

1 THE STATE BAR OF CALIFORNIA
2 STANDING COMMITTEE ON
3 PROFESSIONAL RESPONSIBILITY AND CONDUCT
4 FORMAL OPINION INTERIM NO. 19-0003
5 ADVISING CLIENT ON ILLEGAL CONTRACT PROVISIONS

6 **ISSUES:** What are a lawyer's ethical duties when advising a client regarding the
7 use of a contract provision in a transaction with a third party that is illegal
8 under the law of the jurisdiction applicable to the transaction?

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

27 **AUTHORITIES**

28 **INTERPRETED:** California Rules of Professional Conduct 1.1, 1.2.1, 1.4, 1.13, 1.16(b), 4.1,
29 8.4(c).^{1/}

30 Business and Professions Code section 6068(d).

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^{1/} Unless otherwise indicated, all references to "rules" in this opinion will be to the Rules of Professional Conduct of the State Bar of California.

INTRODUCTION

Certain types of contract provisions are illegal under California law.^{2/} For example, provisions in employment contracts that impair the ability of employees to compete against their employers following termination of employment have generally been found to be illegal under California law, subject to limited exceptions. See *Edwards v. Arthur Andersen LLP* (2008) 44 Cal.4th 937, 945 [81 Cal.Rptr.3d 282]; *Robinson v. U-Haul Co. of California* (2016) 4 Cal.App.5th 304, 309 [209 Cal.Rptr.3d 81]; Business and Professions Code section 16600. For purposes of this opinion, the Committee does not opine on whether a particular clause in a contract is illegal as this raises an issue of law; instead, the Committee confines its discussion to the ethical issues presented by the factual scenarios below and assumes that the contract provision is unambiguously illegal at the time the agreement is made and not potentially subject to an exception that would make the provision legal.

STATEMENT OF FACTS

Lawyer works for a large California corporation (“Company”) providing employment law advice to the 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 by HR to new hires in California as a non-negotiable agreement that must be signed as a condition of employment. Lawyer is tasked with reviewing and updating the Agreement, which contains a provision that is illegal under California law.

Factual Scenarios

1. Lawyer knows that the provision is illegal, but advises HR to use the Agreement 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 HR that the contract provision is illegal under California law, but does not recommend against including the provision.
4. Same facts, except that Lawyer advises HR that the contract provision is 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. HR has asked the Lawyer to assist in enforcing the provision.

^{2/} This opinion is not intended to address provisions that are legal, but against public policy, unenforceable or subject to some other prohibition. Nor is it intended to address situations where the lawyer knows a court has held the provision to be unlawful, but nonetheless has a good faith belief that the ruling was incorrect, another court has ruled or would rule otherwise, or the provision might be enforceable under some circumstances. See Rule 1.2.1, Comment [3].

DISCUSSION

A. Duty to Advise of an Illegal Contract Provision

Rule of Professional Conduct 1.2.1(a) 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.) Rule 1.2.1 is modeled in substance after former rule 3-210 but adds clarifying language derived from ABA Model Rule 1.2(d). The California rule is broader than the ABA Model Rule 1.2(d), which merely prohibits counseling or assisting a client on conduct known to be criminal or fraudulent.^{3/} Both the California rule^{4/} 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.^{5/}

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 Negotiations* (August 2002), at pp. 46-47) (“A lawyer should not negotiate a settlement provision that the lawyer knows to be illegal.”).^{6/}

In Scenario 1, Lawyer recommends the inclusion of a provision that Lawyer knows is illegal in violation of rule 1.2.1(a) and not potentially subject to an exception that would make the provision legal.^{7/} Rule 1.0.1(f) helps to define “knowing”: “‘Knowingly,’ ‘known,’ or ‘knows’ means actual knowledge of the fact in question. A person’s knowledge may be inferred from circumstances.” Knowing here means the lawyer has actual knowledge that the provision in

^{3/} ABA Model Rule 1.2(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/} Rule 1.2.1(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.”

^{5/} See California State Bar Formal Opn. 2020-202, generally, for discussion on the scope of permitted advice and assistance a lawyer may provide to clients related to conduct described in rule 1.2.1(a).

^{6/} 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 California Rule of Professional Conduct 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).

^{7/} The Committee would reach the same conclusion in all four scenarios if Lawyer was drafting the agreement *ab initio*.

question is prohibited by the controlling legal authority in the jurisdiction whose law is applicable to the transaction or contract.

Conversely, in Scenario 2, Lawyer does not know that the specific type of contract provision is illegal under the controlling legal authority of the applicable jurisdiction. Therefore, the lawyer does not violate rule 1.2.1.

However, in Scenario 2, the Lawyer likely violated the duty of competence under rule 1.1(a). Knowing that the specific provision was illegal as defined above is likely to be reasonably necessary to provide competent legal advice to HR on employment law matters consistent with rule 1.2.1(b). Rule 1.1(c) allows a lawyer to be competent by associating or consulting a lawyer they reasonably believe to be competent or acquiring sufficient learning and skill to become competent before performance is necessary. A lawyer's failure to consult with a lawyer reasonably believed to be competent, or to acquire such learning and skill by conducting reasonable research relating to the material employment law provisions before advising the client, might be grossly negligent under rule 1.1(a) to the extent lawyer's conduct reflects deliberate and reckless disregard of the lawfulness of the agreement. *See also* Rule 1.1(b).

B. Duty Not to Assist Enforcement of an Illegal Contract Provision

While the ABA frames this issue in terms of fraud or crime, the 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 under rule 1.2.1 not only to advise the client or client constituent, HR, on the applicable law and the possible consequences of using the provision in question, but also to recommend against its use and avoid assisting the client's enforcement of the illegal provision. *See also* Rule 1.4(b) ("A lawyer shall explain a matter to the extent reasonably* necessary to permit the client to make informed decisions regarding the representation.").

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).

If the lawyer later assists the client in promulgating or enforcing the illegal provision, the lawyer's conduct can be characterized as a misrepresentation by omission or an affirmative misrepresentation that the provision is legal. *See* Rule 4.1(a), Comment 1.

A lawyer may not knowingly make 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. Using or enforcing a knowingly illegal provision in an

employment agreement for its chilling effect^{8/} on third parties would violate Rule 4.1(a), Rule 8.4(c), and Business and Professions Code section 6068(d). *See also*, Cal. Formal Opn. 2015-194, where this Committee opined that a lawyer may not knowingly make false statements of fact or implicit misrepresentations of material fact during negotiations.^{9/}

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.*; see also California State Bar Formal Opn. 2015-194.

In addition, a lawyer may not make or ratify a false statement of law or fact made by the client that the lawyer knows is false. See rule 4.1(a); *see also* South Carolina Bar Ethics Opn. 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 4.1 and 8.4(c)); *In re Discipline of Attorney* (2008) 451 Mass. 131 [884 N.E.2d 450] (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 a failure to disclose a material fact necessary to avoid assisting in a "criminal or fraudulent" act by a client, which is narrower than illegal conduct.^{10/} However, the advocacy of a contract provision known both by the client and the lawyer to be illegal for its chilling effect could be viewed as a fraudulent act by the client. Whether rule 4.1(b) applies will depend on the scope of the attorney's conduct in promulgating or enforcing the provision.

C. Lawyer May Have a Duty to Withdraw from the Representation

In Scenario 4, if HR insists on including the illegal provision, Lawyer may withdraw but is not compelled to withdraw merely because the client chooses to use the illegal provision, despite the lawyer's admonition. Even where the use of that contract provision is deemed fraudulent or

^{8/} The chilling effect includes situations where a client wants to include a term not merely to frighten employees, but to obtain the client's desired result by inducing employees to comply with an illegal provision out of a mistaken fear of liability or fear of the risks and costs of litigation.

^{9/} Cal. Formal Opn. 2015-194 was issued prior to the time that CRPC, Rule 4.1, was enacted; the Committee principally relied on existing statutory law (Bus. & Prof. Code §§ 6106, 6128(a), and 6068(d)), and related California case law, but it also relied on ABA Model Rule 4.1 in support of its argument.

^{10/} Under rule 1.0.1(d): "Fraud" or "fraudulent" means conduct that is fraudulent under the law of the applicable jurisdiction and has a purpose to deceive.

even criminal, withdrawal from representation is permissive, not mandatory (see Rule 1.2.1, Comment [1]; rule 1.16(b)(1) -(3).)^{11/}

If, however, HR not only ignores Lawyer's advice, but insists that Lawyer be involved with promulgating or enforcing the illegal contract provision, Lawyer would likely be required to terminate his representation of Company with respect to this matter¹². Rule 1.16(a)(2) provides that withdrawal is 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" Lawyer's continued, active participation in promulgating and enforcing the illegal contract provision would likely violate rules 1.2.1, 4.1, 8.4 and possibly Business and Professions Code section 6068(d).^{13/}

D. Duty to Report Up in An Organization

Lawyer in Scenario 4 has a duty to report the conduct of the corporate constituent (*e.g.*, HR) to the higher authority within Company because the lawyer knows that the HR's conduct is illegal^{14/} and it is "likely to result in substantial injury to the organization" See Rule 1.13(b). Rule 1.13(b) provides for an exception to reporting up if the facts indicate that "it is not necessary in the best lawful interest of the organization to do so." *Id.* While the duty to report up is fact-specific, in Scenario 4, if HR insists on using the illegal provision or that Lawyer participates in

^{11/} 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 . . ."). (Emphasis added.)

¹² For the purposes of this opinion, we assume that the in-house Lawyer would be permitted to terminate his representation of Company with respect to this matter and that it would not impact Lawyer's representation of Company on other matters. The question of whether Lawyer may be required to terminate his employment at Company based on HR's instructions or continued demands is beyond the scope of this opinion.

^{13/} If this matter was before a tribunal, the lawyer may not reveal confidential advice or information regarding the use of the illegal provision in seeking withdrawal, except as required by rule 1.13. (See rule 1.6 and Cal. Bus. & Prof. Code § 6068(e)(1). See also Cal. State Bar Form. Opn. 2015-192, generally, for discussion on lawyer's duty to maintain confidential information when withdrawing from a client representation.)

^{14/} See also Labor Code section 432.5 ("No employer, or agent, manager, superintendent, or officer thereof, shall require any employee or applicant for employment to agree, in writing, to any term or condition which is known by such employer, or agent, manager, superintendent, or officer thereof to be prohibited by law.") For purposes of this opinion, we assume that the contract provision is unambiguously unlawful under California law.

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promulgating or enforcing the illegal provision, reporting up would very likely be in the best lawful interest of Company.

Moreover, because Lawyer has a duty not to withdraw without taking reasonable steps to avoid reasonably foreseeable prejudice to the organization client under rule 1.16(d), this disclosure must be made even if Lawyer opts to withdraw under the permissive withdrawal provisions in Rule 1.16(b)(1) – (3). Beyond this scenario, a lawyer should evaluate carefully whether disclosure to a higher authority within the organization is reasonably necessary, which will depend on the relevant circumstances.¹⁵

CONCLUSION

A California lawyer has a duty not to counsel 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. That conduct includes the use of a contract provision in a transaction with a third party that is unambiguously illegal under the law of the jurisdiction applicable to the transaction and not potentially subject to an exception that would make the provision legal. If the lawyer knows that the provision is illegal, the lawyer: (1) should advise the client accordingly; (2) may not recommend the use of the provision; and (3) must counsel the client not to use it.

If the client insists on the use of the illegal provision against the lawyer's advice, the lawyer may not participate in presenting the illegal provision to the third party and may not assist the client in enforcing the provision against a third party. In that event, the lawyer may withdraw from the representation or, depending on the client's continued conduct, may be required to do so.

If the lawyer concludes that the conduct is a violation of law reasonably imputable to the organization and likely to result in substantial injury to the organization, the lawyer for an organization must report the actions of the client constituent to a higher authority within the organization, unless the lawyer reasonably concludes that it is not in the best lawful interest of the organization to do so.