gut instinct that patenting legal strategies is wrong. The ethical problems raised by patented legal strategies may prove controllable, but the overall effect on the legal profession is uncertain and difficult to predict. The problem deserves serious study from many perspectives, but the bar should proceed with caution before staking out a firm position.

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