

Memorandum

To: Committee on Professional Responsibility and Conduct (COPRAC)

From: David C. Carr

Date: January 8, 2020

Re: 19-0003 Re: Improper Contract Provisions - Summary of Public Comment

I am updating my previous memorandum with a summary of public comment received on this proposed opinion, some additional authority and an expanded list of issues for consideration.

Public Comments Against the Requested Opinion

- Gerald Nieser, Nieser & Vestal LLP, July 25, 2019; Peter Califano, Cooper White Cooper, August 7, 2019).
 - The request encompasses contract clauses that
 - (a) impose a post-employment non-compete agreement on the employee (Bus. & Prof. § 16600);
 - (b) impose a post-employment non-solicitation (of the employer's other employees) agreement on the employee (Bus. & Prof. § 16600);
 - (c) include a provision whereby the employee agrees that, as to any dispute arising under the employment agreement, the employer has the unilateral right to select an arbitrator to rule upon the dispute. Labor Code § 925(a)(1) prohibits an employer from requiring, as a condition of employment, that the employee agree to adjudicate outside of California a claim "arising in California".
 - make the drafting or reviewing of employment agreements containing these clauses a per se violation of the Rules of Professional Conduct could put an attorney in an untenable position with respect to her duties to the employer client.
 - post-employment covenant not to compete or solicit employees may be enforceable:
 - (1) if the employer can demonstrate that the employee, by taking employment with a competitor, has afforded to the new employer knowledge of the employer's critical trade secrets or confidential proprietary information (Thompson v. Impaxx, Inc. (2003) 113 Cal. App. 4th) or
 - (2) ex-employee may be employed in a state where the covenant is enforceable.
 - Clauses are not "unambiguously illegal or unenforceable"; Labor Code § 925 provides that employer may not make it a condition of employment that the employee agree to a provision that would "deprive the employee of the substantive protection of California law with respect to a controversy *arising in California*." If the employee quits to take employment with the employer's arch competitor in another State, has the controversy arisen in California? Taking employment outside California would create the controversy.
 - Similarly, clause in the employment agreement that would require the employee to arbitrate or adjudicate in a foreign jurisdiction selected by the employer, is also not "unambiguously illegal or unenforceable" if the controversy does not "arise in

California." Tortious behavior of the former employee committed outside of California may render such clauses enforceable.

- If employer intimidation is a problem, that can be solved through statute.
- Making the attorney responsible for the breach of the law by the employer would create a conflict of interest.

Public Comments Favoring the Requested Opinion

Bridget Gramme from the Center for Public Interest Law (CPIL) and Brian Shearer from Justice Catalyst Law (JCL) November 6, 2019.

- COPRAC should focus on non-compete agreements because they are explicitly unenforceable under long-standing California law. Cal. Bus. & Prof. Code § 16600; *Edwards v. Arthur Anderson LLP*, 44 Cal.4th 937 (2008)
- Conduct does not need to rise to the level of fraud to be considered unethical. With a term that is so obviously unenforceable as noncompetes in California, COPRAC should assume a lawyer knows it is not enforceable, and thus, their only intention would be to mislead in violation of Rule 8.4.
- If a lawyer does not know that non-complete clauses are unenforceable, this is a competence violation under Rule 1.1.
- The reason California lawyers are including non-competes in contracts is because they know the contract itself has a deterrent effect, even if it isn't enforceable. 45.1% of businesses in California use non-compete agreements. In recent studies, 40% of noncompete signers cite their non-compete clauses as a reason they turned down an offer from a competitor employer.
- A violation of 1.2.1 need not rise to the level of fraud. A lawyer may not assist a client in conduct the lawyer knows violates *any* California law.
- A lawyer's participation in the drafting, review (without objection), approval, or execution of contractual language in an employment agreement that is **unambiguously** illegal or unenforceable is a violation of Rule 8.4(c), Rule 1.2.1, or Rule 1.1.

Other Authority

ABA Formal Ethics Opinion 436 addresses ABA Model Rule 1.2(d) which is virtually identical to California Rule 1.2.1 in the context of combating money laundering and other criminal and fraudulent activity.

The opinion is of limited utility in addressing violations of the duty to avoid assisting the client in violating laws in contexts that are not criminal and fraudulent. The opinion downplays the idea that lawyers can or should play a "gatekeeping" role:

In an effort to combat money laundering and terrorist financing, intergovernmental standards-setting organizations and government agencies have suggested that lawyers should be "gatekeepers" to the financial system. The underlying theory behind the "lawyer-as-gatekeeper" idea is that the lawyer has the capacity to monitor and to control, or at least to influence, the conduct of his or her clients and prospective clients in order to deter wrongdoing. Many have

taken issue with this theory and with the word “gatekeeper.” The Rules do not mandate that a lawyer perform a “gatekeeper” role in this context...

ABA formal opinion 436 notes that ABA Model Rule Rule 1.16(b)(2) states that a lawyer may withdraw from representing a client if “the client persists in a course of action involving the lawyer’s services that the lawyer *reasonably believes* is criminal or fraudulent. California Rule 1.16(b)(2) is similar: a lawyer may withdraw “if the client either seeks to pursue a criminal or fraudulent* course of conduct or has used the lawyer’s services to advance a course of conduct that the lawyer *reasonably believes** was a crime or fraud.”

California Rule 1.16(a)(2) requires a lawyer to withdraw if the lawyer knows* or reasonably should know* that the representation will result in violation of these rules or of the State Bar Act.” ABA Model Rule 1.16(a)(2) requires withdrawal if “the representation will result in violation of the rules of professional conduct or other law.”

New Issues

- Does a California lawyer's involvement with his or her client in the proffering of an unconscionable clause in a contract involve conduct involving fraud in violation of Rule 8.4(c)?
- What if the lawyer counsels against using such a clause and the client refuses to take the lawyer's advice? Does Rule 1.2.1 compel a lawyer to be a "gatekeeper" for illegal client contact?
- Does the lawyer have a duty to withdraw? If so, when?
- Does proffering a non-compete clause in an employment contract always violate California law?
- Should an opinion discussing lawyer involvement in the client's proffering of an unconscionable clause in a contract be limited to the non-compete clauses in an employment contract or address a broader question whether lawyer involvement in unconscionable clauses in any type of contract violates Rule 1.2.1?
- Does a lawyer's ignorance as the unconscionability of a particular type of contract clause violate California's competence Rule 1.1, which is limited in scope to intentional, reckless, grossly negligence, or repeated acts or omissions?

The text of my prior memorandum follows.

Hypothetical

Lawyer works for large corporation providing employment law advice to Human Resources department (HR) responsible for all non-executive hiring. Employees hired through HR are presented with a standard form written employment agreement. These agreements are presented to new hires as a "contract of adhesion" take it or leave it, agreements that must be signed as a condition of employment. Lawyer is tasked with writing and updating those agreements. In

updating each agreement, Lawyer includes a provision from a former agreement that has recently been found to be illegal and unconscionable under California law.

(a) Lawyer knows that the provision has been found to be illegal and unconscionable but advises HR to use the forms anyway, without further advice or analysis.

(b) Same facts, except that lawyer does not know that the provision has been illegal and unconscionable.

(c) Same facts, except that lawyer advises that the contract provision has been found to be illegal and unconscionable, advises HR that there is some risk that this provision in the agreement may not be enforced but does not recommend against including the provision

(d) Same facts, except that lawyer advises that the contract provision has been found to be illegal and unconscionable, advises HR that there is some risk that this provision in the agreement may not be enforced and recommends against including the provision.

Issues

Does merely proffering an illegal or unenforceable provision in a proposed contract amount to misrepresentation or fraud? When?

Is unenforceable the same as fraudulent?

Does lawyer representing a client in the transaction owe any duty to make sure the other party to the transaction is treated fairly?

Does it make a difference if the lawyer does not have any direct contact with the other party to the contract?

What if those duties conflict with the client's interests?

Does the disparity in bargaining power ("Contracts of Adhesion") matter?

Is the employment context different?