



**THE STATE BAR
OF CALIFORNIA**

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OFFICE OF PROFESSIONAL COMPETENCE

PLANNING, AND DEVELOPMENT

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III.F. Rule 3-300 [1.8.1]
March 31 - April 1, 2016
Open Session

MEMORANDUM

DATE: March 22, 2016

TO: Members, Commission for the Revision of the Rules of Professional Conduct

FROM: Randall Difuntorum, Director, Professional Competence

SUBJECT: Proposed Rule 1.8.1 (3-300) Business Transactions with a Client and Pecuniary Interests Adverse to a Client

The attached draft of the subject rule is the current draft that should be considered in preparation for the discussion at the March 31st and April 1st meeting. The redline/strikeout markings show changes to the proposed rule contained in the drafting team's report and recommendation. The revisions are intended to be organizational changes rather than substantive.

ATTACHMENT
PROPOSED RULE 1.8.1 [3-300]
(DFT1.4 – 3/22/16)

Rule 1.8.1 Business Transactions with a Client and Pecuniary Interests Adverse to a Client

| (a) A lawyer shall not enter into a business transaction with a client, or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

| (a~~1~~) The transaction or acquisition and its terms are fair and reasonable to the client and the terms and the lawyer's role in the transaction or acquisition are fully disclosed and transmitted in writing to the client in a manner that should reasonably have been understood by the client; and

| (b~~2~~) The client either is represented in the transaction or acquisition by an independent lawyer of the client's choice or client is advised in writing to seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

| (c~~3~~) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.

| (d~~b~~) As used in this Rule, An an independent lawyer is a lawyer who (i) does not have a financial interest in the transaction or acquisition, (ii) does not have a close legal, business, financial, professional or personal relationship with the lawyer seeking the client's consent, (iii) is selected by the client; and (iv) represents the client with respect to the transaction or acquisition.

Comment

| [1] Fairness and reasonableness under paragraph (a)(~~1~~) are measured at the time of the transaction or acquisition based on the facts that then exist.

[2] This Rule is not intended to apply to the provisions of an agreement between a lawyer and client relating to the lawyer's hiring or compensation unless the agreement confers on the lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client. This Rule also does not apply to an agreement to advance to or deposit with a lawyer a sum to be applied to fees, or costs or other expenses, to be incurred in the future. Such agreements are governed, in part, by Rules 1.5 and 1.15.

[3] This Rule does not apply where a lawyer and client each make an investment on terms offered by a third person to the general public or a significant portion thereof. This Rule also does not apply to standard commercial transactions for products or services that a lawyer acquires from a client on the same terms that the client generally markets them to others, where the lawyer has no advantage in dealing with the client, and the requirements of the Rule are unnecessary and impractical. This Rule does apply where a lawyer wishes to obtain an interest in a client's property in order to secure payment of the lawyer's past, current, or future fees, or costs or other expenses.

[4] In addition to where a lawyer holds an ownership, possessory or security interest adverse to a client, a lawyer has a pecuniary interest adverse to a client when the lawyer has the unilateral ability to materially interfere with or prejudice the client's rights or interests. See *Fletcher v. Davis*, 33 Cal. 4th 61, 68 (2004). Also see Bus. & Prof. Code § 6175.3 ("Sale of financial products to elder or dependent adult clients; Disclosure").

DRAFTING TEAM REPORT AND RECOMMENDATION: RULE 3-300

Lead Drafter: Kehr
Co-Drafters: Bleich, Harris
Meeting Date: March 31 – April 1, 2016

I. CURRENT CALIFORNIA RULE

Rule 3-300 Avoiding Interests Adverse to a Client

A member shall not enter into a business transaction with a client; or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

- (A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and
- (B) The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and
- (C) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.

Discussion:

Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client, unless the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client. Such an agreement is governed, in part, by rule 4-200.

Rule 3-300 is not intended to apply where the member and client each make an investment on terms offered to the general public or a significant portion thereof. For example, rule 3-300 is not intended to apply where A, a member, invests in a limited partnership syndicated by a third party. B, A's client, makes the same investment. Although A and B are each investing in the same business, A did not enter into the transaction "with" B for the purposes of the rule.

Rule 3-300 is intended to apply where the member wishes to obtain an interest in client's property in order to secure the amount of the member's past due or future fees.

II. DRAFTING TEAM'S RECOMMENDATION AND VOTE

There was consensus among the drafting team members to recommend a proposed amended rule as set forth below in Section III.

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III. PROPOSED RULE (CLEAN)

Rule 1.8.1 Business Transactions with a Client and Pecuniary Interests Adverse to a Client

A lawyer shall not enter into a business transaction with a client, or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

- (a) The transaction or acquisition and its terms are fair and reasonable to the client and the terms and the lawyer's role in the transaction or acquisition are fully disclosed and transmitted in writing to the client in a manner that should reasonably have been understood by the client; and
- (b) The client either is represented in the transaction or acquisition by an independent lawyer of the client's choice or client is advised in writing to seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and
- (c) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.
- (d) An independent lawyer is a lawyer who (i) does not have a financial interest in the transaction or acquisition, (ii) does not have a close legal, business, financial, professional or personal relationship with the lawyer seeking the client's consent, (iii) is selected by the client; and (iv) represents the client with respect to the transaction or acquisition.¹

Comment

[1] Fairness and reasonableness under paragraph (a) are measured at the time of the transaction or acquisition based on the facts that then exist.

[2] This Rule is not intended to apply to the provisions of an agreement between a lawyer and client relating to the lawyer's hiring or compensation unless the agreement confers on the lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client. This Rule also does not apply to an agreement to advance to or deposit with a lawyer a sum to be applied to fees, or costs or other expenses, to be incurred in the future. Such agreements are governed, in part, by Rules 1.5 and 1.15.

¹ The term "independent lawyer" also is used in Rule 1.8.8, which suggests that the definition might be placed in Rule 1.0.1. However, the same phrase is used in Rule 4.2(c) but with a different meaning. The better solution therefore might be to place an agreed definition both here and in Rule 1.8.8.

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[3] This Rule does not apply where a lawyer and client each make an investment on terms offered by a third person to the general public or a significant portion thereof. This Rule also does not apply to standard commercial transactions for products or services that a lawyer acquires from a client on the same terms that the client generally markets them to others, where the lawyer has no advantage in dealing with the client, and the requirements of the Rule are unnecessary and impractical. This Rule does apply where a lawyer wishes to obtain an interest in a client's property in order to secure payment of the lawyer's past, current, or future fees, or costs or other expenses.

[4] In addition to where a lawyer holds an ownership, possessory or security interest adverse to a client, a lawyer has a pecuniary interest adverse to a client when the lawyer has the unilateral ability to materially interfere with or prejudice the client's rights or interests. See *Fletcher v. Davis* (2004) 33 Cal. 4th 61, 68 [14 Cal.Rptr.3d 58]. Also see Bus. & Prof. Code § 6175.3 ("Sale of financial products to elder or dependent adult clients; Disclosure").

IV. PROPOSED RULE (REDLINE TO CURRENT CALIFORNIA RULE 3-300)

Rule ~~3-300~~**1.8.1** **Avoiding** Business Transactions with a Client and Pecuniary Interests Adverse to a Client

A ~~member~~lawyer shall not enter into a business transaction with a client~~;~~¹ or knowingly acquire an ownership, possessory, security~~;~~² or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

- ~~(A)~~(a) The transaction or acquisition and its terms are fair and reasonable to the client and the terms and the lawyer's role in the transaction or acquisition are fully disclosed and transmitted in writing to the client in a manner ~~which~~that should reasonably have been understood by the client; and
- ~~(B)~~(b) The client either is represented in the transaction or acquisition by an independent lawyer of the client's choice or client is advised in writing ~~that the client may to~~ seek the advice of an independent lawyer of the ~~client's~~client's choice and is given a reasonable opportunity to seek that advice; and
- ~~(C)~~(c) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.
- (d) An independent lawyer is a lawyer who (i) does not have a financial interest in the transaction or acquisition, (ii) does not have a close legal, business, financial, professional or personal relationship with the lawyer seeking the client's consent, (iii) is selected by the client; and (iv) represents the client with respect to the transaction or acquisition.

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Comment~~Discussion~~

[1] Fairness and reasonableness under paragraph (a) are measured at the time of the transaction or acquisition based on the facts that then exist.

[2] ~~This Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client,~~ provisions of an agreement between a lawyer and client relating to the lawyer's hiring or compensation unless the agreement confers on the ~~member~~lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client. ~~Such~~ This Rule also does not apply to an agreement ~~is to advance to or deposit with a lawyer a sum to be applied to fees, or costs or other expenses, to be incurred in the future.~~ Such agreements are governed, in part, by ~~rule 4-200~~Rules 1.5 and 1.15.

[3] ~~This Rule 3-300 is~~does not ~~intended to~~ apply where ~~the member~~a lawyer and client each make an investment on terms offered by a third person to the general public or a significant portion thereof. ~~For example, rule 3-300 is not intended to apply where A, a member, invests in a limited partnership syndicated by a third party. B, A's client, makes the same investment. Although A and B are each investing in the same business, A did not enter into the transaction "with" B for the purposes of the rule.~~ This Rule also does not apply to standard commercial transactions for products or services that a lawyer acquires from a client on the same terms that the client generally markets them to others, where the lawyer has no advantage in dealing with the client, and the requirements of the Rule are unnecessary and impractical. This Rule 3-300 is intended todoes apply where ~~the member~~a lawyer wishes to obtain an interest in ~~client's~~a client's property in order to secure ~~the amount~~payment of the ~~member's~~lawyer's past ~~due,~~ current, or future fees, or costs or other expenses.

[4] In addition to where a lawyer holds an ownership, possessory or security interest adverse to a client, a lawyer has a pecuniary interest adverse to a client when the lawyer has the unilateral ability to materially interfere with or prejudice the client's rights or interests. See *Fletcher v. Davis* (2004) 33 Cal. 4th 61, 68 [14 Cal.Rptr.3d 58]. Also see Bus. & Prof. Code § 6175.3 ("Sale of financial products to elder or dependent adult clients; Disclosure").

V. PUBLIC COMMENTS SUMMARY

- **Scott Garner, COPRAC, 6/16/2015:** Suggest comprehensive set of conflict rules that closely resemble the model rules to cover topics not addressed in the current rules, eliminate the significant differences between California and ABA, and provide greater guidance in the area of conflicts.
- **Richard Zitrin, On Behalf of Law Professors, 3/3/15:** Recommended against excluding fee modifications from the rule's application. The group believed that, based on the ongoing fiduciary duty owed to an existing client, all modifications to fee agreements are business transactions with a client (i.e. subject to rule 3-300) and may also involve acquisition of an adverse pecuniary interest.

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VI. OCTC / STATE BAR COURT COMMENTS

A. Jayne Kim, OCTC, 9/2/15:

Modification of fee agreements should require compliance with rule 3-300 regarding adverse interests. A lawyer holds a position of trust and has a fiduciary duty vis-a-vis his or her client. Compliance with rule 3-300 will help prevent lawyers from abusing their position and overreaching when renegotiating a fee agreement.

B. RUSSELL WEINER, OCTC, 6/15/2010:

OCTC believes proposed rule 1.8.1 should apply to all modifications of fee agreements regardless of whether an adverse interest is conferred. However, at that time, OCTC accepted the compromise adopted by the Board, discussed below.

C. MIKE NISPEROS, OCTC, 9/27/2001:

OCTC recommends clarifying the duties of an attorney when entering into a business transaction with a client. The recommendations further resolve issues that have developed in the application of the current rule.

Add:

(A) For purposes of this rule "client" means an individual or entity who the member is representing in a legal matter or other person or entity to whom the member owes a fiduciary duty as prescribed by law or a former client or other person or entity to whom the member owed a fiduciary duty and who expects the member to exercise professional judgment for the protection of the client. For purposes of paragraph (B) of this rule, a member shall be conclusively found to be a client's lawyer for three years after the relationship has terminated. However, this shall not prevent a finding that even after three years the person or entity expects the member to exercise professional judgment for the protection of the client.

And revise the current language as follows:

(B) A member or his or her agents shall must not directly or indirectly enter or attempt to enter into a business transaction with a client or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

(A)(1) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in a clear and conspicuous writing to the client in a manner which should reasonably have been understood by the client. This disclosure shall be made in a separate document, appropriately entitled, in 12-point print with one inch of space on all borders, signed by the client or the client's conservator, guardian, or agent under a valid durable power of attorney. It shall also be presented to the client at

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least three days prior to the parties entering into the transaction; and

(B)(2) The client is advised in writing ~~that the client may~~ that he or she should seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(G)(3) The client thereafter ~~consents~~ gives informed consent in a writing signed by the client to the terms of the transaction or the terms of the acquisition and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction is clearly explained. This document will be separate from the disclosure document required in paragraph (B)(1) of this rule.

OCTC COMMENTS:

OCTC recommends that this rule have a definition section. In that definition section, the rule should expressly state that the rule applies to fiduciary relationships as well as traditional attorney-client relationships. This is already the law. (See e.g. *In the Matter of Hultman* (Review Dept. 1995) 3 Cal. State Bar Ct. Rptr. 297, 307.)

Paragraph (A) should also state that the rule applies when a former client or fiduciary expects that the attorney will exercise professional judgment on behalf of the client or other person or entity to whom the member owes a fiduciary duty as prescribed by law. In *Hunnicutt v. State Bar* (1988) 44 Cal.3d 362, 371, the California Supreme Court held that "if there is evidence that the client placed his trust in the attorney because of the representation, an attorney-client relationship exists for the purposes of [former] rule 5-101 [the predecessor of current rule 3-300] even if the representation has otherwise ended." Thus, this provision is codifying existing law.

OCTC also recommends that a member shall be conclusively found to be a client's lawyer for three years after the relationship has terminated. However, this shall not prevent a finding that even after three years the person or entity expects the member to exercise professional judgment for the protection of the client. By requiring the rule to apply for at least three years after the relationship terminates, the rule will protect the client's understanding of the relationship and make it less likely that an attorney will use information obtained in his representation for the attorney's own advantage. It will also emphasize to attorneys that this rule still applies after the termination of the relationship. Further, this change would adopt what the legislature has mandated in Business & Professions Code section 6175.3. That statute requires an attorney to comply with the conditions imposed in that statute (many of which are similar to the requirements of rule 3-300) when the attorney sells financial products to an elder or dependent adult with whom the lawyer has or has had an attorney-client relationship. Thus, we are only extending a protection already provided for some clients to all clients.

OCTC recommends that the rule apply not just to the member but also to the member's agents and to direct and indirect transactions. This would require of attorneys no more than what is already required of real estate brokers - that they can not do indirectly or thorough

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relatives and others what they are prohibited from doing for themselves directly. In *In the Matter of Fandey* (Review Dept. 1994) 2 Cal. State Bar Ct. 767, 777, the Review Department held that former rule 5-101 did not apply to transactions between the member's parents and the member's client because there was no evidence that the member was a party to or benefitted financially from the property transactions. However, the California Supreme Court has held that "[t]he rule that an agent employed to sell the principal's property may not, without the principal's full knowledge and consent, become the purchaser, is aimed at an indirect or collusive sale or transfer, as well as a direct sale or transfer to the agent, and extends to a relative of the agent, or to his partner or employee. The rule also applies where the sale or transfer is made to a corporation in which the agent has a large concealed interest, or indirectly to the agent in the name of a third person." *Batson v. Strehlow* (1968) 68 Cal.2d 662, 675-676. In *Marlowe v. State Bar* (1965) 63 Cal.2d 304, the California Supreme Court held that an attorney could not avoid the consequences of discipline if his wife, instead of himself, purchased a client's property. To protect clients from unscrupulous attorneys and to protect attorneys from challenges of misconduct, this rule should be revised so that it imposes discipline when the attorney indirectly or thorough agents or close relatives engages in conduct, which if done by the attorney, would require compliance with rule 3-300.

The rule should also apply to attempts by attorneys to enter into transactions with a client without full compliance with the appropriate conditions.

OCTC recommends that section 1 of the rule be revised to include much of the language and conditions required by Business & Professions Code section 6175.3. Not only must the transaction be fair and reasonable to the client, but the terms should be provided in a clear and conspicuous writing separate from any other document, appropriately entitled, in at least 12 point type, signed by the client and presented at least three days prior to the parties entering into the transaction. This is necessary to ensure that the client understands the transaction, has time to review and evaluate it, and to allow for the client to consult an independent lawyer. It provides a cooling off period where the client can reconsider the transaction outside the influence of the attorney. By requiring a separate document, the terms will not be lost or missed by the client and it helps to ensure that the transaction is only entered into after reasoned consideration by the client. These requirements seem particularly appropriate given the nature of the relationship and the trust that clients often place in their attorneys.

Section 2 eliminates a confusing aspect of the current rule. The current rule states that the attorney is to advise the client in writing that the client "may" seek the advice of an independent lawyer. However, the California Supreme Court has held that the member "must" advise the client to seek independent counsel. OCTC's proposal eliminates any doubt that the lawyer must advise the client to seek the advice of an independent lawyer.

In section 3, the proposed new language adds to the rule a requirement that the client's written consent must be informed consent. This is a codification of existing case law. Case law requires that the lawyer provide the client with all the information he or she would

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provide if another person instead of the member was attempting to negotiate this transaction with the client. That informed consent should require that the client consent in writing to the terms of the transaction, the risks, the lawyer's role in the transaction, whether the lawyer is representing the client in the transaction, and any other relevant information.

- **State Bar Court:** No comments received from State Bar Court.

VII. COMPARISON OF PROPOSED RULE TO APPROACHES IN OTHER JURISDICTIONS (NATIONAL BACKDROP)

Massachusetts Rule 1.8(a) Conflict of Interest: Current Clients: Specific Rules

- (a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:
- (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
 - (2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and
 - (3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

The ABA State Adoption Chart, entitled "Variations of the ABA Model Rules of Professional Conduct, Rule 1.8: Conflict of Interest: Current Clients: Specific Rules," revised May 13, 2015, is available at:

- http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc_1_8.authcheckdam.pdf
- Twenty-nine states have adopted the model rule 1.8(a) verbatim,² fourteen states have adopted variations of model rule 1.8(a),³ and eight jurisdictions have a different rule or a materially modified version of model rule 1.8(a).⁴

² The twenty-nine states are: Arizona, Arkansas, Colorado, Delaware, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine; Massachusetts, Missouri, Nebraska, Nevada, New Hampshire, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Wisconsin, West Virginia, and Wyoming.

³ The fourteen states are: Alabama, Alaska, California, Georgia, Hawaii, Illinois, Michigan, Mississippi, New Jersey, New Mexico, Ohio, Texas, Virginia, and Washington.

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VIII. CONCEPTS ACCEPTED/REJECTED; CHANGES IN DUTIES; NON-SUBSTANTIVE CHANGES; ALTERNATIVES CONSIDERED

A. Concepts Accepted (Pros and Cons):

1. Change the title of the Rule.
 - Pros: The current title is not descriptive of the rule's content. A more specific title should assist lawyers in locating this Rule.
 - Cons: None identified.
2. Specify in paragraph (a) that the required disclosure includes the lawyer's role in the transaction or acquisition
 - Pros: There is substantial authority that the lawyer's role cannot be hidden from the client. See, e.g., In the Matter of Crane and DePew, 1 Cal. State Bar Ct. Rptr. 139 (Rev. Dept. 1990). In addition, because the disclosure must be in writing, the information about the lawyer's role will be readily available to any independent lawyer who the client might choose to provide advice on the transaction or acquisition.
 - Cons: This addition is unnecessary and micro-manages the concept of a full disclosure to the client about the transaction or acquisition.
3. Clarify in paragraph (b) that there is no requirement to advise a client to seek an independent lawyer in circumstances where the client is already represented on the transaction or acquisition.
 - Pros: No public protection is realized by requiring an advisement in such circumstances because the objective of the requirement is already met. Moreover, this pointless advisement might be perceived by the client as denigrating the independent lawyer that the client has already chosen and therefore could interfere with the client's confidence in that lawyer's advice.
 - Cons: The required advisement should be given even if the client is already represented by an independent lawyer. In such circumstances, this would function as an opportunity for the client to communicate confirmation that the client has in fact secured an independent lawyer concerning on the transaction or acquisition. Also, nothing in the rule dictates that the advisement be presented in a manner that denigrates the lawyer-client relationship that is being confirmed by the advisement. For example, the client's right to continue with their chosen independent counsel can be emphasized in conveying the advisement.
4. Revise the paragraph (b) requirement to advise the client that it "may" seek independent counsel in order to make the first lawyer's disclosure more definitive.

⁴ The eight jurisdictions are: Connecticut, District of Columbia, Florida, Maryland, Minnesota, Montana, New York, and North Dakota.

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- Pros: Case law tends to read the rule in this stricter fashion, and a lawyer's more definite statement is more likely to convince the client to seek independent counsel.
 - Cons: None identified.
5. Add a new paragraph (d) that provides a definition of an independent lawyer for purposes of this rule.
- Pros: The question of whether a lawyer is independent within the meaning of this rule does cause confusion. It is important to define the concept to help assure that the client actually receives independent advice. The receipt of truly independent advice can provide crucial protection for the client. This issue has been litigated under the prior rule (Rule 5-101). In *Conner v. State Bar* (1990) 50 Cal.3d 1047, 1058–59, the Supreme Court concluded that, as a general rule, a member, associate, or partner of a law firm cannot serve as the “independent counsel” required by the rule. In this case the purported independent counsel was the respondent's law partner and girlfriend. While it might be correct, as suggested immediately below, that it might be more difficult in the smallest communities to locate an independent lawyer, we believe that all clients are entitled to the protection afforded by having a truly independent voice, and the Rule applies to all lawyers.
 - Cons: The proposed definition would disqualify a person who is in a close legal, business, financial, professional, or personal relationship with the lawyer. In a small rural community with few lawyers, this might be burdensome.

B. Concepts Rejected (Pros and Cons):

1. Include in the Rule any new or modified fee agreement with current client.
 - Pros: It has been argued in a letter from OCTC and in a letter on behalf of various law professors that fee negotiations with current clients should be included in the Rule, in substance under the theory that a fiduciary relationship exists with current clients but not with a potential client.
 - Cons: The first sentence in the official Discussion to current rule 3-300 states: “Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client, unless the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client. Such an agreement is governed, in part, by rule 4-200.” It sometimes has been argued that this sentence applies only to the agreement by which a lawyer *first* is retained by a client although it does not be its terms refer only to initial retention. See *Priester v. Citizens Natl. Bank*, 131 Cal. App.2d 314, 321 (1955), which held that a lawyer has burden of proving that fee agreement with existing client was fair and reasonable and no advantage was taken. This states the correct concept that the negotiation of a standard fee agreement is an arms-length transaction but one that a court will review to see whether the lawyer exercised any undue influence. See also, Cal. State Bar Op. 1989-116: “Ethical considerations do exist, however, whenever an attorney attempts to negotiate

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an arbitration provision with a client during the course of an existing attorney-client relationship. Although rule 3-300 still does not apply because no ownership, possessory, security, or other pecuniary interest is involved, an attorney nevertheless has an on going ethical duty to preserve the trust and confidence existing clients place in the attorney.” Other courts have tacitly recognized this by ignoring rule 3-300 when addressing fee agreements between lawyers and current clients. See, e.g., *Stroud v. Tunzi*, 160 Cal. App.4th 377 (2008) (holding that any modification or amendment to a contingent fee agreement must comply with § 6147); *Severson & Werson v. Bolinger*, 235 Cal. App.3d 1569, 1573 (1991) (holding, among other things, that a lawyer may not change billing rates during a representation with notice to the client); *Ramirez v. Sturdevant*, 21 Cal. App.4th 904, 913 (1994); and *Walton v. Broglio*, 52 Cal. App.3d 400, 404 (1975) (discussing the possible application of Prob. C. § 16004 but ignoring rule 3-300). Courts and law firms properly do not generally treat the renegotiation of a fee agreement in a current representation to change the billing rate, the amendment of a fee agreement with a current client to alter the scope of services, or the negotiation with a current client of a fee agreement in a new matter as subject to rule 3-300. If this Rule were to apply to all fee agreements between a lawyer and a current client, it would require compliance each time a lawyer: (i) agrees to represent a current client in a new matter; (ii) agrees to a change in the billing rate; and (iii) agrees to alter the scope of a current representation. Discipline already is available when a lawyer utilizes the lawyer-client relationship to manipulate a client. See *Matter of Shalant*, 4 Cal. State Bar Ct. Rptr. 829 (2006). In addition, we believe that including fee agreements with current clients within this rule would denigrate the importance of the standards that apply to initial fee agreements; any impropriety in dealings with a new client will cause the lawyer to violate the unconscionable fee standard of *Herrscher v. State Bar of California*, 4 Cal. 2d 399 (1935). The first Commission dealt with this topic through the following Comment sentence: “This Rule does not apply to an agreement by which a lawyer is retained by a client or to the modification of such an agreement, unless the agreement or modification confers on the lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client, such as when the lawyer obtains an interest in the client's property to secure the amount of the lawyer's past due or future fees.” The ABA Model Rules takes the approach we recommend and, as did the first Commission, does so through a Comment: “[This Rule] does not apply to ordinary fee arrangements between client and lawyer, which are governed by Rule 1.5, although its requirements must be met when the lawyer accepts an interest in the client's business or other nonmonetary property as payment of all or part of a fee.” In lieu of the wording selected by the first Commission or the ABA, the language used in this draft comes directly from Prob. C. § 16004(c) in order to make clear that the application in this respect is the same for disciplinary and for civil purposes.

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2. OCTC recommends that this rule state that it applies to fiduciary relationships as well as lawyer-client relationships, arguing that this is already the law. (See e.g. In the *Matter of Hultman*, 3 Cal. State Bar Ct. Rptr. 297 (Review Dept. 1995). We recommend against making this change. It is correct that the lawyer in *Hultman* was disciplined under rule 3-300 for utilizing his position as a trustee to make loans to himself, but the lawyer was the drafter of the trust instrument on behalf of his law client. It therefore is not certain from *Hultman* that the result would have been the same if there had been no lawyer-client relationship. *Hultman* has been cited as a lawyer-client business transaction case. See *Matter of Van Sickel*, 2005 Calif. Op. LEXIS 3.
3. OCTC recommends that the rule state that it can apply to transactions involving former clients in some circumstances and, presumably because of the difficulty of drafting a rule that accurately describes current case law in this area, recommends that a lawyer adoption of a bright-line standard that a person is a lawyer's client for three years after the relationship has terminated (presumably meaning, only for purposes of this rule), but that this three-year standard should not prevent a finding that even after three years the former expects the lawyer to exercise professional judgment for the protection of the client. We recommend against this because we do not believe that it correctly states current law as stated in *Hunnecutt v. State Bar*, 44 Cal.3d 362 (1988) and *Beery v. State Bar*, 43 Cal.3d 802 (1987) which describe a more nuanced approach to the question of whether the rule should be applied to a transaction involving a former client. This would be a place for a Comment alerting the reader, but we think that would amount to the kind of practice guidance that we are directed to avoid in our Comments.
4. OCTC recommends that the rule apply to an attempt to enter into a business transaction or acquire an adverse pecuniary interest, but we disagree. Including attempts within this rule would create a new and undefined body of law dealing with the scope of "attempt". This would leave open many questions. For example: How far along the process would a lawyer have to go to be subject to discipline under the rule? What if the client rejected the attempt so quickly that the transaction was not yet in writing as required by the rule? What if the lawyer withdrew the attempt on the lawyer's own volition?.
5. OCTC recommends that the rule be expanded to include much of Bus & Prof Code § 6175.3 (titled: "Sale of financial products to elder or dependent adult clients; Disclosure"). We disagree. This already is part of a statutory scheme that creates specific remedies in § 6175.3 and authorizes professional discipline in § 6175.5. We see no benefit to including portions of this scheme in the rule. This would make the rule considerably more complex and cumbersome, and therefore less easily accessible to readers, and would risk creating conflicts between the rule and the statutory scheme (however, we have added a Comment reference to these statutes

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for the information of readers).

6. OCTC recommends that the consent requirement be changed to one of “informed consent”, arguing that this merely codifies existing case law. We recommend against this change because it would conflict with the current standard that applies when the client is independently represented with regard to the transaction or acquisition by suggesting that a low quality of independent representation could lead to disciplinary consequences for the lawyer who participates in the transaction or acquisition. See *Ferguson v. Yaspan*, 233 Cal. App. 4th 676, 689 (2014) (concluding that the quality of advice by independent counsel should be tested only in a malpractice action against that lawyer).
7. OCTC recommends that the rule obligate the lawyer to state whether the lawyer represents the client in the transaction. We recommend against this change because it is a matter of law that the lawyer represents the client unless the client is represented by independent counsel. Compare *Ferguson v. Yaspan*, 233 Cal. App. 4th 676 (2014) and *Felton v. Le Breton*, 92 Cal. 457 (1891). The suggested addition at best would be surplus and at worse might suggest to some readers that *Felton* is being implicitly overruled.
8. OCTC recommends that the rule be extended to state that it applies to transactions between a lawyer and a client’s agent. We recommend against this. A transaction will be with the client if entered into in the client’s name, even if the negotiations are with the client’s agent. The result would be the same if entered into in the name of the agent for the benefit of the client if the client’s position is disclosed to the lawyer (see Restatement Third of Agency § 6.01 (3rd Ed. 2006)). In these two situations the OCTC recommendation would serve no purpose. There is a third situation, which is where the agent’s principal is not disclosed. In that situation, the lawyer’s conduct should not be governed by this rule, but it would be under the OCTC recommendation because an undisclosed principal is a party to a contract made by an agent on the principal’s behalf. (see Restatement Third of Agency § 6.02 (3rd Ed. 2006)). A lawyer should not be subject to scrutiny under this rule for entering into a transaction with a client’s agent if the lawyer does not know of that agency relationship.
9. OCTC recommends that the rule be extended to state that it applies to transactions with a client’s close relative. We recommend against this. A lawyer under current law does not owe the fiduciary duties of a lawyer-client relationship to a non-client even if that person has a close or even a family relationship with a client. We see no basis for altering this well-understood concept.

C. Changes in Duties/Substantive Changes to the Current Rule:

1. Requiring that the disclosure must include the lawyer’s role in the transaction or

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acquisition is a substantive change to the rule. (See VIII.A.2, above.)

2. Providing there is no requirement to advise a client to seek an independent lawyer in circumstances where the client is already represented on the transaction or acquisition is a substantive change to the rule. (See VIII.A.3, above.)

D. Non-Substantive Changes to the Current Rule:

1. Substitute the term “lawyer” for “member”.
 - Pros: The current Rules’ use of “member” departs from the approach taken in the rules in every other jurisdiction, all of which use the term lawyer. The Rules apply to all non-members practicing law in the State of California by virtue of a special or temporary admission. For example, those eligible to practice pro hac vice or as military counsel. (See e.g. rules 9.40, 9.41, 9.42, 9.43, 9.44, 9.45, 9.46, 9.47, and 9.48 of the California Rules of Court.)
 - Cons: Retaining “member” would carry forward a term that has been in use in the California Rules for decades.
2. Change the rule number to conform to the ABA Model rules numbering and formatting (e.g., lower case letters).
 - Pros: It will facilitate the ability of lawyers from other jurisdictions who are authorized by various Rules of Court to practice in California to find the California rule corresponding to their jurisdiction’s rule, thus permitting ease of determining whether California imposes different duties. It will also facilitate the ability of California lawyers to research case law and ethics opinions that address corresponding rules in other jurisdictions, which would be of assistance in complying with duties, particularly when California does not have such authority interpreting the California rule. As to the “Con” that there is a large body of case law that cites to the current rule numbers, the rule numbering was drastically changed in 1989 and there has been no apparent adverse effect. A similar change in rule numbering of the Rules of Court was implemented in 2007, also with no apparent adverse effect.
 - Cons: There is a large body of case law that cites to the current rule numbers and California lawyers are presumed to be familiar with that numbering system.
3. Revising the paragraph (b) requirement to advise the client that it “may” seek independent counsel in order to make the first lawyer’s disclosure more definitive is a non-substantive change to the rule; it merely reflects how the rule has been interpreted. (See VIII.A.4, above.)
4. New paragraph (d), defining “independent lawyer,” is a non-substantive change to the rule; it merely clarifies what the law is. (See VIII.A.5, above.)

E. Alternatives Considered:

None.

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IX. OPEN ISSUES/CONCEPTS FOR THE COMMISSION TO CONSIDER

None.

X. COMMENTS FROM DRAFTING TEAM MEMBERS OR OTHER COMMISSION MEMBERS

Kehr

- [Date]: Email Comment

Bleich

- [Date]: Email Comment

Harris

- [Date]: Email Comment

XI. RECOMMENDATION AND PROPOSED COMMISSION RESOLUTION

Recommendation:

That the Commission recommend that the Board of Trustees of the State Bar of California adopt proposed amended Rule 3-300 [1.8.1] in the form attached to this report and recommendation.

Proposed Resolution:

RESOLVED: That the Commission for the Revision of the Rules of Professional Conduct recommends that the Board of Trustees adopt proposed amended Rule 3-300 [1.8.1] in the form attached to this Report and Recommendation.

XII. DISSENTING POSITION(S)

None.

XIII. FINAL COMMISSION VOTE/ACTION

Date of Vote:

Action:

Vote: X (yes) – X (no) – X (abstain)

CURRENT CALIFORNIA RULE 3-300
“Avoiding Interests Adverse to a Client”

I. Text of Current Rule:

A member shall not enter into a business transaction with a client; or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

- (A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and
- (B) The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and
- (C) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.

Discussion:

Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client, unless the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client. Such an agreement is governed, in part, by rule 4-200.

Rule 3-300 is not intended to apply where the member and client each make an investment on terms offered to the general public or a significant portion thereof. For example, rule 3-300 is not intended to apply where A, a member, invests in a limited partnership syndicated by a third party. B, A's client, makes the same investment. Although A and B are each investing in the same business, A did not enter into the transaction "with" B for the purposes of the rule.

Rule 3-300 is intended to apply where the member wishes to obtain an interest in client's property in order to secure the amount of the member's past due or future fees. (Amended by order of Supreme Court, operative September 14, 1992.)

II. Background/Purpose:

Rule 3-300 originated with the first rules promulgated in 1928. Former rule 4 provided an outright prohibition: "A member of the State Bar shall not acquire an interest adverse to a client." When the entire rules were revised operative January 1, 1975, rule 4 became new rule 5-101 (Avoiding Adverse Interests), which narrowed the original prohibition by permitting a "business transaction with a client" or acquisition of an "ownership, possessory, security or other pecuniary interest adverse to a client" if three conditions were all met: (1) the transaction and terms are fair and reasonable to the client and fully disclosed in writing in a manner and terms which should have reasonably

been understood by the client; (2) the client is given a reasonable opportunity to seek the advice of independent counsel; and (3) the client consents in writing.

The entire rules were revised operative on May 29, 1989. Rule 5-101 was renumbered as rule 3-300 and reorganized with subparagraphs. The rule was amended to refine the requirements by: setting apart the concepts of a “business transaction” and “ownership, possessory, security or other pecuniary interest;” adding a requirement that the client be advised in writing that the client may seek independent counsel; and clarifying that the client’s consent must be after paragraphs (A) and (B) are satisfied. Three Discussion paragraphs were also added.

The rule was last amended effective September 14, 1992. The only change revised the rule’s title to “Avoiding Interests Adverse to a Client” to better distinguish the rule from rule 3-310 (Avoiding the Representation of Adverse Interests).

III. Input from the State Bar Office of the Chief Trial Counsel (OCTC):

A. 2016 Comment¹

In a _____, 2016 memorandum to the Commission, OCTC provided the following comment regarding rule 3-300:

(Note: OCTC is expected to provide new comments on this rule. These comments will be distributed to the drafting team when they are received from OCTC.)

B. 2010 Comment

In a June 15, 2010 memorandum to the first Commission, OCTC provided the following comment on proposed rule 1.8.1:

1. There are too many comments and many are too long and incorporate other rules and comments. They seem more appropriate for treatises, law review articles, and ethics opinions.
2. While OCTC believes modifications would normally apply to this rule (see OCTC’s written Comment to COPRAC’s Proposed Formal Opinion Interim No. 05-0001, already provided in OCTC’s August 26, 2008 comments to the rules), it

¹ Although OCTC has not yet provided comments on rule 3-300, in a September 2, 2015 memorandum to the Commission providing comments on rule 4-200 (Fees for Legal Services), OCTC provided the following comment relevant to rule 3-300:

5. Modification of fee agreements should require compliance with rule 3-300 regarding adverse interests. A lawyer holds a position of trust and has a fiduciary duty vis-a-vis his or her client. Compliance with rule 3-300 will help prevent lawyers from abusing their position and overreaching when renegotiating a fee agreement.

See additional discussion at section VI.B, below.

supports the compromise adopted that states in most cases modifications will be governed by proposed rule 1.5(f).

3. The first sentence of Comment 6 seems unnecessary. Comment 6's last sentence should make clear that a contingent fee could fall within this rule if the lawyer obtains a proprietary interest in the client's property. For example, if an attorney represents a client in a civil lawsuit over the shares of a company and if the agreement states that if successful the lawyer obtains a percentage of the shares and not just a percentage of the worth of the shares the attorney's agreement should come within proposed rule 1.8.1. The Commission rejected ABA rule 1.8(i) because they believed proposed rule 1.8.1 was sufficient. Thus, when we are discussing an actual interest in the subject of the representation, and not just monetary percentages, rule 1.8.1 should apply, even for contingency agreements.
4. The last sentence of Comment 9 should be stricken as it is legally incorrect. It states "Except in a disciplinary proceeding, the burden is always on the lawyer to show that the transaction or acquisition and its terms were fair and just and that the client was fully advised." If the Commission is stating or implying that in a disciplinary proceeding the attorney does not have the burden of showing that the transaction or acquisition and its terms were fair and reasonable or just and that the client was fully advised, the Commission is wrong. It is well established that the attorney in a disciplinary proceeding has the burden of showing that the transaction is fair and reasonable and was fully known and understood by the client. (Rodgers v. State Bar (1989) 48 Cal.3d 300, 314; Hunnicutt v. State Bar (1988) 44 Cal.3d 362, 372-373; Clancy v. State Bar (1969) 71 Cal.2d 140, 146-147; In the Matter of Hagen (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 153, 165; In the Matter of Peavey (Review Dept. 2002) 4 Cal. State Bar Ct. Rptr. 484, 489; In the Matter of Gillis (Review Dept. 2002) 4 Cal. State Bar Ct. Rptr. 387, 394-395.)
5. Comments 10-14 could be shortened and tightened.

C. 2001 Comment

In a September 27, 2001 memorandum to the first Commission, OCTC provided the following comment on current rule 3-300:

OCTC recommends clarifying the duties of an attorney when entering into a business transaction with a client. The recommendations further resolve issues that have developed in the application of the current rule.

Add:

(A) For purposes of this rule "client" means an individual or entity who the member is representing in a legal matter or other person or entity to whom the member owes a fiduciary duty as prescribed by law or a former client or other person or entity to whom the member owed a fiduciary duty and who expects the member to exercise professional judgment for the protection of the client. For purposes of paragraph (B) of

this rule, a member shall be conclusively found to be a client's lawyer for three years after the relationship has terminated. However, this shall not prevent a finding that even after three years the person or entity expects the member to exercise professional judgment for the protection of the client.

And revise the current language as follows:

(B) A member or his or her agents shall ~~must~~ not directly or indirectly enter or attempt to enter into a business transaction with a client or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

(A) (1) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in a clear and conspicuous writing ~~to the client~~ in a manner which should reasonably have been understood by the client. This disclosure shall be made in a separate document, appropriately entitled, in 12-point print with one inch of space on all borders, signed by the client or the client's conservator, guardian, or agent under a valid durable power of attorney. It shall also be presented to the client at least three days prior to the parties entering into the transaction; and

(B) (2) The client is advised in writing ~~that the client may~~ that he or she should seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(C) (3) The client thereafter ~~consents~~ gives informed consent in a writing signed by the client to the terms of the transaction or the terms of the acquisition and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction is clearly explained. This document will be separate from the disclosure document required in paragraph (B)(1) of this rule.

OCTC COMMENTS:

OCTC recommends that this rule have a definition section. In that definition section, the rule should expressly state that the rule applies to fiduciary relationships as well as traditional attorney-client relationships. This is already the law. (See e.g. *In the Matter of Hultman* (Review Dept. 1995) 3 Cal. State Bar Ct. Rptr. 297, 307.)

Paragraph (A) should also state that the rule applies when a former client or fiduciary expects that the attorney will exercise professional judgment on behalf of the client or other person or entity to whom the member owes a fiduciary duty as prescribed by law. In *Hunnicutt v. State Bar* (1988) 44 Cal.3d 362, 371, the California Supreme Court held that "if there is evidence that the client placed his trust in the attorney because of the representation, an attorney-client relationship exists for the purposes of [former] rule 5-101 [the predecessor of current rule 3-300] even if the representation has otherwise ended." Thus, this provision is codifying existing law.

OCTC also recommends that a member shall be conclusively found to be a client's lawyer for three years after the relationship has terminated. However, this shall not prevent a finding that even after three years the person or entity expects the member to

exercise professional judgment for the protection of the client. By requiring the rule to apply for at least three years after the relationship terminates, the rule will protect the client's understanding of the relationship and make it less likely that an attorney will use information obtained in his representation for the attorney's own advantage. It will also emphasize to attorneys that this rule still applies after the termination of the relationship. Further, this change would adopt what the legislature has mandated in Business & Professions Code section 6175.3. That statute requires an attorney to comply with the conditions imposed in that statute (many of which are similar to the requirements of rule 3-300) when the attorney sells financial products to an elder or dependent adult with whom the lawyer has or has had an attorney-client relationship. Thus, we are only extending a protection already provided for some clients to all clients.

OCTC recommends that the rule apply not just to the member but also to the member's agents and to direct and indirect transactions. This would require of attorneys no more than what is already required of real estate brokers - that they cannot do indirectly or through relatives and others what they are prohibited from doing for themselves directly. In *In the Matter of Fandey* (Review Dept. 1994) 2 Cal. State Bar Ct. 767, 777, the Review Department held that former rule 5-101 did not apply to transactions between the member's parents and the member's client because there was no evidence that the member was a party to or benefitted financially from the property transactions. However, the California Supreme Court has held that "[t]he rule that an agent employed to sell the principal's property may not, without the principal's full knowledge and consent, become the purchaser, is aimed at an indirect or collusive sale or transfer, as well as a direct sale or transfer to the agent, and extends to a relative of the agent, or to his partner or employee. The rule also applies where the sale or transfer is made to a corporation in which the agent has a large concealed interest, or indirectly to the agent in the name of a third person." *Batson v. Strehlow* (1968) 68 Cal.2d 662, 675-676. In *Marlowe v. State Bar* (1965) 63 Cal.2d 304, the California Supreme Court held that an attorney could not avoid the consequences of discipline if his wife, instead of himself, purchased a client's property. To protect clients from unscrupulous attorneys and to protect attorneys from challenges of misconduct, this rule should be revised so that it imposes discipline when the attorney indirectly or through agents or close relatives engages in conduct, which if done by the attorney, would require compliance with rule 3-300.

The rule should also apply to attempts by attorneys to enter into transactions with a client without full compliance with the appropriate conditions.

OCTC recommends that section 1 of the rule be revised to include much of the language and conditions required by Business & Professions Code section 6175.3. Not only must the transaction be fair and reasonable to the client, but the terms should be provided in a clear and conspicuous writing separate from any other document, appropriately entitled, in at least 12 point type, signed by the client and presented at least three days prior to the parties entering into the transaction. This is necessary to ensure that the client understands the transaction, has time to review and evaluate it, and to allow for the client to consult an independent lawyer. It provides a cooling off period where the client can reconsider the transaction outside the influence of the attorney. By requiring a separate document, the terms will not be lost or missed by the

client and it helps to ensure that the transaction is only entered into after reasoned consideration by the client. These requirements seem particularly appropriate given the nature of the relationship and the trust that clients often place in their attorneys.

Section 2 eliminates a confusing aspect of the current rule. The current rule states that the attorney is to advise the client in writing that the client “may” seek the advice of an independent lawyer. However, the California Supreme Court has held that the member “must” advise the client to seek independent counsel. OCTC’s proposal eliminates any doubt that the lawyer must advise the client to seek the advice of an independent lawyer.

In section 3, the proposed new language adds to the rule a requirement that the client’s written consent must be informed consent. This is a codification of existing case law. Case law requires that the lawyer provide the client with all the information he or she would provide if another person instead of the member was attempting to negotiate this transaction with the client. That informed consent should require that the client consent in writing to the terms of the transaction, the risks, the lawyer’s role in the transaction, whether the lawyer is representing the client in the transaction, and any other relevant information.

IV. Initial Public Comments Received:

At its April 24, 2015 meeting, the Board of Trustees Regulation and Discipline Committee authorized a 45-day public comment period to seek general input on possible amendments to the Rules of Professional Conduct that ought to be considered by the Commission. The Commission received two public comments regarding the conflict of interest rules, in general – one from COPRAC and one from an individual. Both recommended amending the current conflict of interest rules to resemble those of the Model Rules.

The Commission received one public comment specific to rule 3-300. A group of legal ethics professors that had commented on the first Commission’s proposed rule 1.8.1, resubmitted its comment on that rule, focusing on two issues. First, the group recommended against the language in proposed Comment [5] excluding fee modifications from the rule’s application. Based on the ongoing fiduciary duty owed to an existing client, the group asserted its position that a fee modification is a business transaction with a client and may also involve acquisition of an adverse pecuniary interest. The group’s comment noted that proposed Comment [5] sets up a conflict between the rules and the lawyer’s ongoing fiduciary duties. See section VI.B below for additional discussion regarding fee modification. Second, the group recommended against the limiting language in proposed paragraph (b) that eliminated the requirement to advise the client to seek independent counsel where the client is already represented by independent counsel. Taken together with proposed Comments [13] and [14], which define independent counsel very broadly, the group argued that the limitation substantially diminishes client protection. Instead, the group recommended adoption of the language in Model Rule 1.8(a)(2) and Comment [4].

V. Potential Deficiencies in the Current Rule:

A. See above 2001 input from OCTC, proposing several modifications to current rule 3-300:

1. The rule should define “client” to clarify that the rule applies not only to traditional lawyer-client relationships, but also to fiduciary relationships. See *In the Matter of Hultman* (Review Dept. 1995) 3 Cal. State Bar Ct. Rptr. 297.
2. The rule should clarify that it applies beyond the termination of the representation where a former client or fiduciary expects the lawyer will exercise professional judgment. See *Hunnicutt v. State Bar* (1988) 44 Cal.3d 362 [243 Cal.Rptr. 699]. The rule should also state that a lawyer will be found to be a client’s lawyer for three years after the relationship has terminated. This change would adopt similar statutory concepts applicable to a lawyer’s sale of financial products to an elderly client or former client. See Bus. & Prof. Code, § 6175.3.
3. The rule should specify that it also applies to agents or close relatives of the lawyer.
4. The rule should apply to attempts to enter into transactions with a client without full compliance with the rule.
5. The rule should require that the client’s consent be *informed* written consent, requiring that the client consent not only to the terms of the transaction, but also to the risks involved and the lawyer’s role in the transaction.

B. The current rule does not contain an exception, either in the black letter or the Discussion, from the requirement that a lawyer advise the client to seek independent counsel for circumstances where the client is already represented by counsel in the transaction. Numerous other jurisdictions follow the model rule approach in Comment [4] to model rule 1.8. See discussion at section VII.

C. Current rule paragraph (B) language that the client “may seek the advice” of independent counsel may be inconsistent with California Supreme Court authority requiring lawyers to advise and perhaps *encourage* the client to seek independent counsel. See discussion at section VI.A.2, below.

D. Current rule paragraph (C) only requires client consent to the terms of the transaction rather than also requiring, similar to the model rule, client consent to the lawyer’s role in the transaction.

E. The current rule does not expressly apply to modifications of fee agreements. The Discussion section states the rule is inapplicable to agreements by which the lawyer is retained unless it confers an interest adverse to the client. However, it does not address a modification to the agreement. Whether the rule should

apply to modifications of fee agreements is an unsettled issue. See discussion at section VI.B, below.

F. The current rule does not define “independent lawyer.”

VI. California Context:

A. California Law Related to Current Rule 3-300

1. Fiduciary Self-Dealing – Presumption of Undue Influence

California law recognizes a fiduciary’s potential for exerting undue influence in transactions with a beneficiary. Under Probate Code, section 16004, the law presumes a fiduciary has used this influence to the fiduciary’s advantage in all dealings with the beneficiary of the trust that “... occurs during the existence of the trust or while the trustee’s influence with the beneficiary remains” Section 16004 applies to the lawyer-client relationship. (See *BGJ Associates, LLC v. Wilson* (2003) 113 Cal. App.4th 1217, 1227. See also, *Ramirez v. Sturdevant* (1994) 21 Cal.App.4th 904, 916.) This standard does not apply to the negotiation of the agreement creating the fiduciary relationship. (See *Seltzer v. Robinson* (1962) 57 Cal.2d 213, 217 [concluding that an attorney should not be put in the “impossible position of becoming the prospective client’s attorney while he was attempting to reach an agreement with him as to whether he should become his attorney or not.”].)

2. Business and Professions Code, section 6175.3 (Sale of Financial Products to an Elder, Dependent Adult, Client or Former Client)

Business and Professions Code, section 6175.3 is similar to current rule 3-300 in that it governs transactions with persons with whom the lawyer has a fiduciary relationship. It applies to a lawyer selling financial products to an elder, or dependent adult, client or former client and has similar requirements to rule 3-300 (e.g. fair and reasonable terms, requirement to advise client they may seek independent advice, client’s written consent). It also includes additional heightened requirements (e.g. the written disclosure must be clear and conspicuous and meet specific formatting requirements, the lawyer must disclose the lawyer’s interest in the sale), and applies for three years following the termination of the lawyer-client relationship.

In its 2001 comment, OCTC suggested language changes to rule 3-300 that tracked the requirements under section 6175.3, reasoning that the changes would simply extend protections already provided for some clients to all clients.

3. Duty to Advise Client: Seeking Independent Counsel

Current rule 3-300 requires lawyers to advise the client that the client “may seek the advice” of independent counsel regarding the transaction or acquisition. The State Bar Review Department indicated that the language of the current rule is inconsistent with California Supreme Court authority that require a lawyer to advise the client *to seek* independent advice. *Matter of Silverton II* (2004) 4 Cal. State Bar Ct. Rptr. 643, n. 16. In *Rose v. State Bar* (1989) 49 Cal.3d 646, 663 [262 Cal.Rptr. 702], where the lawyer

told the client that she could consult another lawyer regarding the transaction, but did not advise her to, and implied that doing so would be unnecessary, the court stated that the lawyer, in entering such transactions with the client, was required to advise the client to seek independent counsel. In *Rodgers v. State Bar* (1989) 48 Cal.3d 300, 309 [256 Cal.Rptr. 381], where the client transferred conservatorship funds to the lawyer for investment with the lawyer's former client, who owed the lawyer money, the court stated that the lawyer was required to *encourage* the client to consult with other counsel.

B. Modification of Fee Agreements

No rule of professional conduct specifically addresses modifications to fee agreements. The Discussion to rule 3-300 states the rule is not applicable to agreements by which the lawyer is retained unless it confers an interest adverse to the client, but is silent regarding modification of the initial agreement. Since the last amendments to rule 3-300, numerous diverging interpretations of the rule's applicability to modifications of fee agreements have emerged.

1. OCTC and the group of Ethics Professors commenting on the current/proposed rules support the position that rule 3-300 applies to all fee modifications.
 - OCTC – in two separate comments, OCTC expressed its position that all modifications to fee agreements should be subject to rule 3-300.
 - 2015 Comment: Kim – In a September 2, 2015 memorandum to the Commission providing comments on rule 4-200 (Fees for Legal Services), OCTC provided the following comment relevant to rule 3-300:
 - 5. Modification of fee agreements should require compliance with rule 3-300 regarding adverse interests. A lawyer holds a position of trust and has a fiduciary duty vis-a-vis his or her client. Compliance with rule 3-300 will help prevent lawyers from abusing their position and overreaching when renegotiating a fee agreement.
 - 2010 Comment: Weiner – OCTC believes proposed rule 1.8.1 should apply to all modifications of fee agreements regardless of whether an adverse interest is conferred. However, at that time, OCTC accepted the compromise adopted by the Board, discussed below.
 - Ethics Professors – in a public comment, a group of ethics professors recommended against excluding fee modifications from the rule's application. The group believed that, based on the ongoing fiduciary duty owed to an existing client, all modifications to fee agreements are business transactions with a client (i.e. subject to rule 3-300) *and* may also involve acquisition of an adverse pecuniary interest.
2. COPRAC supported the position that rule 3-300 applies only to fee modifications that confer an interest *adverse* to the client. In 2009, COPRAC issued an Ethics

Alert² discussing whether modifications of lawyer fee agreements are subject to rule 3-300, and noting the controversial and unsettled nature of the issue. The Ethics Alert began as Proposed Formal Opinion Interim No. 05-0001, which concluded that rule 3-300 does not apply to *all* fee modifications, only those that confer an interest adverse to the client.³ COPRAC believed, at least under the facts presented in the opinion, that (1) fee modifications are not business transactions with clients, and (2) not all fee modifications would confer an interest adverse to the client. After receiving numerous public comments on the proposed opinion, the Board Committee declined to adopt the opinion.

3. The first Commission's proposed rule 1.8.1 resulted from a Board compromise that reflected the minority position of the Commission and essentially struck a balance between the two positions discussed above. The first Commission majority had proposed that all modifications of fee agreements be treated the same as an initial fee agreement (i.e. as an arm's length transaction), reasoning that many fee modifications are beneficial to clients and that existing California case law protects clients from fee modifications that involve overreaching or undue influence by the lawyer.⁴ The Board rejected that position in favor of the minority's proposed compromise.⁵ The compromise limited the applicability of proposed rule 1.8.1 to modifications that confer an interest adverse to the client and added a new provision to proposed rule 1.5 (Fees for Legal Services), which prohibited a lawyer from making material modifications to a fee agreement unless the client is either represented by an independent lawyer regarding the modification or is advised in writing to seek such advice.⁶

² See, Ethics Hotliner, Ethics Alert: Uncertain Ethics Requirements for Attorney Fee Modifications - Counsel Compliance with Rule 3-300 when Modifying a Fee Agreement (COPRAC 2009) found at:

http://ethics.calbar.ca.gov/Portals/9/documents/Publications/EthicsHotliner/Ethics_Hotliner-Fee_Modification_Rule_3-300-Summer_09.pdf

³ The full text of the proposed opinion is part of the Ethics Alert article. See footnote 3.

⁴ Two members of the first Commission submitted a separate memorandum to the Board opposing the Board compromise. The members argued that existing law already affords adequate public protection and provided examples to demonstrate their position. See, Kehr and Peck position memorandum to the Board, dated 12/13/2009.

⁵ One member of the first Commission submitted a separate memorandum to the Board opposing the majority position. The memo stated that whether a modification is subject to the rule depends on the particular modification and its effect on the client's rights. See, Tuft position memorandum to the Board, dated 10/18/2009.

⁶ Paragraph (e) of the first Commission's proposed Rule 1.5 provided:

(e) A lawyer shall not make a material modification to an agreement by which the lawyer is retained by the client that is adverse to the client's interests unless the client is either represented with respect to the modification by an independent lawyer or is advised in writing by the lawyer to seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice

The rule provision was accompanied by four explanatory comments.

4. This Commission's drafting team for rule 4-200 did not adopt the same compromise as the first Commission. Instead, the drafting team rejected the concept that a provision regarding fee modifications should be added to rule 4-200. See, Drafting Team Report and Recommendation: Rule 4-200.

VII. Approach In Other Jurisdictions (National Backdrop):

A. ABA Model Rule 1.8

ABA Model Rule 1.8(a) is the Model Rules counterpart to current rule 3-300. The language and substance of model rule 1.8(a) is very similar to current rule 3-300, but with two substantive differences in the black letter. First, model rule 1.8(a) requires that the client be advised in writing "of the desirability of seeking" independent counsel on the transaction, whereas rule 3-300 requires that the client be advised in writing "that the client may seek the advice" of independent counsel. See additional discussion in section VI.A.2, above. Second, model rule 1.8(d) requires that the client consent to the terms of the transaction *and* to the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction, whereas rule 3-300 only requires consent to the terms of the transaction or acquisition.

Additionally, model rule 1.8, Comment [4] provides guidance on the applicability of the requirement to advise the client to seek independent counsel. Comment [4] states that the requirement is inapplicable to clients that are independently represented in the transaction, and that the requirement is fulfilled by a written disclosure by either the lawyer involved in the transaction or by the client's independent counsel.

Model rule 1.8 also contains two related paragraphs that are not in current rule 3-300. Model rule 1.8(d) prohibits, prior to the conclusion of the representation, agreements giving literary or media rights to a lawyer. In California, such agreements have been permitted.⁷ Model rule 1.8(i) prohibits a lawyer from acquiring a proprietary interest in the subject matter of litigation, and is based on concepts of champerty and maintenance.

B. The ABA State Adoption Chart for Model Rule 1.8(a)

The ABA State Adoption Chart, entitled "Variations of the ABA Model Rules of Professional Conduct, Rule 1.8: Conflict of Interest: Current Clients: Specific Rules," revised May 13, 2015, is available at:

http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc_1.8.authcheckdam.pdf

⁷ See, *Maxwell v. Superior Court* (1982) 30 Cal.3d 606, 616, n. 6 [180 Cal.Rptr. 17], in which the Court held defense counsel could obtain an ownership right to the life story of his criminal defendant client where there were extensive disclosures and the client was advised to seek the advice of independent counsel, and the client knowingly consented to the arrangement.

Twenty-nine jurisdictions have adopted the model rule 1.8(a) verbatim,⁸ fourteen jurisdictions have adopted variations of model rule 1.8(a),⁹ and eight jurisdictions have a different rule or a materially modified version of model rule 1.8(a).¹⁰

VIII. Public Comment Received by the First Commission:

The clean text of proposed rule 1.8.1 drafted by the first Commission and adopted by the Board to replace rule 3-300 is enclosed with this assignment, together with the synopsis of public comments received on that proposed rule and the full text of those comments. Although the proposed rule differs from current rule 3-300, the drafting team might consider to what extent, if any, the public comments received on the proposed rule provide helpful information in analyzing the current rule.

To facilitate the review and to appreciate the relevance of these public comments, a redline comparison of the first Commission's proposed rule showing changes to rule 3-300 is also enclosed with the public comments received. However, given the Board's charge to engage in a comprehensive review of the current rules and to retain the historical nature of the California Rules as "a clear and enforceable articulation of disciplinary standards," a drafting team that considers amendments developed by the first Commission should not presume that the approach taken by the first Commission was appropriate to achieve those objectives.

IX. Potential Issues Identified by Professional Competence Staff Following Review of the Proposed Rule Developed by the First Commission and Adopted by the Board:

Bearing in mind the Commission's Charter to engage in a comprehensive review of the current rules and to retain the historical nature of the California Rules as "a clear and enforceable articulation of disciplinary standards," Professional Competence staff identified the following rule amendment issues (in no particular order) that the drafting team might consider. The drafting team need not address any of the issues. For example, if after critically evaluating an issue addressed by a revision made by the first Commission, the drafting team determines that the revision does not address an actual (as opposed to theoretical) public protection deficiency in the current rule, then the drafting team should hesitate to recommend a change to the current rule despite the prior decision by the first Commission and the Board to address the issue. (Note: For the sake of completeness and ease of reference, some of the issues listed below may have already been mentioned in connection with other information provided above, such as in connection with the approaches taken in other jurisdictions or prior public

⁸ The twenty-nine jurisdictions are: Arizona, Arkansas, Colorado, Delaware, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine; Massachusetts, Missouri, Nebraska, Nevada, New Hampshire, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Wisconsin, West Virginia, and Wyoming.

⁹ The fourteen jurisdictions are: Alabama, Alaska, California, Georgia, Hawaii, Illinois, Michigan, Mississippi, New Jersey, New Mexico, Ohio, Texas, Virginia, and Washington.

¹⁰ The eight jurisdictions are: Connecticut, District of Columbia, Florida, Maryland, Minnesota, Montana, New York, and North Dakota.

comment. Multiple mentions of an issue do not necessarily warrant the drafting team taking action on an issue.)

A. Whether the rule should define “client” so as to make rule applicable to fiduciary relationships.

B. Whether the rule should clarify that it applies beyond the termination of the representation and/or include a bright-line provision that rule applies for three years after the relationship has terminated.

C. Whether the rule should specify that it applies to agents or close relatives of the lawyer.

D. Whether the rule should apply to attempts to enter into transactions with a client without full compliance with the rule.

E. Whether the rule should require that the client’s consent be *informed* written consent and require that the client also consent to the lawyer’s role in the transaction.

F. Whether the rule should retain the requirement that the attorney advise all clients that they may seek independent counsel, or instead provide an exception to the requirement where the client is already represented by counsel in the transaction.

G. Whether the rule should retain the language in paragraph (B) that the client “may seek the advice” of independent counsel, or instead adopt new language to avoid conflict with authority requiring lawyers to advise and perhaps *encourage* the client to seek independent counsel.

H. Whether the rule should expressly apply to all modifications of a lawyer-client fee agreement.

I. Whether the rule should include a definition of “independent lawyer”.

X. Research Resources:

- Business & Professions Code, section 6175.3
- Probate Code, section 16004
- *In the Matter of Hultman* (Review Dept. 1995) 3 Cal. State Bar Ct. Rptr. 297
- *Hunnecutt v. State Bar* (1988) 44 Cal.3d 362 [243 Cal.Rptr. 699]
- *Matter of Silverton II* (2004) 4 Cal. State Bar Ct. Rptr. 643, n. 16.
- *Rose v. State Bar* (1989) 49 Cal.3d 646, 663 [262 Cal.Rptr. 702]
- *Rodgers v. State Bar* (1989) 48 Cal.3d 300, 309 [256 Cal.Rptr. 381]
- *BGJ Associates, LLC v. Wilson* (2003) 113 Cal. App.4th 1217, 1227
- *Ramirez v. Sturdevant* (1994) 21 Cal.App.4th 904, 916
- *Seltzer v. Robinson* (1962) 57 Cal.2d 213, 217
- Ethics Alert: Uncertain Ethics Requirements for Attorney Fee Modifications - Counsel Compliance with Rule 3-300 when Modifying a Fee Agreement (COPRAC 2009)