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United States District Court for the

Northern District of California

THE MAGNAVOX COMPANY, a Corporation, and SANDERS ASSOCIATES, INC., a Corporation, Plaintiffs, vs. ACTIVISION, INC., a Corporation, Defendant.	No. C 82 5270 TEH

REPLY MEMORANDUM IN SUPPORT OF

PLAINTIFFS' MOTION TO DISQUALIFY

DISQUALIFY DEFENDANT'S COUNSEL

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Activision does not deny that the subject matter of this action is "substantially related" to the subject matter of the earlier action in which the Flehr firm represented Atari. Activision affirmatively asserts that the American Bar Association Code of Professional Responsibility sets forth basic principles of legal ethics which may be

used to interpret the California Rules of Professional Conduct (Memo., p. 2). Thus, the cases cited in plaintiffs' opening memorandum, Trone v. Smith (9 Cir. 1980) 621 F.2d 994 and Unified Sewerage Agency v. Jelco Inc. (9 Cir. 1981) 646 F.2d 1339, require disqualification here. Faced with the readily apparent conflict problem as well as the contractual obligation of its counsel, Activision attempts to rely on a series of technical arguments. None of those arguments is sufficient to relieve its counsel of the obligations created by its representation of Atari. A case relied upon by Activision and decided by this very Court demonstrates the error of many of defendant's arguments In re Airport Car Rental Antitrust Litigation (N.D.Cal. 1979) 470 F.Supp. 495).

A. THE SIMPLE FACT OF THE FLEHR FIRM'S REPRESENTATION OF ATARI IN THE PRIOR ACTION REQUIRES DISQUALIFICATION.

The Flehr firm's present representation of Activision, despite Activision's protestations, is clearly adverse to the present interest of Atari. Atari is a licensee under the patents in suit and has paid $1,500,000 for that license (par. 3.01, pp. 6&7, Exhibit A to Herbert affidavit). Atari considers it to be in its best interests to remain a licensee and not to have the patents held invalid (Paul affidavit, pars. 6&7; Paul deposition, pp. 11-14). Atari certainly believes the Flehr firm's representation of Activision in this action is adverse to it (Paul affidavit, par. 7; Paul deposition, p. 14). Atari clearly has a present interest in

seeing that the value of its license is maintained and that other companies in the television game business are also appropriately licensed under the plaintiffs' patents. The Magnavox/Atari license includes a specific provision for Atari's benefit obligating Magnavox to prosecute infringement actions as may be reasonably necessary to protect unlicensed competition from materially interfering with the business of Atari under the license agreement (par. 4.02, p. 7, Exhibit A to Herbert affidavit). One of Atari's concerns is that Magnavox monitor and enforce the patents under which Atari is licensed (Paul deposition, pp. 25-27). While Atari may have no right of its own to prosecute actions for infringement of the patents in suit, it has a very definite and readily apparent interest in the successful prosecution of such actions by the plaintiffs.

It has previously been found under earlier A.B.A. Canon Six that a patent licensee has sufficient interest in the licensed patents that his former counsel should not represent a defendant in an infringement action on the same patents. A.B.A. Committee on Professional Ethics Formal Opinion 177 (1938) (copy attached hereto) explicitly found on facts quite similar to those present here that an attorney who represented the licensees of a patent in a suit brought by the licensor may not subsequently represent a third party defendant in an infringement suit brought by the licensor. In that opinion, the licensees specifically claimed that as licensees it was in their best interest to have the validity of the patents upheld. They further claimed that it would

be a violation of their former counsel's obligations to them to use information and experience gained in preparation for trial of the earlier case to attempt to invalidate or narrow the scope of the patents in the present action. The opinion stated:

> "A licensee acquires an interest in the invention and is mutually interested with the owner in sustaining the validity of the patent.
>
> "Hence when [the licensees] acquired licenses, it became to their interest to sustain rather than defeat the patents covered by their respective licenses.
>
> "Should [the licensees' former counsel] accept the proffered employment, he would be in a position to employ in the defense of the latter suit the information and experience he had acquired in the earlier suit to the detriment of his former clients, and if successful in establishing the invalidity of the patents he would destroy the value of the license grants for which his former clients had paid substantial considerations and had obligated themselves to pay accruing royalties."

The opinion found that Canon Six concerning the obligation to maintain the confidences of a client "clearly forbids" the subsequent representation. This opinion has been frequently cited in subsequent opinions, Informal Decisions C-493 (1961), C-564 (1962), and C-930 (1966), and is referenced in the notes supporting Canon 4 of the present

A.B.A. Code of Professional responsibility, i.e., note 4 to Ethical Consideration 4-2 and note 13 to Disciplinary Rule 4-101(b)(3) forbidding use by a lawyer of a client confidence for the benefit of himself or a third person.

Activision's contention that its counsel's representation of it is consistent with its representation of Atari is shown to be specious by the above Ethics Opinion 177. In its representation of Atari, the duty of the Flehr firm was to advance those positions with respect to plaintiffs' patents which were in the interests of Atari. Its duty remained the same both during the prior litigation and after it was settled. It is not contested that Flehr's representation of Atari continued after the settlement and well into 1977 and 1978. Representation of Activision now is not only inconsistent with Atari's present interests, but is also inconsistent with the interests of Atari as they existed in 1977 and 1978 while Flehr indisputably still represented Atari.

Activision's contention that there is no threat of any revelation of any Atari confidence by its representation of Activision is equally deficient. When, as here, there is a substantial relationship between the subject matters of the earlier and latter representations, there is an irrebutable presumption of transfer of client confidences during the earlier representation (In re Airport Car Rental Antitrust Litigation, supra, p. 499, n. 3). Moreover, even if the imparted irformation could be obtained through discovery or public records, this is not sufficient reason for denying

disqualification (In re Airport Antitrust Litigation, supra, p. 501; NCK Organization Ltd. v. Bregman (2 Cir. 1976) 542 F.2d 128, 133; Emile Industries, Inc. v. Patentex, Inc. (2 Cir. 1973) 478 F.2d 562, 572-573). The Paul affidavit and deposition establish that confidences of Atari were certainly transferred to the Flehr firm. Mr. Herbert in his affidavit neither denies that he or his firm received any confidences from Atari nor asserts that all the confidences which the firm did receive were turned over to counsel for other parties to the prior cases or made a public record in the earlier cases.

Activision also contends that Atari is no longer a client of the Flehr firm. The Paul affidavit (par. 9) and deposition (pp. 23-24) show that Flehr has continued to do legal work for Atari. Mr. Herbert's affidavit (par. 15) demonstrates that it was not until February 8, 1983, after this motion was filed, that Flehr attempted to completely terminate its relationship with Atari. That action of Flehr was simply too late to avoid any conflict and, of course, in no way abrogates Flehr's duty to Atari as a former client.

B. THE NECESSARY STANDING IS PRESENT.

In cases where the conflict of interest and resultant ethical violation is apparent on its face, a court has a plain duty to act to eliminate the conflict (In re Yarn Processing Patent Validity Litigation (5 Cir. 1976) 530 F.2d 83, 89). In some cases the conflict can be so egregious that a court may act absent even a motion from the adverse party (Empire Linotype School, Inc. v. United States

(S.D.N.Y. 1956) 143 F.Supp. 627, 631). A former client may advocate disqualification even though it is not the formal moving party (Estates Theatre, Inc. v. Columbia Pictures, Inc. (S.D.N.Y. 1972) 345 F.Supp. 93). In Altschul v. Paine Webber, Inc. (S.D.N.Y. 1980) 488 F.Supp. 858, 860, n. 1, the court stated, "Competence to raise disqualification is not limited to former or aggrieved clients," and permitted the defendant to move for disqualification of an attorney representing both the plaintiff and a crossclaim defendant on grounds of differing interests of those two parties.

None of the cases Activision relies upon requires that the counsel's former or present client be the party making the motion to disqualify. Earl Scheib Inc. v. Superior Court for County of Los Angeles (1967) 61 Cal.Rptr. 386 and Cooke v. Superior Court of Los Angeles County (1978) 83 Cal.App.3d 589, 147 Cal.Rptr. 915 state only that the confidences to be protected are ones imparted in an attorney-client relationship. Clearly such a relationship existed between Atari and the Flehr firm. Neither of these cases denied disqualification on lack of standing. Further, in neither of In re Yarn Processing Patent Validity Litigation (5 Cir. 1976) 530 F.2d 83, Krebs v. Johns-Manville Corp. (E.D.Pa. 1980) 496 F.Supp. 40 nor Fred Weber Inc. v. Shell Oil Co. (8 Cir. 1977) 566 F.2d 602 is there any indication that the former client in any way complained about its counsel's representation in the case before the court. In Yarn Processing, the court specifically noted that it could

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not determine the existence of a conflict until the former client made its position known (530 F.2d, 88).

The facts here are distinctly different. Atari has made its position openly and well known in this proceeding. It is greatly displeased with the Flehr firm's representation of Activision in this action. It is a complaining party. A rule which required Atari to be a formal party to the action in order to have the obligations of its counsel enforced would to a large degree strip those obligations of any meaning. It is quite clear that ethical considerations do not apply only to litigated matters, and it is not necessary to be a party to litigation to enforce such considerations. Moreover, to the extent that this motion is based upon the contractual obligation of the Flehr firm, Magnavox and Sanders are both also parties to that contract with the right to seek to enforce it.

C. ATARI HAS NOT CONSENTED TO FLEHR'S REPRESENTATION OF ACTIVISION HERE.

Activision appears that the transfer of some undefined files from Atari to the Flehr firm somehow manifested Atari's consent to Flehr's representation of Activision against plaintiffs. This argument is untenable.

First, it is quite clear that even if there were any such manifestation, it would not relieve the Flehr firm of its obligations. Both Rule 4-101 and Rule 5-102 of the California Rules of Professional Conduct require that any consent from a client or former client to adverse or conflicting representation must be written (In re Airport Car

Rental Antitrust Litigation, supra, at 500). Activision does not even claim that Atari gave any consent in writing.

Second, Activision presents no direct evidence that Atari consented even orally to Flehr's representation of Activision. Mr. Herbert's affidavit makes no reference to any statements made by any official of Atari which supposedly sets forth any such consent.

Third, the naked return of files to the law firm that generated those very files can hardly be taken as an indication that those files may be used for any purpose whatever. This is especially true when that law firm is still performing at least some legal work for the party returning the files. The Paul deposition testimony shows that the files were returned with the assumption that they would be used within the customary confines of the attorney-client relationship and not for any purpose contrary to Atari's best interests (p. 30). Not even Mr. Herbert's affidavit states that he had any understanding that the files were being returned so that the contents might be used in the course of representing Activision. It would be naive to suggest that Atari would have returned its legal files so that they could be used against its own interests. The Herbert affidavit at most says that the files were being turned over "at the behest of Activision" (par. 17). Even if true, this cannot now be bootstrapped into an expression of informed consent.

D. THE CONTRACT WITH THE FLEHR FIRM SHOULD BE RECOGNIZED AND ENFORCED.

The Flehr firm's representation of Activision clearly violates the prior settlement agreement between Atari, Magnavox, Sanders, and Flehr. The Flehr firm is a party to that agreement and any termination of its representation of Atari did not abrogate its obligations under that agreement. While the Activision television game cartridges might be usable with Atari game consoles, the manufacture and sale of such cartridges by Activision are the acts of contributory patent infringement which are being complained of here, and those acts are completely independent of Atari. The cartridges are neither made by nor for Atari. Activision is not here being sued for infringement in connection with any sale by it of any television games made by Atari, but only in connection with sale by it of television game cartridges made by it. None of the exceptions stated in the agreement itself apply here.

Public policy interests should not prevent enforcement of this contractual agreement. The agreement does not in any way prevent Activision from contesting the validity of plaintiffs' patents. It merely removes one law firm from the wide spectrum of those available to Activision. While considerations of public policy may dictate that a patent license agreement not estop the licensee from contesting validity of the licensed patent because that licensee is often the principal member of the public with sufficient financial incentive to contest the patent (Lear, Inc. v.

Adkins (1969) 395 U.S. 653), such reasoning simply does not logically extend to counsel.

Activision complains that the settlement agreement has no time limit. But it does have such a limit. By its own terms it expires with any termination of the Atari license. As a practical matter, it also expires with the expiration of the patents referred to in the agreement.

Section 16000 of the California Business and Professions Code is no bar to contracts such as the one here (KGB, Inc. v. Giannoulas (1980) 104 Cal.App.3d 844, 164 Cal.Rptr. 571), is not to the contrary. Although containing strong language, it actually extensively considers whether the statute should be applied to the contract before it. Moreover, the cases cited in plaintiffs' opening memorandum, King v. Gerold (1952) 109 Cal.App.2d 316, 240 P.2d 710 Gordon v. Landau (1958) 49 Cal.2d 690, 321 P.2d 456 and Boughton v. Socony Mobil Oil Company, Inc. (1958) 231 Cal.App.2d 188, 41 Cal.Rptr. 714, conclusively establish that this statutory section is not an absolute bar but is subject to a rule of reason. The narrow restrictions placed on the Flehr firm by this contract are only consistent with the ethical obligations it faces absent the contract and cannot be deemed unreasonable. Certainly this California statute should not be applied to an arms-length agreement, willingly signed by California lawyers in settling Federal litigation in Illinois.

CONCLUSION

In defense of its counsel, Activision belittles the importance of the ethical rules. It argues that A.B.A. Canon 9 concerning avoidance of an appearance of impropriety should be given little consideration. It cites and extensively quotes Westinghouse Electric Corp. v. Rio Algom Limited (N.D.Ill. 1978) 448 F.Supp. 1284, a case which was reversed at Westinghouse Elec. Corp. v. Gulf Oil Corp. (7 Cir. 1978) 588 F.2d 221. Just as the District Court's failure to give proper respect to ethical considerations was there reversed, Activision's misguided arguments should not be permitted to succeed. Plaintiffs' motion should be granted.

Dated: March 7, 1983.

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By _____

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AMERICAN BAR ASSOCIATION

OPINIONS of the Committee on Professional Ethics

with the

CANONS OF PROFESSIONAL ETHICS

Annotated

and

CANONS OF JUDICIAL ETHICS

Annotated

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interests in estates, under which the lawyer investigates the interest to be purchased and receives from the layman a share of the interest purchased. The lawyer is to examine the records in the probate court and furnish the layman with names of legatees having an interest which might be secured. Circulars are then issued to such legatees from the office of either the layman or the lawyer. The lawyer is then expected to procure collection by litigation or otherwise.

The opinion of the committee was stated by MR. MCCRACKEN, Messrs. Phillips, Arant, Houghton, Brown, Jones and Miller concurring.

This practice offends two of the Canons of Professional Ethics—*Canon 10*, which prohibits a lawyer from purchasing any interest in the subject matter of litigation which he is conducting, and *Canon 28*, proscribing the stirring up of strife and litigation. It is true that litigation may never ensue, and that it is not in course of conduct at the time the purchase is made, but, in the opinion of the committee this does not alter the unprofessional nature of the transaction.

In *Opinion 51*, we held that it was improper for a lawyer to purchase judgment notes, or other choses in action, for less than their face value, with the intent of collecting them at a profit to himself. We said in that opinion:

> This opinion, it may be claimed, bars attorneys from entering a speculative field, which might be profitable and which is open to laymen; nevertheless, we feel that the dignity of the profession, as well as the ethics of the situation, are entirely consonant with the view herein expressed.

That language applies to the instant question. While the lawyer does not advance his own funds for the purchase of the interests involved, he participates from the beginning to the end of the transaction. It is his search of the record which discloses the legatees to be approached; he is asked to assist in the approach through circulars or otherwise; he undoubtedly would be expected to prepare and have executed the appropriate documents of transfer and probably make the settlement; and he participates in the profit on some kind of percentage basis. In the event of an attack upon the transaction when the legacy falls in and is collectable, he is in a position of defending himself as well as the purchaser. He thus places himself in the category of voluntary litigants for a profit and makes a business of doing so. It is difficult to imagine any transaction in which the legal training and equipment of a lawyer would be more definitely devoted to commercial purposes.

FORMAL OPINION 177
(February 18, 1938)

An attorney who represented the licensees of a patent in a suit brought by the licensor may not subsequently represent a third party defendant in an infringement suit brought by the licensor.

CANON INTERPRETED: PROFESSIONAL ETHICS 6

A member of the American Bar Association has requested our opinion on the questions hereafter stated:

A, the owner of certain
B, a retailer of alleged i
alleged infringing devices
sent B, C, and D in the sui
After the evidence in ch
introduced, a compromise
of licenses under the pate
sideration and obligated h
X actively participated
Later A brought an in
sought to employ X to d
ground that they had take
the validity of the patents
obligations to them for hi
the preparation for and th
ter suit either to narrow t
X has not been retained b
May X with ethical pr
suit?
May X do so if he uses o
records in the second suit?
The opinion of the com
Cracken, Arant, Houghton
A licensee is obligated t
the patent, and may not a
liability for royalties that h
A licensee acquires an i
with the owner in sustainin
Hence, when C and D a
tain rather than defeat the
Should X accept the pr
employ in the defense of t
had acquired in the earlier
successful in establishing t
value of the license grants
considerations and had obl
Canon 6 in part reads:

> The obligation to repr
> divulge his secrets or co
> of retainers or employm
> interest of the client wit

In *Opinion 64* this comm
accept employment to attac
a client, said:

> The attorney should n
> instrument and cannot a
> services are sought by ne
> release the attorney fro

Canon 6 relating to confl

A, the owner of certain patents, brought a patent infringement suit against B, a retailer of alleged infringing devices. C and D, manufacturers of the alleged infringing devices, intervened. X, a lawyer, was employed to represent B, C, and D in the suit.

After the evidence in chief of plaintiff, defendant and intervenors had been introduced, a compromise was effected under which C and D received grants of licenses under the patents for which each paid a substantial present consideration and obligated himself to pay future royalties.

X actively participated in the consummation of the compromise.

Later A brought an infringement suit on the same patents against E. E sought to employ X to defend the suit for him. C and D objected on the ground that they had taken out licenses; that it was to their interest to have the validity of the patents upheld; and that it would be a violation of X's obligations to them for him to use the information and experience secured in the preparation for and the trial of the earlier suit, in an endeavor in the latter suit either to narrow the scope or establish the invalidity of the patents. X has not been retained by C or D since the termination of the first suit.

May X with ethical propriety accept employment from E in the second suit?

May X do so if he uses only such information as is available from the court records in the second suit?

The opinion of the committee was stated by MR. PHILLIPS, Messrs. McCracken, Arant, Houghton, Brown, Jones and Miller concurring.

A licensee is obligated to pay royalties, is estopped to deny the validity of the patent, and may not assert an adjudication of invalidity as a defense to liability for royalties that had accrued at the time of the adjudication.

A licensee acquires an interest in the invention and is mutually interested with the owner in sustaining the validity of the patent.

Hence, when C and D acquired licenses, it became to their interest to sustain rather than defeat the patents covered by their respective licenses.

Should X accept the proffered employment, he would be in a position to employ in the defense of the latter suit the information and experience he had acquired in the earlier suit to the detriment of his former clients, and if successful in establishing the invalidity of the patents he would destroy the value of the license grants for which his former clients had paid substantial considerations and had obligated themselves to pay accruing royalties.

Canon 6 in part reads:

> The obligation to represent the client with undivided fidelity and not to divulge his secrets or confidences forbids also the subsequent acceptance of retainers or employment from others in matters adversely affecting any interest of the client with respect to which confidence has been reposed.

In *Opinion 64* this committee, in holding that an attorney cannot properly accept employment to attack the validity of an instrument which he drew for a client, said:

> The attorney should not attempt to nullify his own work. He drew the instrument and cannot attack its validity after his client has died and his services are sought by new clients. The death of the former client does not release the attorney from his obligation. The case comes fairly within *Canon 6* relating to conflicting interests.

In *Opinion 71* this committee held that an attorney who had represented a municipality in proceedings for the issuance and validation of bonds could not in a subsequent proceeding represent a party undertaking to establish the invalidity of the bonds.

In *Opinion 37* this committee held that an attorney who had previously investigated and reported on a title as a public examiner of titles could not thereafter accept private employment in a case wherein issues respecting the same title were directly involved.

See also *Opinions 26* and *167*.

We are of the opinion that *Canon 6* as construed in the opinions above adverted to clearly forbids X accepting the proffered employment.

FORMAL OPINION 178
(February 19, 1938)

It is improper for a creditor's attorney to send papers to debtors which, unless carefully read, will create the false impression that suit has been instituted against the debtor when, in fact, it is a demand for payment.

CANONS INTERPRETED: PROFESSIONAL ETHICS 9, 15

A lawyer has requested the opinion of the committee as to whether it is permissible to deliver or send the following form of instrument to a debtor prior to entering suit upon an account:

ORIGINAL NOTICE BEFORE SUIT.

STATE OF .....) FOR PLAINTIFFS—STATE OF .....
.....COUNTY)

vs.

.....*Plaintiffs,*
.....*Defendant.*

You will please take notice that the above named plaintiffs claim that you are indebted to them in the sum of ..... for ..... and that although duly demanded, the same has not been paid or any part thereof.

Unless you remit to ..... on or before the ..... day of ....., A. D., 19...., and make payment to them of said claim, or provide for the adjustment thereof, suit may be brought forthwith for the total amount with interest, together with the costs and disbursements of the action.

Dated at ..... this ..... day of ....., 19 ....

.....
For Plaintiffs.

(REVERSE.)

FINAL NOTICE.

.....
Plaintiffs.

CERTIFICATE OF SERVICE BY MAIL

United States District Court

Northern District of California

I, the undersigned, hereby declare this 7 day of March, 1983, at San Francisco, California, under penalty of perjury, that the following statements are true and correct:

1. My business address is 225 Bush Street, San Francisco, California 94104. My mailing address is P.O. Box 7880, San Francisco, CA 94120. I am employed in the City and County of San Francisco, over the age of eighteen years, and I am not a party to the cause entitled upon the document hereinafter referred to.

2. I served a copy of the annexed Reply Memorandum in Support of Plaintiffs' Motion to Disqualify Defendant's Counsel upon each of the following named attorneys in said action by depositing on March 7, 1983, a true copy thereof in the United States mail at San Francisco, California, said copy being then and there enclosed in a sealed envelope with the proper postage thereon prepaid.

3. Said envelope was addressed as follows:

Wilson, Sonsini, Goodrich and Rosati
Harry B. Bremond
~~Michael A. Ladra~~
Two Palo Alto Square
~~Palo Alto, California 94303~~

Michael K. Kaczon

CERTIFICATE OF SERVICE BY HAND

United States District Court

Northern District of California

I, the undersigned, hereby declare this 7 day of March, 1983, at San Francisco, California, under penalty of perjury, that the following statements are true and correct:

1. My business address is 225 Bush Street, San Francisco, California 94104. My mailing address is P.O. Box 7880, San Francisco, CA 94120. I am employed in the City and County of San Francisco, over the age of eighteen years, and I am not a party to the cause entitled upon the document hereinafter referred to.

2. I served a copy of the annexed Reply Memorandum in Support of Plaintiffs' Motion to Disqualify Defendant's Counsel upon each of the following named attorneys in said action by delivering on March 7, 1983, a true copy thereof by hand, said copy being then and there enclosed in a sealed envelope.

3. Said envelope was delivered to the following address: Flehr, Hohbach, Test, Albritton & Herbert
Aldo J. Test
Thomas O. Herbert
Edward S. Wright
Suite 3400, Four Embarcadero Center
San Francisco, CA 94111

_____

Marlao L. Schaaf