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Considerations for Noncompete Agreements in Oregon and Washington

By Tab Wood and Tyler Volm, Sussman Shank LLP

On the spectrum of post-employment restrictions, noncompete agreements are the most restrictive. On the other end of the spectrum are nondisclosure agreements, which generally prohibit the unauthorized use or transfer of the employer's confidential information. In the middle of the spectrum are nonsolicitation agreements, which generally prohibit contacting the former employer's customers in an effort to move their business to the employee's new place of business. Depending on various factors, a more restrictive covenant may be needed. This article will discuss what an employer should consider prior to requiring noncompete agreements.

What is at stake?

Designed to keep confidential information from walking out the door and across the street to a competitor via a high-level employee, noncompete agreements go even further by prohibiting the employee from working in a similar position for a competitor for a specific duration. ORS 653.295(7)(d) defines noncompete agreement to mean "an agreement, written or oral, express or implied, between an employer and employee under which the employee agrees that the employee, either alone or as an employee or another person, will not compete with the employer in providing products, processes or services that are similar to the employer's products, processes or services for a period of time or within a specified geographic area after termination of employment." Because noncompete agreements are the most restrictive, they are also subject to the most judicial scrutiny, particularly in the employment context. However, noncompete agreements in the sale of a business context are not subject to the restrictions discussed in this article.

Is it worth it?

Before requiring a noncompete agreement for certain employees, the employer must consider three cost points. First, there is the initial cost of drafting and negotiating the agreement. During this process, the company should carefully consider the employee's position, their access to proprietary information, and the geographic scope and duration of the restriction. Second, there is the cost of administering the agreement. Oregon requires pre-employment notice and a post-employment copy of the agreement within 30 days after the date of termination. There is also the essential administrative cost of maintaining appropriate protections for the trade secrets that constitute the employer's protectable interest. Third, there is the cost of enforcement, which can quickly rise given the injunctive relief that is regularly sought on an expedited basis in these cases. Even with a prevailing-party provision, a party who seeks to enforce restrictive covenants can expect upfront legal costs. Thus, an employer should consider these three cost points of noncompete agreements on an employee-by-employee basis.

How did we get there?

One of the earliest reported cases of noncompete agreements involved a blacksmith attempting to limit his apprentice from opening up a competing forge within a neighboring hamlet. See *Dyer's Case* (1414) 2 Hen. V., fol. 5., pl. 26. One can understand the mentor

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Noncompete agreements *Continued from page 1*

Tab Wood is a partner and the chair of the Litigation Group at Sussman Shank LLP. His practice focuses on employment and commercial litigation.

Tyler Volm is a member of Sussman Shank's Business Group and Employment Practice Group. His practice is focused on business matters, including labor and employment, civil litigation, real estate, and tax.

blacksmith's concern in not wanting to train someone who will put him out of business. Traditional case-law analysis examined whether the restriction was reasonable in geographic scope and duration in light of the interest the employer was attempting to protect.

In 2008, Oregon implemented a new statutory scheme to regulate what the legislature perceived to be the over-use of noncompete agreements with employees who were not traditionally subject to these restrictions and who did not have access to confidential, proprietary information. The statute specifically carved out covenants not to solicit or transact business and bonus restriction agreements.

The statute has undergone several amendments since 2008, so practitioners will need to review the effective date of the relevant agreement to determine which statutory scheme was in place when the agreement was signed.

Oregon

Oregon statutory requirements can be summarized as follows:

Advance Notice/Bona Fide Advancement: If the noncompete agreement is required as a condition of employment, the employer must inform the employee two weeks before the first day of employment (or presented to a current employee on a bona fide advancement—usually into a position where the employee will have more access to proprietary information).

Exempt Employee: The employee is not a person described in ORS 653.020, which defines excluded employees.

Protectable Interest: See discussion above of proprietary information.

Salary Threshold: In the year preceding the termination of employment, the total amount of the employee's gross salary and commissions must exceed the median family income for a four-person family. (For 2022, that number is $100,533.) Note that the statute allows enforcement of a noncompete agreement against an employee that does not meet the salary threshold or exempt employee requirement so long as the employer pays the employee the minimum salary threshold amount during the period of enforcement—i.e., "pay to play" or "garden leave."

Post-Termination Copy of Agreement: Within 30 days after the date of termination, the employer must provide a signed, written copy of the terms of the noncompete agreement.

In the most recent amendments, the Oregon legislature further limited the maximum duration to 12 months (formerly 18 months) for agreements entered into after January 1, 2022. In addition, the legislature changed the language to make a noncompliant agreement "void" instead of "voidable."

Washington

Washington adhered to the traditional reasonableness analysis for a while longer, until 2019 when it passed its own statute governing noncompete agreements. RCW 49.62, which took effect January 1, 2020, imposes a number of significant restrictions including:

Notice Requirement: The employer must give written notice of the terms of the noncompete before the employee accepts an offer of employment. A separate notice is required where the employee makes less than the threshold amount at the time the agreement is signed, but may ultimately exceed that threshold.

Salary Threshold: $100,000 annually

Maximum Duration: 18 months

Penalty and Attorney Fees Available: The penalty may be enforced even if the court ultimately revises the agreement to conform to reasonable standards under the circumstances. See RCW 49.62.080.

Mandatory Choice of Law and Forum: Must be Washington State for a Washington-based employee.

Note that some of the Washington requirements are more stringent than those in Oregon.

A litigator's perspective

The employee has left, and now the question becomes whether or not to litigate. Before that decision is made, the first step in most cases is to send the departing employee a letter reminding them of their duties and obligations under the employment agreement. This is often referred to as a "reminder of covenants" letter.

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Noncompete agreements

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Given the complexity and cost of drafting, administering, and enforcing noncompete agreements, employers should consider whether there are other tools it can use to protect its proprietary information.

The purpose of the letter is to promptly put the employee on notice that the employer is aware of, and will enforce, the post-separation covenants in the employment agreement. Sometimes, this letter will deter wrongful conduct and head off the need for litigation. Other times, it won't. In those instances, the employer must consider several factors in determining how to proceed.

Is there evidence of wrongful conduct sufficient to warrant litigation?

Often, just leaving and joining a competitor isn't enough. Courts will consider whether the employee wrongfully took confidential or trade secret information, or whether the employee has wrongfully solicited clients or prospects. Before the employer rushes into court, they should carefully review the facts surrounding the departure.

If there is evidence of wrongful conduct, does the harm—or threatened harm—justify the expense of litigation?

Seeking a Temporary Restraining Order (TRO)—which immediately prevents the employee from engaging in further wrongful conduct—is expensive because it requires thorough motion practice and often expedited discovery, including depositions and the exchange of documents. The harm has to be worth the expense.

Is the employer ready and available to proceed quickly?

Depending on venue, a TRO is only good for 10–14 days, after which the party seeking to enforce the agreement has to present a case for a preliminary injunction. That proceeding is essentially a mini-trial, and the result, if successful, is that the employee is prevented from engaging in further wrongful conduct throughout the duration of the case—which could be anywhere from a year to two years, depending on venue. Accordingly, once the employer decides to institute litigation, the process is very time consuming and key employees and management personnel need to be ready to participate.

Those are only a few considerations. Employers are always wise to promptly seek legal advice to formulate a complete legal strategy and plan.

Other considerations

Situs of employment would typically override a choice of law in these agreements (i.e., if the employee worked in Oregon but the agreement provided for New York law, an Oregon court would likely enforce ORS 653.295). But that dynamic has been turned on its head as remote work was accelerated by the recent COVID-19 pandemic.

Employers should consider requiring employees to work a certain number of days at the employer's principal place of business or within the identified jurisdiction to protect against another state imposing a more restrictive analysis on the noncompete agreement.

Given the complexity and cost of drafting, administering, and enforcing noncompete agreements, employers should consider whether there are other tools it can use to protect its proprietary information. As noted at the outset, robust nondisclosure and agreements can provide much of the desired protection, without the strict requirements imposed by ORS/RCW/statutes. However, in certain cases, particularly where the use of confidential information in the new position is inevitable or unavoidable, a noncompete agreement may be required.

Employers can also consider proprietary information and invention assignment agreements. (Be sure to include Washington carve-out for inventions developed on the employee's own time and with their own tools and equipment.) Another option is a training reimbursement agreement, which requires the training to have independent economic value outside the employer's operation. Finally, employers should always consider increasing their employee retention efforts. ◆

Insolvency Risk and Guaranty Pitfalls

By Erich M. Paetsch, Saalfeld Griggs PC

Erich Paetsch is a member of the Creditors' Rights & Bankruptcy Group and the Litigation Group at Saalfeld Griggs PC. His practice is focused on providing financial institutions and business clients with a broad array of legal services. He is experienced in defending lawsuits involving creditors' rights and lender liability issues. He has extensive experience representing creditors in complex bankruptcy proceedings and businesses in contract disputes.

A common requirement of financing and contractual agreements is a guaranty. The reasons to include one are numerous. For example, when multiple entities are involved or a lender would prefer a strong personal commitment to a project or business, a guaranty reduces liability or guarantees performance by generally including other assets or ensuring individual investment in a project's success. The number and types of guarantees are limited only by the creativity of the parties who structure a transaction and their risk tolerance. This article focuses on the most common guaranty—the personal guaranty—and explores some considerations for a creditor and guarantor including bankruptcy.

What is a personal guaranty?

A personal guaranty is a contract under which the guarantor has an obligation to pay after the default of the primary obligor. Oregon law does not require specific language to form a guaranty, but it is subject to the Statute of Frauds and must be in writing and signed to be valid. *Warm Springs Forest Products Industries v. Rimrock Ranch, Inc.*, 83 Or. App. 175, 178, 730 P.2d 1255, 1257 (1986); ORS 41.580.

Like other contracts, a personal guaranty can only be made by mutual assent and must be supported by valuable consideration to be enforceable. While consideration is required, the guarantor is not required to receive a direct benefit from either the principal contract or the guaranty; a benefit to the principal or a detriment to the creditor is sufficient.

Because a guaranty is a contract, familiar contractual requirements and defenses apply. Typically, a guarantor may raise any defense that the principal obligor may have raised to the underlying obligation. *Man-Data, Inc. v. B&A Automotive, Inc.*, 247 Or. App. 429, 437, 270 P.3d 318, 323 (2011).

In addition to typical contract formation defenses, there are affirmative defenses that may be available to a guarantor to avoid liability under the guaranty. These include material modification of a contract without consent, failure to pursue a primary obligor before pursuing the guarantor, failure to give adequate notice, and fraudulent conveyance law under state law and the bankruptcy code.

Because multiple defenses are available to guarantors, it is common to seek waivers of these defenses. A guarantor may often waive defenses which would otherwise be available, but caution is necessary when using catch-all waivers because some courts have held that waivers must be specific. *California Bank & Trust v. DelPonti*, 232 Cal. App 4th 162, 181 Cal Rptr. 3d 216 (4th Dist. 2014). Oregon courts have upheld general waivers that are absolute. *W.J. Seufsert Land Co. v. Greenfield*, 262 Or. 83, 88-89, 496 P.2d 197, 199-200 (1972).

An overlooked risk: ECOA

An overlooked risk for lenders when requiring a personal guaranty is the Equal Credit Opportunity Act (ECOA) and its implementing Regulation B. While commonly considered in the context of consumer transaction, ECOA prohibits discrimination against any applicant based on certain statuses, including marital status, in a consumer and commercial transaction. Regulation B applies whenever the guaranty of a spouse is required as part of a transaction. See 12 CFR §202.

A common violation of Regulation B is requiring the guaranty of a spouse. Generally, Regulation B imposes an obligation to evaluate ownership at the time any personal guaranty is made, including for commercial loans. A change in the form of ownership of assets due to a change of marital status, for example, cannot be considered. In situations where the spouse is an owner or officer of a company, Regulation B recognizes that obtaining a personal guaranty may be appropriate. However, in situations where the spouse is completely independent of the company, obtaining a personal guaranty may run afoul of Regulation B. Alternative arrangements such as obtaining a secondary source of collateral owned by the spouse may provide a better solution than a personal guaranty and scrutiny for compliance with ECOA.

The risks of improperly requiring a personal guaranty under Regulation B can be significant. Including a spousal guaranty, even if ultimately found legal, may delay a speedy recovery through litigation by a creditor if defaults occur. In addition, ECOA includes significant penalties, including a right to recover actual damages, punitive damages, and attorney fees and costs. While commonly overlooked, requiring the guaranty of a spouse or other party protected under ECOA may not resolve performance and payment risks and instead create liability.

Commonly used guaranty terms

Although many types of personal guarantees are available to fulfill the needs of parties and specific transactions, other commonly used guarantees may be considered. These terms are used to define the scope or duration of a guaranty. Examples include *unconditional*, *conditional*, *limited*, and *unlimited* guarantees.

An unconditional guaranty, or payment

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guaranty is a contract in which the guarantor promises that if the debtor does not perform, the guarantor will perform. The only condition to the guarantor's obligation to perform is the principal's default. A guarantor who makes an unconditional guaranty is not entitled to require pursuit of the primary guarantor first, and becomes primarily liable if the guaranteed obligation matures or is not performed.

In contrast, a conditional guaranty is a contract in which a guarantor promises that they will perform, but only when a contingent event happens or for a specified period. A typical conditional guaranty requires that the creditor pursue collection from the primary obligor before the guarantor is liable.

Another type of commonly used restriction in a guaranty limits the scope that the guarantor is contractually obligated to address. A limited guaranty, or restricted guaranty, concerns a single or limited number of transactions. A limited guarantor only guarantees transactions that are specifically identified. Creditors prefer to use an unlimited guaranty. An unlimited or continuing guaranty is a guaranty that covers a series of transactions, all debt, or all future obligations. An unlimited guaranty is typically used in connection with lines of credit. It includes all current and future transactions that are within the contemplation of the agreement and can include future debt.

Depending on the scope and other requirements of the guaranty, different guarantor defenses apply unless waived. For example, an unconditional guaranty eliminates a guarantor's requirement of enforcement against the primary obligor before enforcing the guaranty. The type of guaranty used may also affect options in the event of insolvency on the part of the primary obligor. A creditor, unless prohibited by the bankruptcy court, may pursue an unconditional guarantor, whereas a conditional guaranty might limit any rights against the guarantor until after any bankruptcy proceeding has concluded.

Bankruptcy injunction protection for personal guarantors

Some personal guarantors assume that bankruptcy on the part of the primarily responsible party will protect the guarantor from liability after a payment or performance default. This belief is understandable, considering general knowledge of the so called "automatic stay" and bankruptcy law. The automatic stay is commonly understood to prohibit a creditor from enforcing their claims once a bankruptcy case is filed. However, this understanding does not recognize that the automatic stay is limited to protecting the debtor in bankruptcy, and not third parties. There is an exception for Chapter 12 and Chapter 13 bankruptcy cases when the so-called co-debtor stay applies under the Bankruptcy Code. The co-debtor stay is not typically available in nonagricultural commercial bankruptcy cases, which are filed under Chapter 11 of the Bankruptcy Code. In addition, the co-debtor stay does not resolve liability; it only prevents activity by a creditor for a period. Because a guarantor is a third party and not the debtor in a bankruptcy case, a personal guarantor cannot assume that the automatic stay will protect them from legal action to enforce the terms of their personal guaranty after a bankruptcy case if filed.

An evolving topic under bankruptcy law is the extent to which a bankruptcy filing can be used to protect a guarantor while the bankruptcy case is pending. When the automatic stay does not apply, a principal obligor may try to use an injunction to delay or prevent action against a personal guarantor. These efforts involve the entire bankruptcy process, from the start of the bankruptcy case until the end of any confirmed plan of reorganization. The use of injunctions to protect guarantors as part of a bankruptcy case remains controversial and is the subject of ongoing litigation.

In the Ninth Circuit, an injunction in favor of a non-debtor party such as a guarantor after a bankruptcy is filed is permitted when the requirements for obtaining an injunction are generally satisfied. *In Re American Hardwood, Inc.*, 885 F.2d 621 (9th Cir. 1989). However, even if an injunction is granted, the duration of such an injunction is not unlimited. In a typical Chapter 11 bankruptcy case, the goal of the debtor after filing is to receive a discharge of liability as part of a confirmed plan of reorganization. To confirm a plan and to receive a discharge of liability, the Bankruptcy Code requires that the discharge "…not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 USC §524(e). The Ninth Circuit has made it very clear that a confirmed bankruptcy plan cannot discharge the liability of personal guarantors. See *In re Lownschuss*, 67 F.3d, 1394, 1401 (9th Cir. 1995) ("This court has repeatedly held, without exception that §524(e) precluded bankruptcy courts from discharging the liabilities of non-debtors.") As a result, a debtor in the Ninth Circuit cannot use a confirmed Chapter 11 bankruptcy plan to protect or eliminate a guarantor's liability under a personal guaranty.

Efforts to include an injunction to protect guarantors as part of a confirmed Chapter 11 plan have been repeatedly rejected by the Ninth Circuit. *In re Excel Innovations, Inc*., 502 F.3d 1086, 1095 (9th Cir. 2007). However, it is possible to include a post-plan confirmation injunction that might ultimately result in a third-party release of the personal guarantor. To do so, the courts require a consensual third-party injunction involving the parties to be affected. *In re Astria Health*, 623 B.R. 793 (Bankr. E.D. Wash. 2021). In the absence of such consent, the rule in the Ninth Circuit remains that an injunction protecting third parties cannot be included as part of a confirmed Chapter 11 plan that also results in a discharge of liability. The challenge and opportunity for guarantors, therefore, is to obtain consent of the affected creditors as part of any proposed plan of reorganization under Chapter 11 of the Bankruptcy Code.

Conclusion

The use of personal guarantees will remain a common way to allocate risk among parties in commercial transactions. The parties should remain mindful of common contractual requirements and defenses and how to waive them when permitted. Bankruptcy by the principal obligor may provide a short-term reprieve from liability under a personal guaranty through the co-debtor stay or a pre-confirmation injunction. However, a guarantor cannot assume a bankruptcy filing by the primary obligor will eliminate their liability as a guarantor. Obtaining an injunction as part of any confirmed plan and discharge of the primary obligor and the guarantor will require the consent of the affected creditor under existing Ninth Circuit precedent. ◆

Ethical Traps in M & A Transactions

by Amber Bevacqua-Lynott & David J. Elkanich, Buchalter

Amber Bevacqua-Lynott is a member of Buchalter's Professional Responsibility Group, and works from the firm's Portland and San Diego offices. Prior to joining Buchalter, she was an assistant disciplinary counsel with the Oregon State Bar for more than 18 years, the last six of which she was the chief assistant and lead trial attorney.

David Elkanich is the Chair of the Professional Responsibility Group at Buchalter, working out of the firm's Portland and Seattle offices. He has more than 15 years of specialized experience in legal ethics and related matters, and teaches legal ethics at Lewis & Clark Law School.

There is no "typical" or common merger and acquisition (M & A) transaction. Although they have some common processes and typical components, each M & A transaction—and its participants—is unique and potentially challenging for the lawyers involved. With so much at stake in most M & A transactions, attorneys may feel pressure to act in ways that may be contrary to their ethical obligations, their client's interests, or both. It may be difficult to determine to whom you are answerable, as well as to understand any obligations to the participants, the companies, and the deal. Moreover, lawyers may find themselves caught in the quagmire of self-preservation if a securities deal goes sideways.

The scenario

ABC, Inc., is looking to buy and merge with its competitor, XYZ, Inc. ABC has dozens of shareholders, but XYZ has only six. You represent XYZ, and have been taking direction from its CEO and majority shareholder. The terms of the deal include both cash and stock options for XYZ's shareholders, and most—but not all—are looking to convert at least a portion of their XYZ shares to ABC shares in the transaction. In addition, ABC has offered XYZ's CEO a lucrative employment deal with ABC after the merger is completed. None of the other XYZ shareholders are being offered employment, but are being asked to sign five-year noncompete agreements.

Considerations before the deal

Who is the client?

Identification of the client determines with whom you communicate and to whom you owe your duties of diligence, confidentiality, and loyalty. Client identity is typically straightforward—a lawyer retained by a company typically represents only the company, and not the individual employees or members forming the company. See RPC 1.13(a). A company cannot, however, speak on its own and so it may act through its "duly authorized constituents." For this reason, it can sometimes be tricky to determine the voice of the company, when—as in the scenario above—there are multiple stakeholders with potentially competing interests, and the client company itself can only speak through such stakeholders. Client identification may further be complicated by the fact that a putative attorney-client relationship may be formed without a fee agreement or other formalized writing.

In Oregon, the existence of this relationship is largely dependent on the putative client's subjective belief that an attorney-client relationship has been established, so long as that belief is objectively reasonable—i.e., whether it is accompanied by evidence "that the lawyer understood or should have understood that the relationship existed, or acted as though the lawyer was providing professional assistance or advice on behalf of the putative client." *In re Weidner*, 310 Or 757, 770, 801 P2d 828 (1990).

But when a lawyer speaks to multiple people on the same "side," even if it is something as simple as taking a stakeholder's call and discussing details of the deal with that person, the lawyer is at risk that person may believe the lawyer is giving them individual advice. As a result, the lawyer may need to take steps to clarify that she is not their personal attorney, that she represents the entity, and that she is not looking out for their interests.

Lawyers are encouraged to detail the client relationship in writing at the beginning of the relationship, including who the lawyer does and does not represent. A comprehensive engagement letter can resolve many of the "who is the client" issues that may arise throughout a matter.

Explaining the process

Often, participants to M & A transactions, including the client representative, may be new to or unfamiliar with the process. Lawyers have an ethical obligation to ensure that their clients are provided with sufficient information to enable informed decisions regarding the representation. See RPC 1.4(b).

A parallel communication rule requires lawyers to keep clients informed of the status of their legal matters—especially those events that affect their legal interests or are potentially determinative of the legal matter. See RPC 1.4(a). See *In re Snyder*, 348 Or. 307, 315, 232 P.3d 952, 957 (2010) (reaffirming ruling under former disciplinary rules that a failure to communicate both good and bad news to the client violates RPC 1.4). See also *Marshall v. PricewaterhouseCoopers*, LLP, 316 Or. App. 416, 505 P.3d 40 (2021), review denied, 369 Or. 855, 512 P.3d 445 (2022). In that case, attorneys who investigated a proposed transaction were subject to malpractice action when they quickly identified a risk, albeit low, that the transaction

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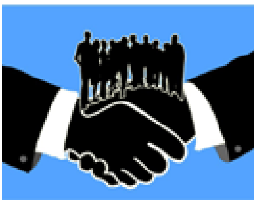
could be challenged as a fraudulent transfer in a bankruptcy proceeding, but did not inform their clients of their research before recommending that their clients go forward with the proposed transaction.

The combination of the obligations in RPC 1.4(a) and (b) also illuminates the need for attorneys involved in M & A transactions to tailor both status and other client communications to the sophistication of their particular client. You must know your audience, and take steps to provide complete and comprehendible information at every juncture.

During the deal

There are several potential pitfalls during the transaction. Successfully navigating them is largely dependent on understanding the relative goals of your client and the other participants to the deal—particularly those purportedly on your client's side. In addition to the potential ethical ramifications, this is now especially important because the current position from the court is that the ten-year period of ultimate repose under ORS 12.115(1) does not necessarily apply to all legal malpractice actions. *Marshall v. PricewaterhouseCoopers*, LLP, 316 Or. App. 416, 426, 505 P.3d 40 (2021), review denied, 369 Or. 855, 512 P.3d 445 (2022).



Understanding the motivations and goals of the participants is key to avoiding personal civil liability, as well as a disciplinary proceeding by the Oregon State Bar or the SEC.

Conflicts in sell-side transactions

Given that XYZ's CEO is being courted to join ABC's organization, the CEO's interests may not necessarily be aligned with those of XYZ or the other shareholders looking to get the highest share price for their stock and other assets. Rather, the CEO may want to maximize value for ABC, and put it in the best position to be profitable following the sale. As the lawyer for XYZ, you need to be on the lookout for this potential conflict of interest—particularly where it could arise in connection with the person from whom you are supposed to be taking direction on behalf of the client. Where the CEO's interests may be contrary to those of your client, you must still act in the interests of your client, even if the CEO is the one paying your bills. See RPC 1.8(f)(2).

In addition, keep in mind the risk for aiding and abetting breach of fiduciary duty by a majority owner to minority owner. See *Granewich v. Harding*, 329 Or. 47, 985 P.2d 788 (1999). In that case, attorneys representing the corporation knew of and participated in a scheme to "squeeze out" a minority shareholder, which resulted in breach of fiduciary duties of controlling shareholders. The court upheld a valid claim against the attorneys for joint liability. Accordingly, care should be taken to avoid perceived participation in actions that fail to consider the effects on minority shareholders, or which could otherwise be viewed as a breach of fiduciary duties. If you find yourself in such a situation, you may consider pointing out the "perceived conflict" to the majority actor (here, XYZ's CEO) and suggest that the CEO consider how the actions would look to others or the public. You may also consider having a committee of disinterested members of the board assume responsibility for the M & A transaction, or agree to act in an oversight capacity.

Other conflicts may exist too, for example, when there are multiple classes of stock, and the parties must allocate transaction consideration (and risk) among different groups of shareholders. Lawyers are sometimes asked by a majority or minority shareholder to assess or protect its individual interests. A lawyer should be on the lookout for diverging interests and reassess conflicts as cases move forward.

Diligence and discovery

Often, complying with requests during due diligence necessitates overcoming two client tendencies: under-sharing and over-sharing. A lawyer should take steps to instruct the client about what to provide—and what not to provide—without crossing ethical lines. After all, the goal is to complete the sale. As such, there is a certain skill and often a bit of strategy that must be employed in determining what to produce on the spectrum of absolutely everything that might potentially be responsive (e.g., all the dirty laundry) to nothing more than is unequivocally requested (i.e., "buyer beware").

A client's misunderstanding about the scope of material to provide in due diligence does not equate to consent. It is incumbent upon a lawyer to ensure that the client provides responsive documentation without surrendering potentially negative information that is beyond the scope of what has been requested or lawfully required.

Supervision of subordinate lawyers

It is often both practical and cost-effective to delegate review of documentation to associates or paralegals. It is important, however, to keep in mind both the relative experience and thoroughness of those individuals.

Under RPC 5.1(b), a lawyer is responsible for the unethical conduct of another lawyer working under their supervision if they know

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Ethical traps *Continued from page 7*

of the subordinate lawyer's conduct at a time when its consequences could be avoided or mitigated, but they failed to take reasonable remedial action. RPC 5.3(a) & (b) impose similar requirements for non-lawyers working under your direction. This means that a lawyer may be subject to discipline if they do not ensure the subordinate lawyer acts in accordance with the ethical obligations under the Rules of Professional Conduct. See, e.g., *In re Kang*, 32 DB Rptr 191 (2018). In that case, the respondent managing partner was suspended for 60 days when he assigned a new associate to a pending personal injury client's matter, and almost immediately—without contacting the client or obtaining his approval—the associate made an offer to settle the case, which was accepted. See also *In re Taylor, 23 DB Rptr 151 (2009) and In re Idiart, 19 DB* Rptr 316 (2005) in which both were publicly reprimanded for delegating tasks to non-lawyer staff without making reasonable efforts to ensure that the staff's conduct was compatible with the disciplinary rules.

In addition to the licensing ramifications, such delegation of seemingly mundane tasks can be financially costly as well. See, e.g., "Are Attorneys Responsible For $600M 'Stupid' Mistake?" *Above the Law* (Mar 3, 2022).

Other tasks, however, are not so mundane (such as due diligence and disclosure schedules, an area often tasked to associates), and a lawyer should take care to make sure associates new to the area understand their obligations.

Planning for post-closing privilege issues

If XYZ is transferred and incorporated into ABC, a common question arises following closing in regard to whether ABC could or would claim the attorney-client privilege and demand the lawyers' communications with XYZ prior to and during the transaction. Given that they now have become XYZ (or rather XYZ has become ABC), they may be entitled to this information. Even more potentially concerning is what ABC might do with this information, and whether they elect to treat it differently than did the XYZ management. For example, the XYZ managers and directors would not waive privilege in a government investigation or suit because they may have personal liability; ABC, however, may not care).

There are two primary categories of privileged documents to consider: (1) those communications relating to the business operations of the selling business, and (2) those communications relating to the negotiation of the merger or transaction. Jurisdictions vary on how they approach the continued confidentiality of both categories. A lawyer may want to consider whether to include a provision in the final documentation regarding where the privilege lies post-closing. Privilege questions, however, are complicated and we recommend that a lawyer consult experienced counsel before doing so.

Conclusion

While seemingly fraught with peril, the M & A process is challenging and rewarding work that requires careful analysis and sometimes creative approaches to "make the deal." Understanding the motivations and goals of the participants is key to avoiding personal civil liability, as well as a disciplinary proceeding by the Oregon State Bar or the Securities and Exchange Commission. ◆

Job Postings

Buckley Law

Shareholder—Real Estate

Buckley Law is looking for a real estate attorney (primarily residential) or small team to add to our group. An established real estate attorney transitioning practice within the next two years is looking for a shareholder/partner-level attorney to take over a high-volume practice.

The ideal attorney (shareholder) will have 8+ years as a practicing attorney with experience in real estate transactions and litigation and an ability to manage a larger volume of cases.

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Extrinsic Evidence—
The Modern Use of the Parol Evidence Rule

By Aukjen Ingraham and William J. Ohle, Schwabe Williamson & Wyatt PC

Aukjen Ingraham, a Shareholder at Schwabe, Williamson & Wyatt PC, is an experienced litigator with more than 17 years of experience in administrative, state, federal, and appellate courts. Her experience spans healthcare, product liability, and transportation litigation.

Wlliam Ohle, a Shareholder at Schwabe, Williamson & Wyatt PC, has more than 20 years of experience representing clients in construction defect and housing accessibility claims. Before joining Schwabe, he served as in-house counsel for a publicly owned electrical, water, and wastewater utility company.

The parol evidence rule, sometimes referred to as "the dreadful parol evidence rule," is often confusing and, in the modern usage with so many exceptions, it is easy to question whether it has any continuing relevance. That is, can a rule of written contracts, with its origins in the Middle Ages, still have any function in a time when contracts are discussed and negotiated, and forever preserved, in emails, texts, and other nearly endless emerging communications technologies?

First, the parol evidence rule is not strictly a rule of evidence, it is both a rule of substantive contract law and a rule of admissible evidence. It is intended to both define the relationship between the parties substantively and dictate what evidence a court or jury can consider when interpreting the language of a written contract.[1]

Going back—way back—to the days of the Norman Conquest (1066) and the beginnings of the English Common Law we have inherited, there was no parol evidence rule.[2] As one would expect, very little was in writing, because very few people knew how to write. The rule, in fact, was that even if an agreement had written evidence, the testimony of live witnesses was still required to establish both the existence of the contract and the terms.

This slowly changed over the next six centuries by way of the use of seals to make written statements undeniable, the invention of the printing press, the overall increase in literacy, and the need to document enforceable transactions over an ever-expanding empire. Eventually, the English Parliament enacted the Statute of Frauds in 1677, which began the modern age of written-document superiority—at least when it came to the requirement that certain contracts must be in writing (e.g., real property, sureties, marriage, and contracts for longer than a year). While the Statute of Frauds itself was quite limited, it codified a distinct change of attitude in the Common Law that quickly spread to all agreements that had been reduced to writing, and the development by the courts of the modern rule that agreements reduced to a final written document between the parties should prevail over their earlier "parol" (written or oral) discussions, even if those earlier discussions could form the basis of an enforceable contract.

The first mention of the parol evidence rule in Oregon cases is in 1881, and the case of *Smith v. Caro*,[3] in which the purchaser of a promissory note argued that at the same time as the endorsement over to him (the written agreement), the originally payee agreed orally that no demand must first be made on the maker before collecting from the payee. The trial court allowed the evidence of the parol modification to the blank endorsement on the note, but the Oregon Supreme Court rejected the evidence, concluding:

> But in our opinion the weight of authority greatly preponderates against the admission of parol evidence of an agreement between the parties to qualify or vary the contract of endorsement, whether it be made in blank or full. [Citing cases from England so old they have no year]. … The rule that parol evidence is not admissible to contradict or vary a written contract, is founded in the highest principles of public policy, and there is no class of contracts to which it should be more inflexibly applied than to those connected with bills of exchange and promissory notes.

In Oregon, the parol evidence rule is codified in ORS 41.740. The language of the statute goes back well over 120 years,[4] but with some modification, renumbering, and changing interpretation:

> When the terms of an agreement have been reduced to writing by the parties, it is to be considered as containing all those terms, and therefore there can be, between the parties and their representatives or successors in interest, no evidence of the terms of the agreement, other than the contents of the writing, except where a mistake or imperfection of the writing is put in issue by the pleadings or where the validity of the agreement is the fact in dispute. However this section does not exclude other evidence of the circumstances under which the agreement was made, or to which it relates, as defined in ORS 42.220 (Consideration of circumstances), or to explain an ambiguity, intrinsic or extrinsic, or to establish illegality or fraud. The term "agreement" includes deeds and wills as well as contracts between parties.

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Despite the strict application of the parol evidence rule in old cases, à la *Smith*, the modern application of the rule has rendered it almost meaningless, especially when determining if a writing is "final" or a contract term is "ambiguous." For example, in *Berger v. Stephan*, the Oregon Court of Appeals ruled:

> The prerequisite to application of the parol evidence rule, that the agreement be "integrated," means that the agreement is one that the parties intended to be a final expression of some or all of the terms of the agreement. … The parol evidence rule applies only to those aspects of a bargain that the parties intend to memorialize in such a writing. It does not come into play if the parties do not intend the writing to embody their final agreement, or when they intend the writing to contain only part of their agreement. … To determine whether a contract is integrated, the court may consider all relevant evidence, including parol evidence. … If the court determines that the writing is not integrated because it is not a full expression of all or some of the terms of the agreement, the extrinsic evidence is admissible.[5]

Thus, if there is parol evidence of a side agreement or additional terms to a contract, that evidence is admissible regardless to show that the written agreement is not "final," and therefore, the parol evidence rule does not apply. The issue then is not whether the parol evidence can be considered, but whether it exists at all. If the evidence of a parol agreement or terms do not exist, the parol evidence rule is inapplicable, and if the evidence does exist, then the rule does not apply.

Similarly, parol evidence is admissible to show that an otherwise unambiguous contract term, when viewed only from the four corners of the document, is nonetheless ambiguous in light of the parties' discussions prior to finalizing the writing. The Oregon Court of Appeals in *Batzer Constr. v. Boyer*[6] concluded:

> [T]o determine whether a contractual provision is ambiguous, the trial court can properly consider the text of the provision in the context of the agreement as a whole and in light of the circumstances underlying the formation of the contract.

Again, in regard to the existence of an ambiguity, the question is not whether parol evidence can be considered, but whether there is parol evidence and the evidence itself supports an interpretation of the contract language different from the plain meaning of the written words themselves. If there is no parol evidence at all, or if the parol evidence is merely consistent with the meaning of the written document, then whether it can be considered or not is irrelevant. If it is relevant, then it is not barred by the parol evidence rule. In fact, in *Batzer Constr.* all the Court of Appeals determined was that the parol evidence was consistent with the written document and did not change a thing.

Therefore, the question must be asked, is the parol evidence rule dead? And the answer is no, not quite. The parol evidence rule can still apply and be effectively employed, if the parties expressly intend, in the written agreement, for the parol evidence rule to apply. This means using an integration clause. In *Warren v. Smart Choicde Payments, Inc.*,[7] the Court of Appeals in 2020 found persuasive the use of a "broad" integration clause when considering whether an arbitration requirement in an earlier agreement survived in a subsequent agreement. The integration clause stated:

> "There are no terms, conditions or obligations made or entered into by the parties other than as contained herein. This agreement, upon execution, shall supersede any and all other employment and compensation agreements between the Corporation and the Employee."

Under the terms of the new agreement with the above integration clause, and the fact that the new agreement expressly referenced the filing of lawsuits as opposed to arbitration to resolve disputes, the Court of Appeals found that the new agreement and the lack of an arbitration clause controlled over the old agreement. Still, despite what appears to be a clear and unambiguous agreement between the parties that the new agreement "superseded" all prior agreements, the Court of Appeals only "assumed" the new contract to be "partially integrated," leaving open the possibility that on the merits of the dispute, the court could determine that other provisions of the earlier agreement were still applicable. Of course, to make such a determination, the court would likely consider parol evidence.

If there is any moral to this story, it is that one cannot rely on a written contract or the parol evidence rule to shield a party from the consequences of what is said in negotiations or other agreements. Careful contract drafting and the use of integration clauses can help, but so can clear documentation of the negotiations and the line of communications. A clever lawyer will always find a way to get parol evidence in front of the court. The only real question is whether that evidence will help or hurt. The advice every lawyer should give their client when embarking on contract negotiations is to always keep in mind that everything said or put in writing, whether letter, email, text, or whatever, will find its way to the judge, arbitrator, or jury, in a dispute, and those statements or writings will have consequences. ◆

Endnotes

1. *Berger v. Stephan*, 241 Or. App. 399, 410 (2011).
2. John H. Wigmore, "A Brief History of the Parol Evidence Rule," 4 *Colum. L. Rev.* 5, p. 338 (May, 1904).
3. 9 Or. 278 (1881).
4. See, e.g., *Long v. Smith Hotel, Co*, 115 Or 306 (1925) (citing O.L. Section 713, predecessor to ORS 41.470); *Hinderman v. Edgar*, 24 Or. 581 (1888) (citing Oregon Code 692, predecessor to O.L. Section 713).
5. 241 Or. App. 399, 410-11 (2011) (internal citations omitted).
6. 204 Or. App. 204, 317 (2006).
7. 306 Or. App. 634, 641 (2020).

2022 Business Law Update

OSB CLE Seminar cosponsored by the Business Law Section

Wednesday November 2, 9:00 AM–12:10 PM; and Thursday, November 3, 9:00 AM–1:20 PM
Live Webcast

Day 1 – November 2, 2022

Cautionary Advice Related to Securities for Business Attorneys

- Basics of: (i) exemption to registration and (ii) adequate disclosure/avoiding material misrepresentations
- Broker-dealer exemption considerations
- Oregon securities liability for attorneys

Presenters:
Dan Keppler, Foster Garvey
Charmin Shiely, Schwabe, Williamson & Wyatt

Upcoming LLC Legislation: A Legislative Preview of Oregon's Version of the Revised Uniform Limited Liability Company Act

- Background of Oregon Law Commission's LLC Modernization Work Group
- Overview of The Revised Uniform Limited Liability Company Act (RULLCA)
- Comparison of RULLCA to Oregon's Current LLC Act
- Next Steps in the Legislative Process

Presenter:
Michael D. Walker, Samuels Yoelin Kantor, LLP

Employment Law Updates for Business Lawyers

Employment law is a fast-changing area that impacts every business sector. If your clients have employees, they have employment law issues.

Join members of the Markowitz Herbold employment team to learn about recent changes to the law that could impact your advice to your business clients, including pay equity, noncompetition and nonsolicitation agreements, and more.

Presenters:
Laura Salerno Owens, Markowitz Herbold
Kathryn P. Roberts, Markowitz Herbold

CLE Planning Committee

Melissa Jaffe
Anne Arathoon
Benjamin Kearney
Charmin Shiely
Matt Larson
Alee Soleimanpour

Day 2 – November 3, 2022

2022/2023 Intellectual Property Updates for Business Lawyers

- The alphabet soup of intellectual property agencies and how they differ
- New initiatives from a variety of organizations designed to incentivize diverse participation
- Common details that will trigger your need to consider intellectual property protections
- Easy ways to protect your clients

Presenter:
Melissa B. Jaffe, Law Offices of Melissa B. Jaffe, PC

Tax Update

- Tax issues coming out of the Inflation Reduction Act
- Brief update on Oregon state and local taxes
- Other Federal, state, and local hot topics and proposals

Presenters:
Dan Eller, Schwabe, Williamson & Wyatt
Alee Soleimanpour, Schwabe, Williamson & Wyatt

A Few of Our Favorite Things Business Lawyers Should Know about Bankruptcy

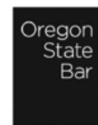
- Overview of the different types of bankruptcy filings
- Pre-bankruptcy issues for debtors and creditors to consider
- Opportunities that bankruptcy presents to businesses
- What is the automatic stay and how to make sure your client doesn't violate it

Presenters:
Ava Schoen, Tonkon Torp
Danny Newman, Tonkon Torp

Ethics in the Age of Social Media: the Dos and Don'ts In and Out of Client Disputes

Lawyers use social media every day, for personal use, to look up clients, to investigate jurors, and to market their legal services. There is no denying the benefits in using it—but there is risk as well. This presentation will review cases and ethics opinions to explore the dos and don'ts of using social media.

Presenter:
David J. Elkanich, Buchalter PC



Business Law Section

The mission of the Oregon State Bar Business Law Section is to provide excellent service to the diverse group of business law practitioners throughout the State of Oregon by providing regular, timely, and useful information about the practice of business law, promoting good business lawyering and professionalism, fostering communication and networking among our members, advocating improvement of business law, and supporting Oregon's business infrastructure and business community.

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