

## **COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.8.1 [3-300]**

### **Commission Drafting Team Information**

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### **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. FINAL VOTES BY THE COMMISSION AND THE BOARD**

### **Commission:**

Date of Vote: January 20 & 21, 2017

Action: Recommend Board Adoption of Proposed Rule 1.8.1 [3-300]

Vote: 14 (yes) – 0 (no) – 0 (abstain)

### **Board:**

Date of Vote: March 10, 2017

Action: Board Adoption of Proposed Rule 1.8.1 [3-300]

Vote: X (yes) – X (no) – X (abstain)

## **III. COMMISSION'S PROPOSED RULE (CLEAN)**

### **Rule 1.8.1 [3-300] 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 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.

#### **IV. COMMISSION’S PROPOSED RULE 1.8.1 (REDLINE TO CURRENT CALIFORNIA RULE 3-300)**

##### **Rule 1.8.1 [3-300–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~~;~~<sub>1</sub> or knowingly<sub>2</sub> acquire an ownership, possessory, security<sub>3</sub>, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

- (Aa) ~~The~~the transaction or acquisition and its terms are fair and reasonable\* to the client and ~~are fully disclosed and transmitted~~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 ~~which~~that should reasonably\* have been understood by the client; ~~and~~
- (Bb) ~~The~~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 ~~that the client may~~to seek the advice of an independent lawyer of the client's choice and is given a reasonable\* opportunity to seek that advice; and
- (Cc) ~~The~~the client thereafter ~~consents in writing~~provides informed written consent\* to the terms of the transaction or ~~the terms of the~~ acquisition~~-,~~ and to the lawyer's role in it.

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

~~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.~~

## **V. RULE HISTORY**

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).

## **VI. OCTC / STATE BAR COURT COMMENTS**

- **Gregory Dresser, Office of Chief Trial Counsel, 9/27/2016**  
**(In response to 90-day public comment circulation):**

1. OCTC believes there should be a Comment that fee modifications would and should 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. See also *In the Matter of Mark Scott* (Review Dept. 2007) Case No. 01-O-05066, Slip Op. p. 19, fn. 22 [contingency fee agreements *renegotiated* at the time of settlement may be governed by rule 3-300, unpublished]; *In re Corcella* (Ind. 2013) 994 N.E.2d 1127.)
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. (See *In the Matter of Fandey* (Review Dept. 1994) 2 Cal. State Bar Ct. Rptr. 767, 776-777 [not applying former rule 5-101 to a transaction between the client and respondent's parents]; *In the Matter of Casey* (Review Dept. 2008) 5 Cal. State Bar Ct. Rptr. 117, 123-124 [not applying rule 3-300 when respondent negotiated a transfer of real property between two of his clients, and as a result of the transfer the attorney's minor son received a 50 percent interest in the property from one of the clients].<sup>1</sup> But see [Rodgers v. State Bar \(1989\) 48 Cal.3d 300](#) [applying former rule 5-101 when attorney persuaded client to loan money to attorney's ex-client and the attorney received most of proceeds of one of the loans as payment of the ex-client's legal fees].) The courts have disciplined real estate brokers for failing to disclose that the purchaser was related to the broker. (*Whitehead v. Gordon* (1969) 2 Cal.App.3d 659 [brother-in-law].) The courts have also applied the presumption of unfair transactions when the purchasers were relatives of the fiduciary. (See *Batson v. Stehlow* (1968) 68 Cal.2d 662, 675; *Adams v. Herman* (1951) 106 Cal.App.2d 92, 99.) Attorneys should be required to comply with rule 3-300 when they *know* or reasonably should know of a transaction or potential transaction between their clients and their relatives. This is necessary for public protection.
3. The rule should also be amended to cover attorney-client transactions for three years after the attorney-client relationship terminated. (Compare *Hunnicutt v. State Bar* (1988) 44 Cal.3d 362, 370-372 [applying former rule 5-100 to a transaction after the termination of the attorney-client relationship] and *In the Matter of Allen* (Review Dept. 2010) 5 Cal. State Bar Ct. Rptr. 198, 203-205 [not applying rule 3-300 to a transaction after the termination of the attorney-client

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<sup>1</sup> The respondents in these cases were found culpable of either violating rule 3-310 or section 6106 for their conduct.

relationship].) The current law is confusing on this issue, applying the rule to some but not all post-representation transactions. One of the purposes of rule 3-300 is to protect clients from their attorneys' personal use of financial information gained from confidences disclosed during the attorney-client relationship. (*Hunnicutt, supra*, 44 Cal.3d at 370.) Further, "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](#) even if the representation has otherwise ended." (*Hunnicutt, supra*, 44 Cal.3d at 370.) Amending the rule to include all transactions within three years of the representation protects clients and clarifies when the rule applies to a transaction and when it does not. Further, such an amendment is consistent with Business & Professions Code section 6175.3 (which requires certain disclosures when an attorney sells financial products to a client or former client within three years of the attorney-client relationship terminating).

4. OCTC supports Comments 1, 2, 4, and 5.

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. (*Rodgers v. State Bar* (1989) 48 Cal.3d 300, 314.)

- **Gregory Dresser, Office of Chief Trial Counsel, 1/9/2017**  
**(In response to 45-day public comment circulation):**

For the 45-day public comment version of the rule, OCTC re-submitted substantially the same comments as on the 90-day public comment version of the rule and the Commission's responses to OCTC remained the same. See 90-Day and 45-Day Public Comment Synopsis Tables, Attachments \_\_\_\_\_ and \_\_\_\_\_.

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

## **VII. PUBLIC COMMENTS & PUBLIC HEARING TESTIMONY**

Three comments, including the above comment from OCTC, were received. One agreed with the proposed rule. Two agreed only if modified. A public comment synopsis table, with the Commission's responses to each comment, is provided at the end of this report.

One speaker appeared at the public hearing whose testimony was not in support of the proposed rule.

## **VIII. RELATED CALIFORNIA LAW AND ABA MODEL RULE ADOPTIONS**

**Massachusetts Rule 1.8(a)** is identical to Model Rule 1.8(a):

- (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.

## **ABA Model Rule Adoptions**

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

## **IX. 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.

<sup>2</sup> 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.

<sup>3</sup> The fourteen jurisdictions are: Alabama, Alaska, California, Georgia, Hawaii, Illinois, Michigan, Mississippi, New Jersey, New Mexico, Ohio, Texas, Virginia, and Washington.

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



- 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. In paragraph (b), revise the requirement in current rule 3-300(B) to advise the client that it "may" seek independent counsel in order to make the first lawyer's disclosure more definitive, i.e., require that the client is advised "to seek the advice of an independent lawyer."
- 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. To this end, the proposed Rule omits the "may seek" concept and requires the lawyer to advise the client to seek independent counsel.
  - Cons: None identified.

5. In paragraph (c), change the consent requirement in current rule 3-300(C) (“the client consents in writing”) to “informed written consent.”
  - Pros: OCTC made this recommendation and the Commission agrees.. This change brings into the Rule a term defined in proposed Rule 1.0.1(e) (“informed consent”) and 1.0.1(e-1) (“informed written consent”).
  - Cons: None identified.
6. Add Comment [1], which explains the meaning of the term “other pecuniary interest adverse to the client” by reference to examples from case law.
  - Pros: This is a difficult concept that has been addressed in the case law, in part because the scope of its application is confusing to lawyers.
  - Cons: None identified.
7. Add Comment [2], which explains what is meant by “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. The proposed comment is based on the work of the first Commission.
  - 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.
8. Add Comment [3], which clarifies that the “fair and reasonable” standard is measured at the time of the transaction or acquisition.
  - Pros: A lawyer should not be second guessed based on subsequent developments not known at the time of the transaction. This coordinates the proposed Rule with the long-standing standard that the conscionability and the reasonableness of a fee agreement are measured when the agreement is made.

- Cons: None identified.
9. Add Comment [4], which explains that under some circumstances, the rule might apply to business transactions with a former client.
- Pros: For purposes of public protection, it is important to alert lawyers that under certain circumstances, i.e., where there is residual trust placed in the lawyer after the lawyer-client relationship has ended, the rule may be applicable.
  - Cons: None identified.
10. Add Comment [5], which carries forward the concept in current rule 3-300, Discussion ¶. 1, and notes that advances for fees are governed by rules 1.5 and 1.15.
- Pros: With respect to the comment's first sentence, it is well-settled that this rule does not apply to the agreement by which the client retains the lawyer. There is no reason to change that rule. As for the sentence regarding advances for fees, this is particularly important because that Commission has recommended the adoption of rule 1.15, which requires that advances for fees must generally be placed in trust.
  - Cons: None identified.
11. Add Comment [6], which carries forward the concept in current rule 3-300, Discussion ¶. 2.
- Pros: The Commission is not aware that this provision has caused any problems.
  - Cons: None identified.

### **Concepts Rejected (Pros and Cons):**

1. 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. Paragraph (b) is explicit that the lawyer is obligated to advise the client to seek independent counsel unless the client already is represented by independent counsel *regarding the transaction or acquisition*.

- 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.
2. Include within the scope of the Rule any new or modified fee agreement with current client.
- Pros: OCTC and a group of California law professors have argued 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 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 ongoing 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. Finally, the theoretical premise for applying the Rule to fee agreements with current clients is that there is no fiduciary relationship with someone who is not yet a client. That is not certain as current rule 3-300 applies to fee agreements entered into before the formation of a lawyer-client relationship and a lawyer can have a duty of communication with someone who is not and never becomes a client. See Calif. Practice Guide: Professional Responsibility at ¶ 5:839 and *Butler v. State Bar* (1986) 42 Cal.3d 323, 329 (1986):

3. Include a provision providing 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).
  - Pros: Such a provision would conform to State Bar Court precedent.
  - Cons: 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 Sickle*, 2005 Calif. Op. LEXIS 3.

4. Include a provision applying the Rule to an attempt to enter into a business transaction or acquire an adverse pecuniary interest.

- **Pros:**

- **Cons:** 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? Would a lawyer be subject to discipline 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. Expand the scope of the Rule to include much of Bus & Prof Code § 6175.3 (titled: “Sale of financial products to elder or dependent adult clients; Disclosure”).

- **Pros:**

- **Cons:** The conduct is already addressed as part of a statutory scheme that creates specific remedies in § 6175.3 and authorizes professional discipline in § 6175.5. There would be no benefit to include 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. Instead, proposed Comment [1] references § 6175.3 for the information of readers.

6. Extend the Rule to apply to transactions between a lawyer and a client’s agent.

- **Pros:**

- **Cons:** The change is unnecessary. 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 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.

7. Extend the Rule be extended to apply to transactions with a client's close relative.

- **Pros:**

- Cons: 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.

This section identifies concepts the Commission considered before the rule was circulated for public comment. Other concepts considered by the Commission, together with the Commission's reasons for not recommending their inclusion in the rule, can be found in the Public Comment Synopsis Tables.

## **B. Changes in Duties/Substantive Changes to the Current Rule:**

1. Requiring that the disclosure must include the lawyer's role in the transaction or acquisition is a substantive change to the rule.

## **C. 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.
  4. New paragraph (d), defining “independent lawyer,” is a non-substantive change to the rule; it merely clarifies what the law is. (See IX.0.5, above.)

**D. Alternatives Considered:**

None.

**X. RECOMMENDATION AND PROPOSED BOARD RESOLUTION**

**Recommendation:**

That the Board of Trustees of the State Bar of California adopt proposed Rule 1.8.1 [3-300] in the form attached to this Report and Recommendation.

**Proposed Resolution:**

RESOLVED: That the Board of Trustees adopts proposed Rule 1.8.1 [3-300] in the form attached to this Report and Recommendation.

Robert L. Kehr  
Commission Member  
Telephone: (310) 651-6500  
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M E M O

To: Randall Difuntorum  
Kevin Mohr

From: Robert L. Kehr

Date: January 30, 2017

Re: Dissent to proposed Rule 1.8.1(a)

This message states my dissent from proposed Rule 1.8.1(a), with the request that it be included with the Commission's submission to the Board of Trustees, and if needed then to the Supreme Court.

Current rule 3-300(A) states, as one of the conditions to a lawyer entering into a transaction with or acquiring a pecuniary interest adverse to a client, that the terms of the transaction or acquisition "are fully disclosed and transmitted in writing to the client". The use of the passive voice recognizes that the source of the writing makes no difference as long as the client has the writing before the transaction or acquisition. The passive voice has been part of California's Rules since the original 1975 ancestor of the current rule (then, rule 5-101) and, so far as I know, the passive voice is used in the corresponding Rule in every U.S. jurisdiction.

During the October 2016 Commission meeting, the passive voice was restated in the active voice. Unfortunately, it was not until the revised Rule went out for public comment and there was time to study it that anyone caught the resulting substantive change. We were alerted to the problem by a public comment letter filed by the L.A. County Bar Assoc. The L.A. letter objects to this change, correctly pointing out that some lawyer-client deals are created by the client, and that the client might know more about the deal than does the lawyer. That letter also says that the source of the information does not provide any additional client protection, which certainly is correct. Here are some examples of lawyer-client transactions that are created by the client:

- Publicly traded corporations commonly offer stock options, ESOP, or other securities-based benefits to employees, including legal staff, and modify outstanding ownership rights.

- Many real estate development and real estate syndication companies routinely have granted limited partnership interests or LLC membership interests in its projects to its key employees, including legal staff.
- On occasion a wealthy individual or family hires a lawyer on terms that include minority interests in particular business assets.

In each of the three preceding examples, the lawyer might have nothing to do with the choice, structuring or expression of the transaction, and the lawyer might not be competent to explain the transaction, and the client might have been independently represented.

To take the first of the listed examples, the in-house lawyer would be subject to disciplinary risks (and potentially to civil risks) for not having responded to the corporation's stock option notice with a return notice saying: "Here is a copy of all the materials you provided to me." Even worse, the individual lawyer might not have a fully copy of all deal documents (some public security, ESOP, and other transactions might include related documents not provided to individual participants), so the lawyer might find it impossible to comply with the new requirement.

The use of the passive voice tacitly creates an affirmative obligation for the lawyer: the lawyer must make certain the client has the full terms in writing because otherwise the lawyer is subject to professional discipline and to the risk that failure to comply with the rule will have civil consequences. The proposed use of the active voice does not alter this but only imposes a new and unnecessary requirement as to the source of the writing.

The L.A. letter says that our current rule is not broken and needs no repair. I agree.<sup>1</sup> Shifting the disclosure obligation to the lawyer will cause needless confusion, in some situations make the lawyer and the Bar look silly by requiring meaningless gestures, and provide no client protection benefit. Because the new requirement would be counter-intuitive and contrary to established California and outside authority, some lawyers will be sandbagged.

For these reasons, I respectfully dissent from proposed Rule 1.8.1(a).

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<sup>1</sup>The Commission's schedule made it difficult to correct the problem although I believe that all three members of the Rule 1.8.1 drafting team agreed with the L.A. letter.

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

<b>TOTAL = 3</b>	<b>A = 1</b>
	<b>D = 0</b>
	<b>M = 2</b>
	<b>NI = 0</b>

No.	Commenter/Signatory	Comment on Behalf of Group?	A/D/M/NI <sup>1</sup>	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>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> <p>The Commission notes, however, that during the further discussion of this comment, a Commission member stated an intent to submit a written dissent to this proposed change to the current rule. The dissent agrees with the commenter that the change to the active voice is problematic and that the passive voice language of the current rule should be retained.</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

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

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

<b>TOTAL = 3</b>	<b>A = 1</b>
	<b>D = 0</b>
	<b>M = 2</b>
	<b>NI = 0</b>

No.	Commenter/Signatory	Comment on Behalf of Group?	A/D/M/NI <sup>1</sup>	Rule Section or Cmt.	Comment	RRC Response
						<p>decided to retain the language from the current rule 3-300 Discussion, with non-substantive wording changes, 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 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>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 rule should also be amended to cover attorney-client transactions for three years after the attorney-client relationship terminated.</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>Hunnecutt 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</p>

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

<b>TOTAL = 3</b>	<b>A = 1</b>
	<b>D = 0</b>
	<b>M = 2</b>
	<b>NI = 0</b>

No.	Commenter/Signatory	Comment on Behalf of Group?	A/D/M/NI <sup>1</sup>	Rule Section or Cmt.	Comment	RRC Response
					<p>question of whether the rule should be applied to a transaction involving a former client based on factors such as 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. 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>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.

