

To: Rules Revision Commission
From: 1.8.1 [3-300] Drafting Team
Re: Proposed Revision to Rule 1.8.1(a) and Public Comment Synopsis Table
Date: January 12, 2017

After reviewing the public comment submitted by the Los Angeles County Bar Association (LACBA), the drafting team unanimously revised paragraph (a) of proposed rule 1.8.1 as a compromise between imposing an affirmative duty on the lawyer to disclose the terms and the lawyer's role in the transaction to the client (as the Commission voted at the October 2016 meeting) and retaining the passive voice construction of current and 90-day public comment version of the rule. Under this compromise approach, paragraph (a) would provide:

- (a) The transaction or acquisition and its terms are fair and reasonable* to the client and the lawyer takes reasonable steps to assure that the terms and the lawyer's role in the transaction or acquisition are fully ~~discloses and transmits~~ disclosed and transmitted in writing* to the client ~~the terms and the lawyer's role in the transaction or acquisition~~ in a manner that should reasonably* have been understood by the client;

Under this approach, the lawyer still must take steps to assure that the terms and lawyer's role have been disclosed to the client even if the lawyer himself or herself does not make the disclosure, as in situations described in the LACBA comment. We are advised that in addition to the LACBA comment, a Board member raised this same point at the November 17, 2016 Board meeting.

The attached Synopsis Table provides two alternatives. ALT1 is a proposed response should the Commission agree with the foregoing recommendation. ALT2 is a proposed response should the Commission decide to retain the language in the public comment draft.

**Rule 1.8.1 [3-300] Business Transactions with a Client and
Pecuniary Interests Adverse to a Client
(Commission's Proposed Rule Adopted on October 21–22, 2016 – Clean Version)**

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 lawyer fully discloses and transmits in writing* to the client the terms and the lawyer's role in the transaction or acquisition in a manner that should reasonably* have been understood by the client;
- (b) The client either is represented in the transaction or acquisition by an independent lawyer of the client's choice or the 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 provides informed written consent* to the terms of the transaction or acquisition, and to the lawyer's role in it.

Comment

[1] A lawyer has an "other pecuniary interest adverse to a client" within the meaning of this Rule when the lawyer possesses a legal right to significantly impair or prejudice the client's rights or interests without court action. See *Fletcher v. Davis* (2004) 33 Cal.4th 61, 68 [14 Cal.Rptr.3d 58]. See also Business and Professions Code § 6175.3 (Sale of financial products to elder or dependent adult clients; Disclosure) and Family Code §§ 2033-2034 (Attorney lien on community real property). However, this Rule does not apply to a charging lien given to secure payment of a contingency fee. See *Plummer v. Day/Eisenberg, LLP* (2010) 184 Cal.App.4th 38 [108 Cal.Rptr.3d 455].

[2] For purposes of this Rule, factors that can be considered in determining whether a lawyer is independent include whether the lawyer: (i) has a financial interest in the transaction or acquisition, and (ii) has a close legal, business, financial, professional or personal relationship with the lawyer seeking the client's consent.

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

[4] In some circumstances, this Rule may apply to a transaction entered into with a former client. Compare *Hunnicutt v. State Bar* (1988) 44 Cal.3d 362, 370-71 ("[W]hen an attorney enters into a transaction with a former client regarding a fund which resulted from the attorney's representation, it is reasonable* to examine the relationship between the parties for indications of special trust resulting therefrom. We conclude 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 [the predecessor rule] even if the representation has otherwise ended [and] It appears that [the client] became a target of [the lawyer's] solicitation because he knew, through his representation of her, that she had recently received the settlement fund [and the court also found the client to

be unsophisticated].”) and *Wallis v. State Bar* (1942) 21 Cal.2d 322 (finding lawyer not subject to discipline for entering into business transaction with a former client where the former client was a sophisticated businesswoman who had actively negotiated for terms she thought desirable, and the transaction was not connected with the matter on which the lawyer previously represented her).

[5] This Rule does not apply to the agreement by which the lawyer is retained by the client, unless the agreement confers on the lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client. Such an agreement is governed, in part, by Rule 1.5. 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.

[6] This Rule does not apply: (i) 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; or (ii) 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.

**Proposed Rule 1.8.1 [3-300] Business Transactions with a Client
and Pecuniary Interests Adverse to the Client
Synopsis of Public Comments**

TOTAL = 3	A = 1
	D = 0
	M = 2
	NI = 0

No.	Commenter/Signatory	Comment on Behalf of Group?	A/D/M/NI ¹	Rule Section or Cmt.	Comment	RRC Response
Y-2016-6a	Los Angeles County Bar Association (LACBA), (Schmid) (12-14-16)	Y	M	(a)	Rule should be modified to reflect the fact that the lawyer may not always propose the transaction and thus the lawyer may not always be in the best position to transmit the terms to the client. The goal is to make sure that the terms have been disclosed and transmitted to the client. If that occurs, it shouldn't matter if the lawyer or independent counsel transmit the terms.	<p>[ALT1] The Commission understands the commenter's concern but continues to believe that the primary responsibility for ensuring that the client is adequately advised regarding the transaction should lie with the lawyer. It has revised the rule to so explicitly provide.</p> <p>[ALT2] The Commission has not made the suggested change. It continues to believe that the primary responsibility for ensuring that the client is adequately advised regarding the transaction should lie with the lawyer. The proposed rule's language, which requires that the lawyer make the disclosure, recognizes that responsibility.</p>
Y-2016-21f	State Bar Office of Chief Trial Counsel (OCTC) (Dresser) (01-09-17)	Y	M		1. OCTC believes there should be a Comment that fee modifications would and should normally apply to this rule.	1. After extensive discussion about the possible application of this Rule to fee modifications, the Commission decided to retain the language from the current rule 3-300 Discussion, with non-substantive wording changes,

¹ A = AGREE with proposed Rule D = DISAGREE with proposed Rule M = AGREE ONLY IF MODIFIED NI = NOT INDICATED

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					<p>2. The rule should be amended to include transactions involving relatives of the attorney when the attorney knows or should know of these transactions or potential transactions.</p> <p>3. The rule should also be amended to cover attorney-client transactions for three years after the attorney-client relationship terminated.</p>	<p>and to leave to case development the question of when, if at all, the Rule would be applied to fee modifications.</p> <p>2. The Commission disagrees. 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. The Commission sees no basis for altering this well-understood concept.</p> <p>3. The Commission agrees that the rule may apply to a former client but disagrees that a bright-line standard applying the rule for three years after termination of the lawyer-client relationship is appropriate. Such a rule would not correctly reflect current law as stated in <i>Hunnicutt v. State Bar</i>, 44 Cal.3d 362 (1988) and <i>Beery v. State Bar</i>, 43 Cal.3d 802 (1987). These cases describe a nuanced approach to the question of whether the rule should be applied to a transaction involving a former client based on factors such as</p>

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					<p>4. OCTC supports Comments 1, 2, 4, and 5.</p> <p>5. OCTC supports Comment 3. However, the Comment should also make clear that it is the attorney's burden to establish that the transaction is fair and reasonable. (<i>Rodgers v. State Bar</i> (1989) 48 Cal.3d 300, 314.)</p>	<p>closing in time and whether the transaction or acquisition is related to the former representation. However, the Commission has added comment [4] to alert lawyers to the fact that the rule may apply to a former client under appropriate circumstances.</p> <p>4. No response required.</p> <p>5. It is correct that the burden is on the lawyer both in the disciplinary setting under rule 3-300 and in the civil setting under Prob. C. § 16004, but including this in the Comment would amount to additional practice guidance, which is contrary to the Commission's Charter..</p>
Y-2016-7d	State Bar Standing Committee on Professional Responsibility and Conduct (COPRAC) (Spencer) (12-21-16)	Y	A		COPRAC supports proposed Rule 1.8.1 as revised following 90-day public comment period.	No response required.

