

1 **THE STATE BAR OF CALIFORNIA**
2 **STANDING COMMITTEE ON**
3 **PROFESSIONAL RESPONSIBILITY AND CONDUCT**
4 **DRAFT FORMAL OPINION INTERIM NO. 19-0003**
5 **ADVISING CLIENT ON ILLEGAL CONTRACT PROVISIONS**
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8 **ISSUES:** What are a lawyer's ethical responsibilities when advising a client
9 regarding the use of a type of contract provision in a transaction with a
10 third person that is illegal in the substantive law in the law of the
11 jurisdiction applicable to the transaction.

12 **DIGEST:** A California lawyer has a duty not to counsel or assist a client in conduct
13 that the lawyer knows is criminal, fraudulent, or a violation of any law,
14 rule, or ruling of a tribunal. That conduct includes the use of a contract
15 provision in a transaction with a third party that has been found to be
16 illegal under the substantive law in the law of the jurisdiction applicable to
17 the transaction. If the lawyer knows that the provision is illegal, the
18 lawyer may not recommend the use of such a provision and must counsel
19 the client not to use it. If the client insists on use of the illegal provision
20 against the lawyer's advice, lawyer may not participate in presenting the
21 illegal provision to the third party. In that event, the lawyer has the option
22 of withdrawing from representation but is not required to. If the lawyer
23 concludes that the conduct is a violation of law reasonably imputable to
24 the organization, and likely to result in substantial injury to the
25 organization, the lawyer for an organization must report the actions of the
26 client constituent to a higher authority, unless the lawyer reasonable
27 concludes that it is not in the best lawful interest of the organization to do
28 so.

29 **AUTHORITIES**

30 **INTERPRETED:** California Rules of Professional Conduct 1.1, 1.2.1, 1.4, 1.13, 1.16(b), 4.1,
31 8.4(c); Bus. & Prof. C. § 6068(d).

32 **INTRODUCTION**

33 Certain types of contract provisions have been found to be illegal under California law. For
34 example, provisions in employment contracts that impair the ability of employees to compete
35 against their employers following termination of employment have generally been found to be
36 illegal under California law subject to limited exceptions. *See Edwards v. Arthur Andersen LLP*
37 (2008) 44 Cal.4th 937, 945 *Robinson v. U-Haul Co. of California* (2016) 4 Cal.App.5th 304,
38 309; Cal. Bus. & Prof. C. §16600. For purposes of this opinion, this Committee does not opine
39 on whether a particular clause in a contract is illegal as this raises an issue of law; instead, the
40 Committee confines its discussion to the ethical issues presented by the below factual scenarios.

STATEMENT OF FACTS

Lawyer works for large California 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 ("Agreement"). This agreement is presented to new hires as a "contract of adhesion," take it or leave it, agreement that must be signed as a condition of employment. Lawyer is tasked with reviewing and updating the agreement, which contains a provision that has been found to be illegal under California law.¹

Alternative Scenarios

1. Lawyer knows that the provision has been found to be illegal, but advises HR to use the forms anyway, without further advice or analysis.
2. Same facts, except that Lawyer does not know that the provision is illegal.
3. Same facts, except that Lawyer advises that the contract provision has been found to be illegal under California law, but does not recommend against including the provision
4. Same facts, except that Lawyer advises that the contract provision has been found to be illegal under California law and recommends against including the provision. HR advises Lawyer that it understands the provision is illegal, but would still like to include it in the Agreement for its chilling effect.

DISCUSSION

1. Duty Not To Advise Or Assist Violations Of Law

California Rule of Professional Conduct 1.2.1(a)² states that "[a] lawyer shall not counsel a client to engage, or assist a client in conduct that the lawyer knows is criminal, fraudulent, *or a violation of any law, rule, or ruling of a tribunal.*" Emphasis added. The California Rule is based upon but broader than American Bar Association (ABA) Model Rule 1.2(d), which merely prohibits counseling or assisting a client conduct on conduct known to be criminal or fraudulent³. Both the California Rule⁴ and the ABA Model Rule allow a lawyer to discuss the legal consequences of any proposed course of action and counsel or assist the client in interpreting the application of any law, rule or ruling to that course of action

The California Rule on its terms applies to every type of legal representation, including transactional work and negotiation. A lawyer cannot knowingly advise a client to propose an illegal provision in a contract that will be offered to a third party. *See* ABA Model Rule 1.2, Comment 10 ("The lawyer is required to avoid assisting the client, for example, by drafting or delivering documents that the lawyer knows are fraudulent or by suggesting how the wrongdoing might be concealed."); ABA Section of Litigation, *Ethical Guidelines For Settlement*

¹ The Committee would reach the same conclusion if the lawyer was drafting the agreement *ab initio*.

² All references to Rule or Rules are to the California Rules of Professional Conduct unless otherwise indicated.

³ (d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

⁴ (b) Notwithstanding paragraph (a), a lawyer may: (1) discuss the legal consequences of any proposed course of conduct with a client; and (2) counsel or assist a client to make a good faith effort to determine the validity, scope, meaning, or application of a law, rule, or ruling of a tribunal.

Negotiations (August 2002), at 46-47)("A lawyer should not negotiate a settlement provision that the lawyer knows to be illegal.").⁵

In scenario 1, Lawyer is knowingly recommending the inclusion of a provision that Lawyer knows is illegal in violation of Rule 1.2.1(a). Conversely, in scenario 2, Lawyer does not know that the specific type of contract provision is illegal and is not culpable of violating the Rule. However, Lawyer likely violated the duty of competence under Rule 1.1(a). Knowing that the specific provision was illegal is likely to be reasonably necessary to provide competent legal advice to the client on employment law matters, consistent with Rule 1.2.1(b) and Lawyer's failure to acquire such knowledge before advising the client might be grossly negligent under Rule 1.1(a). *See also* Rule 1.1(b).

2. *Duty to Prevent Lawyer's Services from Being Used to Violate the Law*

Beyond merely advising the client as to the consequences of using the illegal provision, a lawyer has a duty to inquire to attempt to make sure that the lawyer services will not be used to violate law. "A lawyer cannot escape responsibility by avoiding inquiry. A lawyer must be satisfied, on the facts before him and readily available to him that he can perform the requested services without abetting fraudulent or criminal conduct and without relying on past client crime or fraud to achieve results the client now wants." *See* ABA Formal Ethics Opinion 1470 (1981); *see also* NY City Bar Ethics Formal Opinion 2018-4 (July 18, 2018); Rules 1.1(a), 1.2.1(a), 1.0.1(f).

While framed in terms of fraud or crime, this duty is broader in California because our variation of ABA Model Rule 1.2(d), Rule 1.2.1, also adds violation of any law, rule, or ruling of a tribunal, even if those violations do not amount to a crime or fraud.

In scenario 3, Lawyer has a duty not only to advise the client or client constituent (the HR Department) on the interpretation of the applicable law and the possible consequences of using the provision in question, but must also inquire as to client's use of the provision and recommend against its use.

In scenario 4, because the client or client constituent insists on including the illegal provision for its in terrorem effect contrary to Lawyer's advice, Lawyer must advise the client regarding the limitations on Lawyer's conduct, including that Lawyer will not represent the client in advocating or attempting to enforce the illegal provision. Rule 1.2.1, Comment [5]; Rule 1.4(a)(4). A lawyer may not knowingly making a false statement of law to a third person. Rule 4.1(a). Rule 8.4(c) states that it is professional misconduct for a lawyer to "engage in conduct involving dishonesty, fraud, deceit, or reckless or intentional misrepresentation." California statutory law states the duty in broader terms. *See* Business and Professions Code⁶ section 6068(d)⁷ (It is the duty of a lawyer "[t]o employ, for the purpose of maintaining the causes confided to him or her those means only as are consistent with truth...."). Including a knowingly

⁵ The ABA Model Rules may be looked to for guidance on proper professional conduct, particularly in areas where there is no contrary California authority or conflicting public policy. *See* Rule 1.0, Comment [4] ("Ethics opinions and rules and standards promulgated by other jurisdictions and bar associations may also be considered" for guidance on proper professional conduct).

⁶ All references to sections are to the California Business and Professions Code, unless otherwise indicated.

⁷ While the statute has most often been applied in the context of a lawyer's duty not to mislead the Court, relying on the second clause of the statute [citation], there is no textual limitation of the application of the first clause to transactional work.

illegal provision in an employment agreement for its chilling effect on third parties would violate Rule 8.4(c) and Business and Professions Code section 6068(d).

Traditionally, in representing a client in arm's length business negotiations, a lawyer owes a limited duty to the other side that does not include a duty to inform that party of relevant facts. "[I]n drafting an agreement or other document on behalf of a client, a lawyer does not necessarily affirm or vouch for the truthfulness of representations made by the client in the agreement or document." Rule 4.1, Comment 1. Nonetheless, a "nondisclosure can be the equivalent of a false statement of material fact *or law* under paragraph (a) where a lawyer makes a partially true but misleading material statement or material omission." *Id.*

Lawyers have less latitude to make or ratify a false statement of *law* made by the client. *See* South Carolina Ethics Op. 05-03 (2005) (lawyer for ex-wife sent letter to ex-husband falsely claiming that ex-husband was required under divorce decree to undergo drug testing; this conduct violated South Carolina Rules of Professional Conduct, Rules 4.1 and 8.4(c)); *In re Discipline of Attorney*, 884 N.E.2d 450 (Mass. 2008) (lawyer disciplined under Rule 8.4(c) alone for sending letters to insurers of opposing parties falsely claiming entitlement to lien on insurance payments payable to his clients). Rule 4.1(b) is limited to disclosures necessary to avoid assisting in a "criminal or fraudulent" act by a client, which is narrower than illegal conduct, however the advocacy of a contract provision *known both by the client and the lawyer* to be illegal for its chilling effect is a fraudulent act.

3. *Withdrawal*

If the client or client constituent insists on including the illegal provision, the lawyer may withdraw, but is not compelled to withdraw in most circumstances merely because the client chooses to use the illegal provision, even if the use of that contract provision is deemed fraudulent or even criminal. Rule 1.2.1, Comment 2; Rule 1.16(b)(1) -(3).⁸ If however, the client conditions the lawyer's employment on continued participation in the client's use of the contract provision, the lawyer may be required to withdraw under Rule 1.16(a)(2) which makes withdrawal mandatory if "the lawyer knows or reasonably should know that the representation will result in violation of these rules or of the State Bar Act", that is, a violation of Rules 1.2.1, 4.1, 8.4 and Business and Professions Code section 6068(d).⁹

4. *Duty to Report Up in An Organization*

If the client is an organization, as in our scenarios, the lawyer will have a duty to report the conduct of the corporate constituent (*e.g.*, the HR Department) to the higher authority in the organization if the conduct "(i) a violation of a legal obligation to the organization or a violation of law reasonably imputable to the organization, and (ii) likely to result in substantial injury

⁸ *See* Rule 1.16 (b) ("Except as stated in paragraph (c), a lawyer *may* withdraw from representing a client if: (1) the client insists upon presenting a claim or defense in litigation, or *asserting a position or making a demand in a non-litigation matter, that is not warranted under existing law and cannot be supported by good faith argument for an extension, modification, or reversal of existing law*; (2) 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; (3) the client insists that the lawyer pursue a course of conduct that is criminal or fraudulent.")

⁹ The lawyer may not reveal confidential advice regarding the use of the illegal provision, except as required by Rule 1.13. Rule 1.6

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144 to the organization" unless the lawyer reasonably believes that "it is not necessary in the
145 best lawful interest of the organization to do so." Rule 1.13(b).

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147 Labor Code section 432.5 provides that "[n]o employer, or agent, manager, superintendent, or
148 officer thereof, shall require any employee or applicant for employment to agree, in writing, to
149 any term or condition which is known by such employer, or agent, manager, superintendent, or
150 officer thereof to be prohibited by law." Business and Professions Code section 16600 states that
151 "every contract by which anyone is restrained from engaging in a lawful profession, trade, or
152 business of any kind is to that extent void. The California Supreme Court concluded that section
153 16600 prohibits employee noncompetition agreements unless the agreement falls within a
154 statutory exception and that the statutory violation could support a civil claim for interference
155 with prospective economic advantage. *See Edwards v. Arthur Andersen LLP* (2008) 44 Cal. 4th
156 937, 942. Given the possibility of substantial injury to the organization, the lawyer must
157 evaluate carefully whether disclosure to higher authority is reasonably necessary. Moreover,
158 because the lawyer has a duty not to withdraw without taking reasonable steps to avoid
159 reasonably foreseeable prejudice to the organization client (Rule 1.16(d), such disclosure must be
160 made even if the lawyer opts to withdraw as provided by Rule 1.16(c)(1) –(3).

DRAFTER'S COMMENTS

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| Page 2: Commented [S1] | Sarah | 10/11/2020 2:15:00 PM |
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Per comments, we should evaluate whether to include alternative where lawyer is charged with drafting agreement as opposed to revising a preexisting agreement.

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| Page 4: Commented [S2] | Sarah | 10/12/2020 9:23:00 AM |
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I don't view the hypos as failing to disclose material facts under 4.1(b); instead by including a knowingly illegal provision, the lawyer is making a false statement of law. Also, I'm not sure what you mean by a safe harbor under 4.1(b).

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| Page 5: Commented [DMR3] | Dena M. Roche | 10/14/2020 9:19:00 AM |
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I like this section, but wondering if these examples are too specific given we says we are not opining on the illegality of non-competes.