In-House Counsel Committee Newsletter

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WELCOME FROM THE CO-CHAIRS OF THE IN-HOUSE COUNSEL COMMITTEE

Alexandra Dapolito Dunn
adunn@amsa-cleanwater.org

Peter Wright,
pcwright@dow.com

Welcome to a new ABA year! Under the leadership of Section Chair Ken Warren, we believe the Section has a great agenda going forward for the rest of 2003 and into 2004.

First, by the time this reaches you, we will have had the pleasure of meeting and talking with some of you at this year's 11th Section Fall Meeting in Washington, D.C. The In-House Counsel Committee is proud of the piece of the Fall program we helped plan, entitled "My Big Fat Conflict of Interest: SEC Disclosure Rules/Impact on Environmental Lawyers." Our Newsletter Vice-Chair Jim Moore was a featured speaker on this program.

Under the leadership of Vice-Chair Raissa Kirk of Crown Central Petroleum in Baltimore, we are thrilled to report that our Committee now has two water quality projects with school children moving forward in Baltimore and Indianapolis. Through our public service project with Earth Force, we are truly helping young people discover and implement lasting solutions to environmental problems in their communities. Our work even received some press coverage in the Indianapolis paper! Be sure to read the article by Vicki Wright in our next Newsletter.

We hope that you might mark your calendar for the 33rd Conference on Environmental Law in Keystone, Colorado, March 11-14, 2004. Alex is part of the planning committee. The agenda is shaping up to be dynamic and packed with relevant topics to your practice.

Finally, planning is already underway for the 12th Section Fall Meeting to be held Oct. 6-10, 2004 in San Antonio, Texas. The Committee is proposing a panel for that meeting on innovative approaches to working with outside counsel. This practical, real world panel would discuss alternatives to hourly billing, preferred provider programs, temporary attorneys, on-site or dedicated counsel, and the like. If you are interested in potentially speaking on these topics, either from the in-house or outside counsel perspective, please let us know. Your input is important to us!

As always, we encourage you to get involved in our activities. Feel free to e-mail either of us, or any of the Committee vice-chairs, that you see listed throughout this Newsletter. Keep in touch!

In-House Counsel
Committee Newsletter
Vol. 7, No.1, December 2003
Jim Moore, Editor

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This newsletter is a publication of the ABA Section of Environment, Energy, and Resources, and reports on the activities of the committee. All persons interested in joining the Section or one of its committees should contact the Section of Environment, Energy, and Resources, American Bar Association, 750 N. Lake Shore Drive, Chicago, IL 60611.

EDITOR'S NOTE

Jim Moore
Huntsman Corporation
Jim_Moore@huntsman.com

We hope you enjoy this issue of the In-House Counsel Committee Newsletter. Please contact me with ideas, suggestions, and contributions for future editions. Articles are always appreciated. We also are interested in short news notes and information on the activities or life changes our members wish to share with the readership. In addition, any suggestions you have for changes in substance or approach will be gratefully accepted.

Feature Articles

We are including three feature articles in this edition of the newsletter that should be of interest to many in-house environmental lawyers.

The first article, authored by In-House Counsel Committee Co-Chair Peter Wright, addresses an issue important to lawyers that have anything to do with SEC disclosure issues –the responsibility that such lawyers have under the new rules, required by Sarbanes-Oxley, to raise compliance concerns to senior officers and possibly the Board of Directors. Peter wishes to remind readers that his article represents his opinions but not necessarily those of his clients.

The second article, "Making Your Intellectual Property Pay Off" was originally published in the March 2003 edition of *EM* magazine, a publication of the Air & Waste Management Association. Because it addresses the intersection of environmental and intellectual property law, we thought it to be of unique potential value to in-house environmental counsel. The author, Robert J. Lambrechts, is a licensed patent attorney and professional engineer.

The third article, authored by Committee Co-Chair Alexandra Dunn and Vice-Chair Tamar Cerafici, is entitled "Protecting Your Vulnerability Assessment." This article focuses on the post Sept. 11 challenges faced by public and private sector attorneys and managers in analyzing potential operational vulnerabilities and determining appropriate corrective steps. Congress has passed legislation, and federal agencies have developed regulations, directing or encouraging certain industrial and utility sectors to conduct vulnerability assessments (VAs) and in some cases to submit these documents to the government for review and safe-keeping. This article reviews the state of VA law and regulation post-Sept. 11, and discusses the protections that may exist for VAs. Tamar is in-house counsel at CH2M HILL and Alexandra is general counsel of the Association of Metropolitan Sewerage Agencies.

SARBANES OXLEY AND THE ENVIRONMENTAL LAWYER

Peter Wright
EH&S Special Projects Counsel
Dow Chemical Company
pcwright@dow.com

Introduction

In wake of the recent public-confidence-shattering corporate scandals, Congress adopted the Sarbanes Oxley Act of 2002 (the "Act"). Of special interest to both corporate and outside counsel who represent publicly traded companies are the SEC's regulations implementing Section 307 of the Act, 15 U.S.C. § 7245, whereby Congress required the SEC to establish standards of professional conduct for attorneys. The Rules were proposed on Nov. 21, 2002, adopted on Jan. 29, 2003, and became effective on Aug. 5, 2003. 17 C.F.R. Part 205 (Part 205 Rules). The Part 205 Rules and 60-plus page commentary from the SEC can be found at http://www.sec.gov/rules/final.shtml.

Overview of the SEC's Implementation of Section 307 Sarbanes Oxley

The basic obligation under the Act and the implementing Rules is for an attorney (in house counsel or outside counsel) to report up the ladder within the corporate law department if the attorney has credible evidence of a material violation of a federal or state securities law or breach of fiduciary duty. This obligation does not end with the report to the general counsel, referenced as the Chief Legal Officer (CLO). The attorney's reporting obligation does not end until the attorney receives an "adequate response" to the attorney's report. If the attorney does not receive an "adequate response" from the CLO, or if making such a report would be futile, the attorney must report to the CEO, and in the absence of an adequate response from the CEO, up to the audit committee or independent committee of the board or the full board.

In its initial proposal of the Rules, the SEC would not have limited the attorney reporting requirements to a report to the full board. The Part 205 Rules, as proposed in November 2002, contained a "noisy withdrawal" provision that would have required an attorney to let the SEC know of any withdrawal from representation for "professional reasons." Industry comments on the proposed Rules argued that the "noisy withdrawal" provision exceeded the SEC's statutory mandate under Section 307 of Sarbanes-Oxley and was inconsistent with the traditional attorney-client relationship. The SEC postponed action on the "noisy withdrawal" portion of the Rules and has not taken any final action on that issue to date.

The applicability and obligations of the Rules that are now in effect turn on a series of

defined terms. The Part 205 Rules apply to attorneys "appearing and practicing" before the SEC who have "credible evidence" of a "material violation" of U.S. or state securities laws or of a "material breach" of a fiduciary duty. The extent of an attorney's reporting obligations under the Rules depends in part on whether the attorney is a "subordinate" or "supervising attorney." The CLO has some more options with respect to fulfilling the CLO's reporting and responding obligations if the company has established in advance of an attorney's report a "Qualified Legal Compliance Committee" (QLCC). Thus, in order to understand the SEC's intentions, it is important to understand both the language of the regulatory definitions and the SEC's commentary on its Rules, which were prepared in response to the extensive comments. This article sets out and discusses key regulatory language along with highlights from the SEC's commentary on the Rules.

From a review of the Part 205 Rules, one can readily conclude that corporate law departments and law firms that counsel publicly traded corporations should consider in advance how to implement the requirements of Act and the Part 205 Rules. Indeed, many corporate law departments are now requiring their outside counsel to adopt specific procedures for the law firms to use if and when a report to the corporation under the Rules is to be made.

Reporting Up the Ladder

Under Section 307 (15 U.S.C. 7245) of the Act, the SEC was directed to

> . . . 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 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.

Section 307 has been implemented through the SEC's adoption of the Part 205 Rules. 17 C.F.R. Part 205.

To Whom Does Part 205 Apply?

The Part 205 Rules apply to those attorneys who are defined to be "appearing and practicing" before the SEC. *Id.* § 205.2(c). The SEC's definition is broad both in the scope of what legal activities are considered within the ambit of this definition and even who is considered to be providing legal services. *See, e.g., id.* § 205.2(a)(1)(iii). The ABA's comments expressed concern that the SEC's broad applicability definition would subject attorneys to the Rules who have very limited or tangential relationship to a company's dealings with the SEC.

Section 205.2 (a) & (c) provide as follows:

> (a) *Appearing and practicing* before the Commission:

> (1) Means:
>
> **…**
>
> (iii) Providing advice in respect of 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 the provision of such advice in the context of preparing, or participating in the preparation of, any such document;* …
>
> [emphasis added]

The SEC explains the intention of this definition as it applies to legal counseling (http://www.sec.gov/rules/final/33-8185.htm at page 5 of 73):

> This broad definition was intended to reflect the reality that materials filed with the Commission frequently contain information contributed, edited or prepared by individuals who are not necessarily responsible for the actual filing of the materials, and was consistent with the position the Commission has taken as *amicus curiae* in cases involving liability under Section 10(b) of the Exchange Act (15 U.S.C. 78j(b)).

An examination of the SEC filings of public companies that have in-house environmental lawyers and that regularly use outside counsel for environmental matters over the last decade or so will likely show a significant increase in the amount of management's discussion of various environmental matters. While the environmental lawyer may not have drafted the actual language that is filed with the SEC, an environmental lawyer likely had some important role in the preparation of much of the information that was reported.

The SEC's intent to have the Rules apply broadly to attorneys is also seen in the definition of the term "attorney" for the purpose of the applicability of the Rules. The SEC explained its intention as follows (http://www.sec.gov/rules/final/33-8185.htm at page 6 of 73):

> Under the final rule, attorneys need not serve in the legal department of an issuer to be covered by the final rule, but they must be providing legal services to an issuer within the context of an attorney-client relationship. An attorney-client relationship may exist even in the absence of a formal retainer or other agreement. Moreover, in some cases, an attorney and an issuer may have an attorney-client relationship within the meaning of the rule even though the attorney-client privilege would not be available with respect to communications between the attorney and the issuer.
>
> The Commission intends that the issue whether an attorney-client relationship exists for purposes of this part will be a federal question and, in general, will turn on the expectations and understandings between the attorney and the issuer. Thus, whether the provision of legal services under particular circumstances would or would not establish an attorney-client relationship under the state laws or ethics codes of the state where the attorney practices or is admitted may be relevant to, but will not be controlling on, the issue under this part.

This broad view with respect to which attorneys are providing legal services may be of concern to those environmental lawyers who have left the law department to go to a company's environmental management

organization or left private legal practice to join the ranks of the environmental consulting world.

When is Reporting Triggered?

As summarized above, the reporting up obligation is triggered when an attorney has material evidence of either a breach of a fiduciary duty or a material violation of a federal or state securities law. These terms are defined as follows in Section 205.2 (d), (e) & (i):

> (d) *Breach of fiduciary duty* refers to 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.
>
> (e) *Evidence of a material violation* means credible evidence, based 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.
>
> …
>
> (i) *Material violation* means a material violation of an applicable United States 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.

The SEC has providing the following explanation of its intentions and interpretation of the above definitions in response to the numerous comments that it received on the proposed rules (http://www.sec.gov/rules/final/33-8185.htm at page 12 of 73):

> Evidence of a material violation must first be credible evidence. An attorney is obligated to report when, based upon that credible evidence, "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." This formulation, while intended to adopt an objective standard, also recognizes that there is a range of conduct in which an attorney may engage without being unreasonable. The "circumstances" are the circumstances at the time the attorney decides whether he or she is obligated to report the information. These circumstances may include, among others, the attorney's professional skills, background and experience, the time constraints under which the attorney is acting, the attorney's previous experience and familiarity with the client, and the availability of other lawyers with whom the lawyer may consult. Under the revised definition, an attorney is not required (or expected) to report "gossip, hearsay, [or] innuendo." Nor is the rule's reporting obligation triggered by "a combination of circumstances from which the attorney, in retrospect, should have drawn an inference," as one commenter feared. [footnotes omitted]

Under the Commission's rule, evidence of a material violation must be reported in all circumstances in which it would be unreasonable 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. To be "reasonably likely" a material violation must be more than a mere possibility, but it need not be "more likely than not." If a material violation is reasonably likely, an attorney must report evidence of this violation. The term "reasonably likely" qualifies each of the three

instances when a report must be made. Thus, a report is required when it is reasonably likely a violation has occurred, when it is reasonably likely a violation is ongoing or when it is reasonably likely a violation is about to occur.

What Response is Required to Reporting?

The basic reporting requirement imposed by the Rule 205 requires a subordinate attorney to report information of a material violation or breach of a fiduciary duty to a supervisory lawyer. The supervisory lawyer in turn must report to the CLO. The CLO then needs to make an inquiry into the lawyer's report. The CLO must determine either that no violation or breach has occurred or that if such a violation or breach may or has occurred, the company has implemented remedial action to avoid or remedy the reported activity. The CLO also needs to make a timely and adequate response to the reporting attorney. A subordinate attorney's report to a supervising attorney can fulfill the subordinate attorney's obligation under Section 205.3. *Id.* § 205.5. An attorney may be considered a subordinate attorney if the attorney does not report directly to the CLO but, instead, reports to another attorney or is engaged in the matter by an attorney other than the CLO. *Id.* § 205.5(a). A subordinate attorney may, but is not required to, go above his or her supervising attorney with regard to reporting if the subordinate believes that the supervising attorney has not reported up the ladder or otherwise fulfilled his or her obligations under Section 205.3.

An attorney is a "supervising attorney" if the attorney is supervising or directing an attorney who is considered to be "practicing before the Commission." *Id.* § 205.4. A CLO is always considered a supervising attorney and so also is any attorney who reports directly to the CLO (*e.g.*, a deputy general counsel). A supervisory attorney is responsible both for having subordinate attorneys comply with Rule 205 and is responsible for reporting up a material violation when a subordinate attorney has reported such to the supervising attorney.

A reporting attorney has the ability to bypass levels of management and ultimately report directly to a company's Board committee or full Board in making the report if the attorney believes reporting to the intervening layers of management (*e.g.*, CLO, CEO) would be futile. The reporting attorney is in fact obligated to report further up the management chain in the event the attorney believes the CLO or CEO has not provided an adequate response to the attorney's report in a timely manner.

If a company has established in advance a "qualified legal compliance committee" (QLCC) (*see id.* § 205.2(k), which sets out specific requirements that must be satisfied in order be a QLCC), a reporting attorney can make a report to the QLCC and have no further obligation. Similarly, a CLO can make a report to the QLCC and inform the reporting lawyer of having made such a report to the QLCC, and then the CLO will have satisfied his or her reporting obligations. The matter than will be for the QLCC to investigate and act upon. The Rules also address the reporting obligations of attorneys who are brought in to investigate matters by the CLO or the QLCC. *See id.* § 205.3(b)(7).

The CLO's obligations upon receiving an attorney's report are set forth in the Rules (*id.* § 205.3(b)(2)) as follows:

> (2) The chief legal officer (or the equivalent thereof) shall cause such inquiry into the evidence of a material violation as he or she reasonably believes is appropriate to determine whether the material violation described in the report has occurred, is ongoing, or is about to occur. If the chief legal officer (or the equivalent thereof) determines no material violation has occurred, is ongoing, or is

> about to occur, he or she shall notify the reporting attorney and advise the reporting attorney of the basis for such determination. Unless the chief legal officer (or the equivalent thereof) reasonably believes that no material violation has occurred, is ongoing, or is about to occur, he or she shall take all reasonable steps to cause the issuer to adopt an appropriate response, and shall advise the reporting attorney thereof. In lieu of causing an inquiry under this paragraph (b), a chief legal officer (or the equivalent thereof) may refer a report of evidence of a material violation to a qualified legal compliance committee under paragraph (c)(2) of this section if the issuer has duly established a qualified legal compliance committee prior to the report of evidence of a material violation.

The reporting attorney needs to make his or her own determination about whether the CLO's response to the reporting attorney is both timely and adequate. The SEC explained its intention with respect to the evaluation to be made by the reporting attorney, as follows (http://www.sec.gov/rules/final/33-8185.htm at page 9 of 73):

> The term "reasonably believes" is defined in Section 205.2(m). In providing that the attorney's belief that a response was appropriate be reasonable, the Commission is allowing the attorney to take into account, and the Commission to weigh, all attendant circumstances. The circumstances a reporting attorney might weigh in assessing whether he or she could reasonably believe that an issuer's response was appropriate would include the amount and weight of the evidence of a material violation, the severity of the apparent material violation and the scope of the investigation into the report. While some commenters suggested that a reporting attorney should be able to rely completely on the assurance of an issuer's CLO that there was no material violation or that the issuer was undertaking an appropriate response, the Commission believes that this information, while certainly relevant to the determination whether an attorney could reasonably believe that a response was appropriate, cannot be dispositive of the issue. Otherwise, an issuer could simply have its CLO reply to the reporting attorney that "there is no material violation," without taking any steps to investigate and/or remedy material violations. Such a result would clearly be contrary to Congress' intent in enacting Section 307. On the other hand, it is anticipated that an attorney, in determining whether a response is appropriate, may rely on reasonable and appropriate factual representations and legal determinations of persons on whom a reasonable attorney would rely.

These reporting requirements may place in house attorneys below the general counsel in the apparent position to second guess the timeliness or appropriateness of the general counsel's response. In response to the potential for an attorney to have to commit what might be seen as a career limiting move by reporting over the head of the general counsel, or reporting in the first place, the Rules allow the discharged attorney to address the attorney's termination directly to a company's board. Section 205.3(b)(10) provides:

> An attorney formerly employed or retained by an issuer who has reported evidence of a material violation under this part and reasonably believes that he or she has been discharged for so doing may notify the issuer's board of directors or any committee thereof that he or she believes that he or she has been discharged for reporting evidence of a material violation under this section.

The SEC has explained (http://www.sec.gov/rules/final/33-8185.htm at page 28 of 73) that this provision directed at the terminated attorney is

> . . . an important corollary to the up-the-ladder reporting requirement, is designed to ensure that a chief legal officer (or the equivalent thereof) is not permitted to block a report to the issuer's board or other committee by discharging a reporting attorney.

It remains to be seen whether this provision will provide any comfort to attorneys who have had to report up the ladder over the head of the general counsel or whether these Rules and their obligations and complexities will seem more like a journey down the rabbit hole.

Some Preliminary Observations

The simple overview of the Rules, which requires the reporting up the ladder of possible misdeeds of individuals employees and officers and continuing to do so until an appropriate response is obtained, will not strike many in-house attorneys as a dramatically different obligation than what is already imposed upon an in-house lawyer by the ethics rules that make clear that the lawyer represents the organization. *See, e.g.*, ABA Model Rule 1.13. This seems to be one of the essential aspects of representing the entity as an organization. Furthermore, it is common in most hierarchical organizations for significant information to be reported up the hierarchy in some fashion.

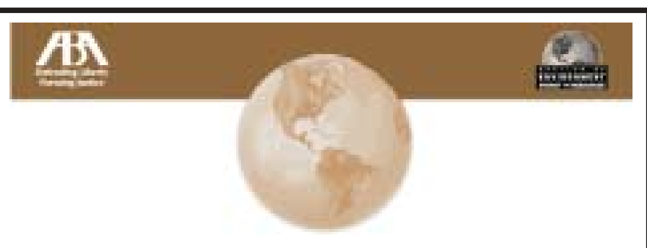
If one believes that most attorneys take to heart the existing ethical rules related to representing the organization and that most corporations do not have the kind of management and corporate cultures exhibited by some of the corporations that inspired the Act, then the SEC's Rules would appear to be unlikely to cause a significant change in reporting-up situations and ultimately in the role and relationship of both in-house and outside counsel to the corporate client. Yet, in practice the Act and Rules may prompt more changes than would be apparent from comparing the existing ethical rules to the requirements of the Rules. These changes may come about because both corporations and their law firms institute more elaborate internal rules and procedures for addressing the reporting obligations. For example, will general counsel of large corporate law departments receive more reports of possible misconduct, that before the Rules, might have been handled entirely at a lower level within the law department?

These Rules and the degree to which they provoke new operating procedures may highlight some of the awkward and difficult aspects of the relationship of in-house and outside counsel to the corporate client. Most in-house counsel only rarely find themselves in situations where they have to remind the company's officers and employees with whom counsel works every day that the lawyer's real client is the corporation and not them personally. The Rules and a company's response to the Rules may cause some clients to reconsider how and when they will involve in-house counsel in particular discussions and matters. For example, some clients may be concerned that involving a lawyer in a matter in the early stages might trigger a report up the ladder prematurely from the client's point of view.

The reporting up the ladder situation may be even more difficult for outside counsel. For example, many outside counsels' principal relationship to a corporation is based on a personal connection with the general counsel, or with certain high level executives, or with the plant manager of a local plant or branch. Going up the ladder may be perceived as harming the personal relationship if, for example, the law firm disagrees with the general counsel's handling of a report. In

addition, many outside counsel may not really have a good understanding of the company's formal and informal management reporting relationships, which might be crucial to how a report up the ladder is perceived. The Act and Rules might remedy the not uncommon situation where an outside lawyer does not know whether the corporation followed the lawyer's advice. Arguably, outside counsel will now be compelled to at least inquire about the status of report made to the CLO under the Rules.

It will also be interesting to see how many corporations adopt QLCCs. The SEC, as part of the cost estimate section of the Rules, predicted 20 percent of companies subject to the Rules might adopt QLCCs. At first glance the QLCCs appear to present a number of procedural benefits to companies. Yet companies will likely weigh the procedural benefits against the burdens imposed on the board members who would serve on the QLCC and concerns for adding a new mechanism into a scheme for corporate governance that may already be working quite well for a company.



IN-HOUSE COUNSEL COMMITTEE NEWSLETTER

We hope you enjoy this issue of the In-House Counsel Committee Newsletter. If you would like to lend a hand by writing, editing, identifying authors, or identifying issues for the Newsletter, please contact the editor Jim Moore at 801/584-5700 or jim_moore@huntsman.com.

MAKING YOUR INTELLECTUAL PROPERTY PAY OFF

Robert J. Lambrechts
Lathrop & Gage L.C.
Kansas City, Missouri

Many companies that offer environmental products and services are experiencing a dip in revenue streams because of the economic recession and the maturation of the laws impacting the environment. For those of you who are challenged to find ways to replace these diminishing returns, consider converting your company's environmental intellectual property – ideas, inventions, innovations, patents, and processes – into commercial technologies.

The demand for innovative and environmentally friendly production processes is ever increasing. With advances in cleanup practices in the past two decades, even the remediation of contaminated industrial properties has undergone revolutionary changes. Many of these innovations are patent-protected by the U.S. government, which gives the inventor a monopoly on his/her invention and excludes others from using it. Not only does the U.S. Patent Office accord special status to patents relating to environmental quality, the U.S. Environmental Protection Agency (EPA) also recognizes the significance of stimulating growth in this area. In February 2002, EPA hosted a workshop in Philadelphia to help small businesses convert environmental ideas, innovations, patents, and processes into commercial environmental technologies. Small Business Workshops; *Solid Waste Report,* Feb. 8, 2002; Vol.3 (6).

In the past several years, a number of companies have successfully secured intellectual property protection on their environmentally related inventions.

- Environmental Technology Unlimited

Corp. announced on Oct. 6, 2000, that it had successfully completed a demonstration to the New York State Department of Environmental Conservation and US EPA of its patented Methex Solvent Extraction System for the removal of PCB-contaminated soil sediment. During the demonstration, the company reduced levels of polychlorinated biphenyl (PCB) contamination in soil to less than 0.15 parts per million (ppm), far exceeding the most stringent cleanup levels mandated by New York and EPA. The company patented Methex7, a system for cleaning soil as well as mixed waste. See U.S. Patent Nos. 5,986,147; 5,895,876; 5,779,813; and http://www.environmental technologyinc.com/news.html.

- Bion Environmental Technologies Inc., a developer of livestock waste management systems, patented a "process." See U.S. Patent Nos. 5,472,472 and 5,078,882. Founded in 1989, the company develops technology for livestock waste management. The patent claims that the process uses biological processes that safely convert animal waste into nutrient-rich soil and fertilizer products that are valued for their high-level organics, slow release nutrients, and odorless characteristics.

- Environmental Research Corporation developed a biodegradable fence, called Biofence, which is used to protect bodies of water from runoff resulting from construction and other erosion problems. Biofence is used by general contractors to protect roads and wetlands and the company claims that the organic fence breaks down and disappears in two years. In 1999-2000, Biofence was laid along a 1200-mile stretch of New Jersey highways in one of the country's largest erosion control projects. The burlap, aspen, wood stakes, and soy-based paint used for the project have since disintegrated into the soil. Rapoza, K. Firm Develops Biodegradeable Fence Product Protects Water from Runoff, Decomposes; *Boston Globe*, Dec. 23, 2001.

- Environmental technology and specialty chemical company, ADA-ES, a subsidiary of Earth Sciences, developed a fluxing additive, ADA-249, that has been successfully used in utility coal-fired boilers. This patented product is designed to help utilities improve combustion of cheaper western coals from the Powder River Basin in cyclone boilers designed to burn eastern bituminous coals. ADA-ES Trumpets New Chemical: *Electric Light and Power,* Nov. 1, 2000; Vol. 78(11). Also see http://www.adaes.com/fluxing.htm.

How Do I Protect My Intellectual Property?

Generally speaking, there are two options for protecting an invention: (1) you can seek patent protection or (2) you can maintain it as a trade secret. (How easily the invention can be reverse-engineered or duplicated will determine whether maintaining it as a trade secret is a prudent option.) Any formula, pattern, compilation, program, device, method, technique, or process that is used in your business can be a trade secret. However, certain types of information are not given trade secret protection because they lack the required competitive "economic" value in your business operation to provide an actual or potential economic advantage over others who do not possess the information. The advantage, however, does not need to be great. It is sufficient if the secret provides an

advantage that is just more than trivial. Novelty, in the patent law sense, is not required for a trade secret. However, some degree of novelty will be required because if something does not possess novelty it is usually known; thus, secrecy, in the context of trade secrets, implies "minimal novelty." A trade secret does not have to be patentable to qualify for trade secret protection.

The existence and maintenance of secrecy is probably the single most important factor in determining whether or not to accord trade secret protection to information. Information that is readily available to the public, generally known in the trade or readily discernible from a product, does not qualify for protection. Sometimes employees are given access to trade secret information on a need-to-know basis. In this situation, it is extremely important that the company takes all necessary steps to protect this information. Having employees sign confidentiality agreements, or restrictive "non-competition" covenants, is one way to maintain trade secret protection. However, a company may still be entitled to trade secret protection if the employees who are not required to sign confidentiality agreements (*i.e.*, those who do not present a significant risk to the company) reveal trade secret information. In this situation, even with the absence of a written agreement, a confidential relationship can be implied under a number of state laws. However, to imply such obligation, it must be shown that there was an expectation of confidentiality. Some companies implement rather extreme precautions to prevent disclosure of their trade secrets. For example, the Coca-Cola secret ingredient is shipped to Coca-Cola bottlers all over the world, but it has yet to be successfully analyzed in spite of modern analysis techniques.

If the invention can be reverse-engineered or duplicated, it would be wise to seek patent protection. The patent laws offer protection for new, non-obvious, and useful inventions, such as machines, devices, chemical compositions, and processes. A patent gives one the right to exclude others from making, using, selling, offering to sell, importing, or, in some circumstances, exporting components of the claimed invention in the United States for 20 years. To obtain a patent, you must file an application with the U.S. Patent and Trademark Office (www.uspto.gov/main/patents.htm). Your application must include what is commonly called a "specification," describing what it is to be patented. You must precisely "claim" the invention. Your claim must point out and distinctly claim the subject matter that you regard as your invention. Your claim ultimately defines the scope of the protection of the patent. Whether you are granted a patent or not is, for the most part, determined by your choice of wording.

The Patent Office will assign your application to an examiner with knowledge in relevant technology to conduct a search of the prior art. The examiner will determine whether your invention complies with the legal requirements of patentability: novelty, utility, non-obviousness, an enabling disclosure, and adequate written specification. If the examiner believes your claims, and the rest of the specifications comply with the law, then a patent is granted. The U.S. patent system is unique among patent systems of the world in that it awards patents among competing inventors by the "first to invent," rather than the "first to file a patent application." In other words, the U.S. patent system seeks to reward the actual first inventor, rather than the winner of a race to the Patent Office.

Patent Inventorship Versus Ownership

It is important to distinguish the issue of inventorship for patent law purposes from the issue of ownership of patent rights in an invention. Inventorship provides the starting point for determining ownership of patent

rights, since an application for a patent must be made by, or on behalf of, the inventor or inventors. Absent an assignment of the patent rights, the individual inventor owns the right to apply for and obtain a patent. Joint inventors jointly own that right. Disputes about ownership may arise even though inventorship may be undisputed. For example, under a contract, an employer may claim ownership of an invention by an employee even though the employer admits that the employee is the sole inventor.

Special Status for Environmentally Friendly Inventions

The U.S. Patent Office accords special status to seven categories of inventions. Special status allows certain applications to be examined out of turn by the Patent Office ahead of applications that may have been filed earlier. The seven categories are inventions pertaining to energy, recombinant DNA, superconductivity, HIV/AIDS and cancer, countering terrorism, inventions relating to biotechnology filed by applicants who are small entities, and inventions relating to environmental quality. Inventions relating to environmental quality are defined as those that seek to materially enhance the quality of the environment by contributing to the restoration or maintenance of the basic life-sustaining natural elements (*i.e.*, air, water, and soil). 37 CFR 1.102 and *Manual of Patent Examining Procedure,* Section 708.02, Subsection V. Environmental Quality, August 2001.

Advancing a patent application out of turn may not seem like a big deal, but when one considers that the average time from the filing of a patent application to the granting of a patent is approximately two years, one can see that any acceleration of the process would be beneficial. *Performance and Accountability Report Fiscal Year 2002*; U.S. Patent and Trademark Office: Washington D.C., 2002.

The patent examination process, known as patent prosecution, can feel like an eternity when an applicant is watching the market for their product shift against or in favor of their invention. In 2002, 333,688 utility patent applications were filed with the U.S. Patent Office; that is more than three times the 96,847 patent applications filed in 1983, and almost double the 171,623 applications filed in 1992. *Id.;* U.S. Patent and Trademark Office: Washington, D.C,. 2002; available at http://www.uspto.gov/web/offices/com/annual/2002/93-140.pdf. More and more patent applications, in all areas of technology, are being filed each year; and there does not appear to be any slowdown in the foreseeable future. The Patent Office is attempting to keep up with the surge in filings by hiring additional examiners and by enhancing, through electronic means, the application and examination process; however, it is a challenging task and the backlog of more than 636,500 pending applications will not be quickly dispatched.

Patent Pending

After an application is filed with the U.S. Patent Office, the applicant is entitled by law to use the terms “patent pending” or “patent applied for” on the invention. These terms are used by manufacturers to inform the public that an application for patient is on file with the Patent Office. The law imposes a fine on those who use these terms falsely to deceive the public. Even though a patent has not yet been granted, the applicant is still accorded some limited measure of protection following publication of the application by the Patent Office.

Commercializing the Invention

Once one decides to pursue a patent, the next step is to commercialize the invention. The patent applicant/holder can manufacture or use the invention, assign the rights to

someone else, or license one or more individuals or entities to make, use, or sell the invention. If the holder/applicant does not have enough capital to invest in the commercializing of the invention, assigning or licensing it can be attractive options.

In 2001, U.S. patent licensing revenue reached approximately $130 billion, and the average licensing value of a patent was approximately $216,000. "Licensing Portfolio Evaluation: Recognizing IP Value," in *Practicing Law Institute, Patents, Copyrights, Trademarks, and Literary Property Course Handbook Series* (Practicing Law Institute, New York City, 2001). IBM is a recognized leader in extracting the most value from its patents. The company has learned that intellectual property is easily undervalued and that a persistent, professional, and reasonable program can yield surprising results. The sheer magnitude of IBM's patent royalties reveals that the company has been very diligent in managing and commercializing its innovations.

How to Value Your Intellectual Property

Those sophisticated in the realm of intellectual property recognized that using professionals to assist in the valuation or evaluation of the property can be critical to the success of licensing programs. Professional valuation of intellectual property attempts to define with precision the financial worth of an asset using various methodologies, including the income approach, cost or replacement method, and the reasonable royalty approach. The income approach estimates the incremental cash flow (*i.e.*, revenue less investment, less expenses) attributable to the intellectual property and discounts it to present value. The cost method measures the value of the resources needed to create the intellectual property. This method contains no information or inputs from the market or from cash flow. It is most useful when one is evaluating new technologies, where potential buyers have little choice but to purchase the technology at the price offered or spend the time and expenses to re-create it themselves. With the reasonable royalty method, a reasonable royalty rate is obtained from comparable intellectual property that has been licensed. The resulting royalty stream, adjusted for tax effects and any associated costs, is then discounted back to present value, as in the income approach. Other more complex valuation methodologies, such as the real option method, may be utilized but are well beyond the scope of this article. Evaluation, which is distinct from valuation, of intellectual property is an expert opinion, based on analysis and experience, that identifies particularly valuable property and attempts to explain why the property has value and how that value might be exploited.

Business Method Patents

In the 1998 case of *State Street Bank & Trust Co. vs. Signature Financial Group*, the Federal Circuit Court of Appeals decided that business methods could be patented if they produce useful, concrete, and tangible results. The court's opinion did not define what a business method patent is; however, one might attempt to define a business method patent as the reduction of a mathematical concept to some practical application rendering it useful. As a result of the decision, the so-called business method patent has now emerged as a special breed of patent.

Since the *State Street Bank & Trust Co.* case, the Patent Office has experienced substantial growth in patent application filings for computer-implemented processes related to electronic commerce. Applications for software-implemented business method patents grew from 170 in 1995 to 7800 in 2000. In 2000, the Patent Office issued 899 business method patents. That number continues to grow with each passing year.

An example of a business method patent with direct application to the environmental arena is U.S. Patent 6,336,096, issued on Jan.1, 2002. Entitled *System and Method for Evaluating Liability*, this patent describes the invention as a system and method of evaluating liability among multiple potentially responsible parties and their insurers. The patent claims a system for arranging for settlements at toxic sites between potentially responsible parties and insurers and, in appropriate cases, settlements of one or more underlying environmental claims. The system purportedly eliminates fragmentation in effecting settlements and handles the interdependence among the parties. According to the patent, the system works as follows: data are gathered, relationships among the data are calculated, a coverage law adjustment factor is applied to the data, allocation and choice of law principles are applied, groupings among the multiple parties and sites are identified based on the apparent settlement potential as identified through the systems' various relationships, and a qualitative decision pertaining to the likelihood of outcome is proposed to the parties within the identified groupings.

Another example of a business method patent with environmental law implications is U.S. Patent 6,253,191, issued on June 26, 2001. Entitled *Brownfields Investing,* the patent describes the invention as a system and method for investing in brownfields-related projects and is capable of supporting all aspects of a brownfields remediation/ redevelopment project, while shielding investors from environmental liability. The patent claims a method for non-recourse, participating capital investments for specific brownfields projects, according to fund investment criteria determined by a fund manager. According to the patent, the investor's risk of incurring environmental liability is substantially reduced by ensuring that the fund is completely passive with respect to the brownfields project (*i.e.*, taking no security or mortgage interest in the brownfields property).

These are just two of numerous examples of non-traditional patents that have evolved with intellectual and technological advances. Patent law has expanded well beyond protecting just tangible widgets and now protects systems and methods of doing business that, if appropriately claimed within a patent, can provide the inventor with a significant revenue source. The importance of the patent system in today's business world cannot be overstated. The grant of a single patent can provide the owner with a powerful competitive advantage. Patents can be used to exclude competitors from lucrative markets or to generate substantial income through licensing. An individual or company is in a position to control the use of the patented technology for the duration of the patent term.

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PROTECTING YOUR VULNERABILITY ASSESSMENT

Alexandra Dapolito Dunn
General Counsel, Association of Metropolitan Sewerage Agencies

Tamar Jergensen Cerafici
CH2M HILL

Although more than two years have passed since the Sept. 11, 2001 terrorist attacks, public and private sector attorneys and managers continue to assist their clients in reviewing potential vulnerabilities and determining appropriate corrective steps. Congress has passed legislation, and federal agencies have developed regulations, directing or encouraging certain industrial and utility sectors to conduct vulnerability assessments (VAs) and in some cases to submit these documents to the government for review and safe-keeping. Any public or private entity conducting a VA, either under a mandatory or discretionary duty, is compelled to reflect on the ultimate handling of a sensitive deliberative document that likely will contain information, facts, and opinions not wholly appropriate for distribution. This article reviews the state of VA law and regulation post-Sept. 11, and discusses the protections that may exist for VAs.

VA Requirements under Federal Law and Regulations

The first post-September 11 legislation addressing VAs was Title IV of the Public Health Security and Bioterrorism Preparedness and Response Act of 2002 (Bioterrorism Act), which President Bush signed into law June 12, 2002. Public Law 107-188, 107th Congress. This Title, which amends the Safe Drinking Water Act, mandates each community water system serving a population of greater than 3,300 persons to conduct an assessment of the vulnerability of its system to a terrorist attack or other intentional acts intended to substantially disrupt the ability of the system to provide a safe and reliable supply of drinking water. This legislation set precedent for mandatory VA submittal, made the U.S. Environmental Protection Agency (EPA) – a public health, non-security oriented agency – the recipient of the information, and included federal funds for the assessment. Under the statute, water systems must certify that their VA is completed and submit a written copy of it to EPA. The statute contains rolling deadlines, which made VAs due March 31, 2003 (for large systems serving a population of 100,000 or more), and will make additional VAs due Dec. 31, 2003 (systems serving a population of 50,000 or more but less than 100,000), and June 30, 2004 (for those systems serving a population greater than 3,300 but less than 50,000).

The U.S. Coast Guard (with the Department of Homeland Security [DHS]) and the U.S. Department of Transportation also require VAs, through the Maritime Transportation Security Act of 2002 (MTSA) and the Homeland Security Act, respectively. The Coast Guard requires VAs and the resulting plans for ports, facilities, and vessels. They must be in place no later than December 2003. 68 FR 39240, July 1, 2003. The DOT requires VAs and plans from shippers, carriers, and those who store or “offer for shipment.” They must be in place and implemented by Sept. 26, 2003. 68 FR 14509, March 25, 2003.

The Wastewater Treatment Works Security Act of 2003 (S. 1039), pending in the Senate, would require publicly owned treatment works (POTWs) to certify that they have conducted VAs. The nearly identical H.R. 866 cleared the House by a vote of 413 -2 in May. Both bills include funding for security enhancements at POTWs. However, at this time the bill is stalled in the Senate

Environment and Public Works Committee due to a clear difference of opinion between the Committee members over whether VA submission to EPA should be mandatory, or whether POTWs should certify that the VA is complete.

Also pending in the Senate is S. 994, the Inhofe/Miller Chemical Security Act. This bill, which would regulate chemical facilities and other entities under Clean Air Act 112(r) Risk Management Planning requirements, requires VAs to be submitted to the DHS, if requested. The VAs must include considerations of chemical alternatives that could reduce the risk of a terrorist release of chemicals. The consideration-of-alternatives provisions have been closely scrutinized as potentially enacting toxic use reduction requirements through the VA process. Given the jurisdictional breadth of CAA 112(r), the bill contains a provision allowing facilities already required to submit a VA under another Federal law to petition the DHS to be subject to that law in lieu of the requirements of this bill, should it become law.

Protecting VAs from Disclosure

With the volume of new VAs being conducted, the natural question is: how will these documents be handled in response to federal Freedom of Information Act (FOIA) or state public records requests, or in litigation? A new climate of "information caution" runs somewhat counter to our country's long-established support for the public's right to obtain information held by the government.

Our national commitment to the public's right to information was resoundingly affirmed when Congress enacted FOIA in 1966, giving the public broad access to unclassified information held by the federal government. 5 U.S.C. § 552. There are nine standard FOIA exemptions and three exclusions that allow federal agencies to withhold information. The exemptions are for (1) classified national defense and foreign relations information, (2) internal agency rules and practices, (3) information prohibited from disclosure by federal law, (4) trade secrets and confidential business information, (5) inter- or intra-agency communications protected by legal privilege, (6) matters of personal privacy, (7) certain law enforcement information, (8) information on the supervision of financial institutions, and (9) geological information on wells. The three exclusions, which are rarely used, pertain to especially sensitive law enforcement and national security issues.

As we moved into the information age in the 1990s, Congress passed the 1996 Electronic Freedom of Information Act (E-FOIA). E-FOIA requires, among other things, that frequently requested records be made publicly available on the Internet. Nearly every state has an open records or public access to information law, many of which are more liberal than FOIA or E-FOIA.

Post-Sept. 11, Attorney General John Ashcroft announced a new Department of Justice (DOJ) FOIA policy. The Oct. 12, 2001 policy allows federal officials to withhold information under FOIA on any "sound legal basis." This legal standard gives federal officials greater ability to deny FOIA requests than they had under a prior 1993 Clinton policy, which allowed FOIA withholding only to prevent "forseeable harm." Where federal agencies legitimately turn down FOIA requests, the new policy assures them that DOJ will defend their decisions. The FOIA policy is available at www.usdoj.gov/04foia/011012.htm. Notably, a September 2003 General Accounting Office report found that only 31 percent of federal agencies have decreased their release of information since the issuance of Ashcroft's FOIA policy.

FOIA & Critical Infrastructure Assessments

When looking for precedent on protecting VAs, it is important to note that federal agencies

have undertaken vulnerability assessments of critical infrastructure for years. DOJ has long asserted that such assessments are protected from disclosure under FOIA Exemption 2. See DOJ FOIA Post (FOIA Post) (Oct. 15, 2001), www.usdoj.gov/oip/foiapost/2001foiapost19.htm. Although the language of Exemption 2 refers to records "related solely to the internal personnel rules and practices of an agency," courts have found that the Exemption extends to those "predominantly internal" agency records where disclosure "significantly risks circumvention of agency regulations or statutes." *Crooker v. BATF*, 670 F.2d 1051, 1053 (D.C. Cir. 1981) (*en banc*). A 1989 DOJ *FOIA Update* notes that this "circumvention provision" is "well suited for application to the sensitive information contained in vulnerability assessments." Courts also extend Exemption 2 protection where the agency's information is effective only when kept confidential or where disclosure would render the information useless. See *Kaganove v. EPA*, 856 F.2d 884, 889 (7th Cir. 1988*), cert. denied*, 109 S. Ct. 798 (1989); *NTEU v. Customs Service*, 802 F.2d 525, 530-31 (D.C. Cir. 1986); see also link in *FOIA Post* to *FOIA Update, Vol. X. No. 3*. In fact, DOJ urges federal agencies to "avail themselves of the full measure of Exemption 2's protection for their critical infrastructure information as they continue to gather more of it, and assess its heightened sensitivity, in the wake of the Sept. 11 terrorist attacks." See *FOIA Post.*

The DOJ guidance and extensive body of case law protecting the disclosure of vulnerability assessments provide helpful precedent to public entities undertaking VAs, especially given that many open records laws mirror, or are based on, FOIA. In addition to the precedent in federal FOIA law to protect vulnerability assessments, state open records laws sometimes contain exemptions from disclosure if the information would cause substantial harm to the public, life, or safety. Many existing regulations (*e.g.*, DOT and Coast Guard) have designated these plans as Security Sensitive Information in accordance with 49 CFR 1502. Generally, documents classified under this regulation are protected from conflicting State disclosure laws.

Vulnerability Assessments and Privilege

Most agencies require review of assessments and plans, but they are not generally submitted to the agency. The DOT merely requires the VA and the related plan to be held in the company's file for inspection. The Coast Guard will approve the plans but notes the MTSA requires the plans "to be kept in a manner that is protected from unauthorized access or disclosure." Because the agency will not necessarily take copies or request a VA and plan, a company will be left to its own devices to protect its information from discovery or shareholder requests. However, private entities not subject to FOIA may not be able to rely on traditional privilege doctrines. After all, these privileges are generally designed to protect work product prepared in anticipation of litigation or confidences shared between clients and their attorneys. Neither privilege would apply here. A private company is simply attempting to comply with a federal regulation. Even if these privileges applied, could a party argue that the privilege was lost when it was shared with a third party (like a government inspector)?

Similar privilege questions arose when corporations began preparing environmental compliance self-audits. The importance of protecting and thereby encouraging environmental audits has been recognized in laws passed in more than 20 states. *E.g.*, Colo. Rev. Stat. Ann. § 13-25-126.5; Or. Rev. Stat. § 468.963; Tex. Civ. Stat. art. 4447cc (Supp. 2002). The arguments for protection here, where questions of national security must necessarily weigh in favor of non-disclosure, are even more compelling. On the

other hand, security plans themselves must be disseminated to employees, and those employees must be trained in that plan. *See, e.g.,* 49 CFR 172.704(a). In future litigation, courts might permit discovery of a plan that was readily available to company personnel, but extend the "state secret privilege" to protect the VA from general discovery through the use of a protective order. That privilege has not, to date, been extended to the private sector; but it has been used to varying degrees of success when federal agencies have sought to protect information obtained during investigations of terrorist activities. It would seem an appropriate means of protecting VAs and related plans from disclosure to the general public.

The Future of Information Disclosure

The "scales of justice" symbol represents the balance that laws are meant to achieve between the various interests and rights on any particular issue. In the case of FOIA and open records, the balance to be achieved lies between continued support for our nation's core belief in the public's access to governmental information, and our need to ensure our homeland's security. Legislation and upcoming regulations will likely favor security protections over the public's right to information obtained from such records.

Disclosure during shareholder or liability litigation is more problematic. The adequacy of a security plan or the quality of the VA might be relevant to a company's liability. In order to allow necessary discovery and litigation to proceed without damaging national security interests in particular cases, courts may find the need to devise and enforce appropriate and what may be innovative protective orders

Protecting information relating to the security and vulnerabilities of vital infrastructure assets is a part of this balancing act. As federal and state laws change to reflect the continuing movement and pressures in this arena, public and private sector attorneys have a valuable role to play in the resulting deliberations.

MEMBER NEWS

Bob Frantz is now Vice President, Environment, Health and Safety at Tyco International, Ltd. Bob moved to Tyco from GE Engine Services, where he served as General Manager and Counsel, Environment, Health & Safety.

Gabriel Eckstein was recently appointed Associate Professor of Law at Texas Tech University. Eckstein is teaching U.S. and international water and environmental law courses, as well as property law. He also was invited to serve as legal advisor to the U.N. Educational, Scientific, and Cultural Organization to help identify and conceptualize international law applicable to transboundary ground water resources. Eckstein's forthcoming article "A Hydrogeological Approach to Transboundary Ground Water Resources and International Law," co-authored with Professor of Hydrogeology, Dr. Yoram Eckstein (yes, his father), will appear in Volume 19 of the American University International Law Review. More information about Professor Eckstein is available on the TTU faculty profile page at: http://www.law.ttu.edu/people/faculty/eckstein.asp.

Please submit any printable committee member news to newsletter editor Jim Moore at jim_moore@huntsman.com.

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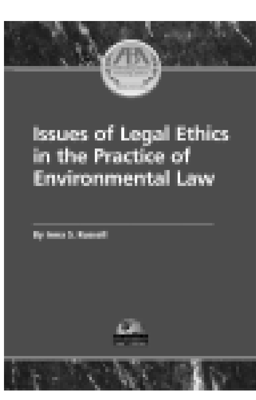

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