

IN-HOUSE COUNSEL DRAFT OPINION

- ISSUES:**
- (1) What are the conflict of interest duties of an in-house lawyer when moving from one company to another?
 - (2) 1.8.1/1.7 re compensation and stock
 - (3) Duties re individual shareholders in context of acquisition/stock sales?

DIGEST: [INSERT]

AUTHORITIES

INTERPRETED: Rules of Professional Conduct 1.0.1, 1.7, 1.8.1, 1.9, 1.10, 1.13

STATEMENT OF FACTS AND QUESTIONS PRESENTED

After practicing law for 5 years as in-house legal counsel for a software company ("Old Company"), Lawyer has decided to take a position as General Counsel for a closely-held software company ("Company"), owned by three shareholders ("Shareholders"). The Shareholders make up the Board of Directors ("Board"). Lawyer is expected to head a small team of three lawyers ("Legal Department").

Company is a competitor of Old Company in that both are in the process of registering competing patents for similar technology. Lawyer was not part of the team that advised Old Company concerning its technology and patent applications. However, Lawyer was responsible for advising Old Company on legal issues concerning its business strategies and marketing, which necessarily involved patented products.

Question 1: *Before formally accepting the position, Lawyer wants to know how to analyze and navigate any potential conflicts that Lawyer might have based on Lawyer's work at Old Company and to what extent an ethical screen may be required.*

As part of Lawyer's employment agreement with the Company, Lawyer is presented with a stock option agreement that is offered to the Company's key employees. The agreement states that Lawyer has an option to purchase a certain number of shares of the Company's common stock at an exercise price equal to the fair market value of such shares on the date of the grant, based on the Company's Stock Incentive Plan. The agreement also states that the securities will vest over time, at increasing percentages over the course of five years. The agreement also states that in the event of a merger with or acquisition by another company, the vesting of the Lawyer's option will immediately accelerate so as to become fully vested.

Question 2: *Lawyer wants to know whether the stock option agreement presents any conflicts of interest, and if so, how and when such conflicts of interest should be addressed with the Company.*

Lawyer begins working for Company. Three years later, after Lawyer's securities are 30% vested, Company begins talks with another Company (Public Company) under which Public

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Company offers to acquire Company through a stock purchase and Company would become a wholly-owned subsidiary of Public Company. [Public Company is also a competitor of Old Company and Company?] Company's CEO asks Lawyer to advise the Shareholders (i.e., the sellers under the proposed deal) about the benefits and risks of the proposed deal, and potential negotiation terms including a sales price.

Question 3: *Lawyer wants to know whether her status as a stockholder in the Company presents a conflict of interest in connection with the requested advice, and if so, whether the conflict may be waived by the Company. Lawyer also wants to know whether the requested advice to the Shareholders will present conflicts of interest between and among the Shareholders and/or between the Shareholders and the Company. Lawyer also wants to know whether she may ethically represent Company in direct negotiations with Public Company and/or its counsel.*

DISCUSSION

Generally, the California Rules of Professional Conduct apply equally to in-house lawyers who are licensed or registered¹ in California to practice law and all other California lawyers. In-house lawyers have attorney-client relationships with the organizations that employ them. "In-house attorneys employed as attorneys for their employer do indeed have an attorney-client relationship with their employers." *Gutierrez v. G & M Oil Co., Inc.* (2010) 184 Cal.App.4th 551, 559. An organization's legal department is encompassed within the definition of "law firm" under the rules. Rule 1.0.1(c) ("Firm" or 'law firm' means a law partnership; a professional law corporation; a lawyer acting as a sole proprietorship; an association authorized to practice law; or lawyers employed in a legal services organization or in the legal department, division or office of a corporation, of a government organization, or of another organization.") A lawyer's duties to an organizational client are the same whether they are "employed or retained" by the organization. Rule 1.13(a). This is because, fundamentally, the underlying purposes of a lawyer's fiduciary duties – protecting the public and the integrity of the legal system and promoting the administration of justice and confidence in the legal profession – are not diminished simply because the lawyer is employed rather than retained by an organizational client.

However, the nature of an in-house lawyer's fiduciary duties may be relative to the nature of the attorney-client relationship between employer and employee. "For example, in-house lawyers may be seen to owe different duties than independent lawyers, perhaps because they are viewed as employees of the client directly rather than indirectly." Klein, No Fool for a Client: The Finance and Incentives Behind Stock-Based Compensation for Corporate Attorneys, 1999 Colum. Bus. L. Rev. 330. Accordingly, "[t]he dual status of in-house counsel—acting as both employee and attorney—and the dual status of the company—acting as both employer and client—can pose some challenging questions about when one role takes precedence over another." *Missakian v. Amusement Industry, Inc.* (2021) 69 Cal. App. 5th 630, 652.

This tension is illustrated in the employment law context. In *General Dynamics Corp. v. Superior Court (Rose)* (1994) 7 Cal.4th 1164, the California Supreme Court addressed the question of whether an in-house lawyer may sue his employer for wrongful discharge notwithstanding the absolute and unfettered

¹ See, California Rules of Court (CRC) 9.46 (Registered In-House Counsel).

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right of a client to discharge an attorney at any time, for any reason. *See Fracasse v. Brent* (1972) 6 Cal.3d 784. The Court found a limited right of action where the reason for the discharge is based on the lawyer's refusal to breach ethical duties or norms - "disagreements over policy are *not* actionable" - and protection of the statutory attorney-client privilege is strictly observed. *General Dynamics Corp. v Superior Court, supra*, 7 Cal.4th 1164, 1188-1192. In so holding, the Court struck a balance between the employer's rights as a client and the lawyer's rights as an employee. That is, because the client was also the employer, the right of discharge is not absolute; the lawyer/employee has a remedy for damages depending on the reason for the termination. Likewise, given the lawyer/employee's duties of confidentiality and loyalty, the right of action is not coextensive with the same rights enjoyed by non-lawyer employees. "The cause of action is thus one designed to support in-house counsel in remaining faithful to those fundamental public policies reflected in the governing ethical code when carrying out professional assignments." *Id.* at 1189.

In short, *General Dynamics* reflects a certain flexibility, or relativity, in the application of ethical rules and norms to in-house lawyers because the nature of the attorney-client relationship is also one of employer-employee. This approach provides guidance in analyzing the conflicts of interest issues presented here. [REWORD]

APPLICATION

I. What is the Scope of Lawyer's Duties To Their Former Employer, Old Company?

The California Rules of Professional Conduct (and Model Rules of Professional Conduct) are typically directed at lawyers practicing at law firms, so in-house lawyers must consider the intent behind each rule as it applies to their practice. As discussed, the California Rules of Professional Conduct are clear that an in-house lawyer (a lawyer "employed or retained by an organization") represents the organization itself as a client. (CRPC 1.13(a).) Thus, Lawyer's previous client was Old Company, and Lawyer's current client is Company, acting through the Shareholders and Board. Keeping in mind who is the client—whether former or current—is important in analyzing potential conflicts, confidential information, and any duty owed by Lawyer. **KR Comment This may be totally "duh" and may be discussed in the introduction (in terms of "who is the client") so feel free to strike this.**

As stated in the comments to the Rules, a lawyer owes two duties to a former client: a duty of loyalty (to refrain from doing "anything that will injuriously affect the former client in any matter in which the lawyer represented the former client"), and a duty of confidentiality (to refrain from ever using against the former client "knowledge or information acquired by virtue of the previous relationship.") (Comment [1] to Rule 1.9 [citing *Oasis West Realty, LLC v. Goldman* (2011) 51 Cal.4th 811, and *Wutchumna Water Co. v. Bailey* (1932) 216 Cal. 564].)

Rule 1.9 states that a lawyer must obtain informed written consent from a former client before representing another client "in the same or a substantially related matter" in which the current client's interests are "materially adverse" to the former client's interests (Rule 1.9(a)). In the case of changing legal departments, the Rules state that a lawyer must obtain informed written consent from a client represented by the lawyer's former law firm if the lawyer finds themselves representing a new client with materially adverse interests and the lawyer "had acquired information protected by Business and Professions Code section 6068, subdivision (e) and rules 1.6 and 1.9(c) that is material to the matter" (Rule 1.9(b).) **KR Comment: I tried to condense the underlying rule here, but I worry that I might have condensed it too much in trying to be succinct, and not highlighted the difference/interplay between the**

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different subsections of 1.9... reading the ABA Formal Opinion 99-415 makes me think they did it much better... Rule 1.9(a) prohibits a lawyer from representing a person whose interests are materially adverse to those of his former employer if he personally represented the former employer in the same or a substantially related matter. Rule 1.9(b) applies this prohibition in situations in which the former in-house lawyer did not personally represent the organization in the same or a substantially related matter, but other lawyers in the legal department did, and the former in-house lawyer acquired protected information during his employment that is material to the prospective client's matter. In contrast to Rule 1.9(b), which only restricts the lawyer in a new matter in which the interests of the client are materially adverse to the former client and the matters are substantially related, Rule 1.9(c) prohibits the use of a former client's protected information (unless it is generally known) as well as its disclosure, even if the lawyer is not adverse to the former client or the adversity is in a matter that is not substantially related to the prior representation.

For an in-house lawyer who provided legal advice to a company concerning a broad range of matters, the question of whether representation of a new company is considered "the same or [] substantially related" is a more difficult question than a lawyer performing legal work at a law firm on a case, matter, or transaction basis. The Second Circuit test of "substantially related" matters—requiring demonstration of either (1) a "patently clear" relationship between the issues in the prior and present representations, or (2) that the issues are "identical" or "essentially the same"—offers little guidance here. (Gov't of India v. Cook Inds., Inc. (2nd Cir. 1978) 569 F.2d 737, 739-40.) Lawyer was not part of the team that advised Old Company concerning its technology and patent applications (this would clearly be "substantially similar," as the two companies are developing similar technology with competing patents). Instead, Lawyer advised Old Company generally on legal issues, and will certainly advise Company on similar matters as head of such a small legal team. KR Comment Do we need more analysis here of whether the two companies are actually materially adverse? That would warrant a whole discussion of 1.7 (see ABA opinion 99-415: The Comment to Rule 1.7 in turn interprets that Rule to prohibit the representation of interests that are "directly" as opposed to "generally" adverse.)

General legal advice is too broad to be considered a "matter"—to do so would necessitate the conclusion that every matter undertaken by an in-house lawyer is substantially similar to every other one, and the result would be a duty of extra loyalty to the detriment of a lawyer's career mobility. Lawyers' mobility—and ability to leverage the expertise and knowledge gained along their career path—is increasingly important. (See ABA Form. Opn. 99-415 at 2 ["The increased frequency with which lawyers employed by an organization are hired by a competitor or by a law firm seeking the expertise gained by the lawyer in his former position has resulted in a greater focus on [the issue of in-house lawyers' duties to former clients].".])

On the other hand, the general nature of an in-house lawyer's work does not create a shield such that an in-house lawyer will have no conflicts and owes no duty to former lawyers. Instead, the analysis should be based heavily on Rule 1.9(b)(2); namely, the acquisition of confidential information. (See 1.9 Comment [3], noting that a lawyer with confidential information would be expected to use or disclose that information in a substantially similar matter.) Here, the concept of "playbook conflicts" may be more informative than merely a plain reading of Rule 1.9. Even if a matter is not substantially similar and a lawyer doesn't have confidential information within the meaning of Business and Professions Code section 6068, subdivision (e) and rules 1.6 and 1.9(c), there are certain situations where a lawyer has gained enough knowledge of a company's strategies and tendencies (or specific facts like its financial situation) to create an advantage when the lawyer finds themselves working for a competitor. KR

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Comment I had a hard time with phrasing the explanation of this comment, but it also felt like not enough explanation to just say “see comment 3” ...

However, similarly to the analysis above regarding substantial similarity, knowledge of a company’s “playbook” alone is not enough to disqualify a lawyer based on the duty of loyalty; instead, there must be a showing that the information gained from the “playbook” is of “critical importance” to the matter at hand. (See *Fremont Indem. Co. v. Fremont Gen. Corp.* (2006) 143 Cal.App.4th 50, 65.) Here, there are no facts to suggest that Lawyer gleaned information from Old Company’s “playbook” regarding its technology or patent applications that would rise to the level of such material importance; thus, absent additional facts about confidential information, the competing nature of the two companies and the similarity of Lawyer’s roles at the two companies does not mean that Lawyer has violated their duties of loyalty or confidentiality to Old Company by accepting employment at Company.

A. Confidential Information Creating Conflict

The confidential information referenced in Rule 1.9 is Business and Professions Code section 6068, subdivision (e) and rules 1.6 and 1.9(c). (Notably, this information is broader than the information protected by attorney-client privilege.) The focus of Rule 1.9 is also on the effect of possession or use of this information: would the knowledge of this information cause a lawyer to advise a new client in a way that unduly harms the old client? Here, Lawyer does not have any information that rises above the general “playbook” information discussed above, so the use of Lawyer’s knowledge of, for example, Old Company’s settlement strategies, risk tolerance, or financial ability to fight patent challenges.

Rules of Professional Conduct aside, Lawyer needs to be aware of any policies at Old Company to keep certain proprietary information secret. [More discussion on this?] KR Comment Sorry, this is weak. I am mostly just leaving this as a placeholder since I’m not sure what the discussion should be for the outline item that said “Company policies/agreement to keep proprietary information secret?”

B. Screening

CRPC 1.10 (Screening Option) *[This is also a placeholder; my analysis above leads me to believe that there is no conflict so no need to screen. Should we discuss what Lawyer’s options would be if there was a conflict? Or if Lawyer wants to be totally safe/conservative and act as though there is a conflict, how would they screen? This is where my lack of practice in legal malpractice/ethics stunts me, because I’m not sure what direction the analysis takes. There is also the issue of how to screen a lawyer who is going to head a 3-person legal department, and whether a company would hire someone who would need to be screened in that way, right?]*

II. What are Lawyer’s Ethical Duties Regarding Stock Options Offered by New Company as Compensation for Employment?

A. CRPC 1.8.1

In the traditional attorney-client relationship, a lawyer’s acceptance of stock or stock options from a client in lieu of fees for legal services is subject to rule 1.8.1, which governs when a lawyer knowingly

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acquires an ownership or other pecuniary interest adverse to a client. *See*, ABA Formal Opn. 00-418 (“[A] lawyer who acquires stock in her client corporation in lieu of or in addition to a cash fee for her services enters into a business transaction with a client, such that the requirements of Model Rule 1.8(a) must be satisfied.”); Rule 1.8.1, Comment [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.”) If rule 1.8.1 applies, the lawyer must ensure that the following requirements are met: (1) the transaction or acquisition and its terms are fair and reasonable to the client and the terms and the lawyer’s role in the transaction or acquisition are fully disclosed and transmitted in writing to the client in a manner that should reasonably have been understood by the client; (2) 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 (3) the client thereafter provides informed written consent to the terms of the transaction or acquisition, and to the lawyer’s role in it.

The purpose of the rule is to address the inherently imbalanced relationship between attorney and client:

“ . . . While an attorney is not prohibited from having business transactions with his client, yet, inasmuch as the relation of attorney and client is one wherein the attorney is apt to have very great influence over the client, especially in transactions which are a part of or intimately connected with the very business in reference to which the relation exists, such transactions are always scrutinized by courts with jealous care, and are set aside at the mere instance of the client, unless the attorney can show by extrinsic evidence that his client acted with full knowledge of all the facts connected with such transaction, and fully understood their effect; and in any attempt by the attorney to enforce an agreement on the part of the client growing out of such transaction, the burden of proof is always upon the attorney to show that the dealing was fair and just, and that the client was fully advised. In the words of Lord Eldon, he must make it manifest that he gave to his client 'all that reasonable advice against himself that he would have given him against a third person.' *Gibson v. Jeyes*, 6 Ves. 278.)”

Beery v. State Bar (1987) 43 Cal.3d 802, 812-813, quoting, *Felton v. Le Breton* (1891) 92 Cal. 457, 469 [28 P. 490], and citing, *Estate of Witt* (1926) 198 Cal. 407, 419; *Gold v. Greenwald* (1966) 247 Cal. App. 2d 296, 305-306. “The law accordingly takes a jaundiced view of business transactions between attorneys and their clients.” *Ferguson v. Yaspán* (2014) 233 Cal.App.4th 676, 685. Indeed, “the law presumes” attorneys engaging in such transactions “wear” a “black” hat. *Mayhew v. Benninghoff* (1997) 53 Cal.App.4th 1365, 1369.²

² A lawyer’s failure to satisfy the requirements of rule 1.8.1 subjects a lawyer to discipline. However, a violation of the rule does not by itself provide a basis for civil liability. Rather, the rule’s “statutory counterpart—Probate Code section 16004—erects a presumption that transactions between an attorney and client ‘by which the [attorney] obtains an advantage’ are a breach of the attorney’s fiduciary duty and are the product of undue influence.”

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However, these concerns are typically not present in the in-house context, where the new lawyer is offered the same general compensation terms, including stock and stock options, as those offered to other key employees. Indeed, the power dynamic is often **[may be?]** reversed. “[T]he economic fate of in-house attorneys is tied directly to a single employer, at whose sufferance they serve. Thus, from an economic standpoint, the dependence of in-house counsel is indistinguishable from that of other corporate managers or senior executives who also owe their livelihoods and career goals and satisfaction to a single organizational employer.” *General Dynamics Corp. v. Superior Court*, *supra* at 1172.

In *Chism v. Tri-State Construction Inc.* (2016) 193 Wn.App. 818, a Washington state court of appeals addressed application of Washington State’s version of rule 1.8.1, Wa. RPC 1.8(a) in the in-house context.³ There, Mr. Chism, Tri-State Construction Inc.’s (Tri-State) general counsel, sued Tri-State for breach of compensation contracts to recover allegedly unpaid bonuses, which were drafted by Mr. Chism and negotiated during his tenure as general counsel. The court of appeals reversed the trial court’s decision finding that the contracts were subject to RPC 1.8(a). In so holding, the court reasoned that

[b]y rendering [the] compensation agreements prima facie fraudulent, the trial court’s interpretation would disturb the settled expectations of many lawyer-employees. It would also subject standard wage contracts for lawyer-employees, which frequently include nonmonetary compensation, to greater scrutiny overall than standard fee contracts, which are generally exempt from the rule. Moreover, it would do this without addressing whether lawyer wage contracts should be exempt from the rule as another type of “transaction [in which] the lawyer has no advantage in dealing with the client,” RPC 1.8 cmt. 1, given that, in general, employees are thought to have relatively little power compared with that of their employers. Cf. *Rickman v. Premera Blue Cross*, 184 Wn.2d 300, 309, 358 P.3d 1153 (2015) (stating, regarding the wrongful termination cause of action, “allowing an exception to the at-will doctrine serves to equalize the imbalance of power that exists in an employment relationship”).

Ferguson v. Yaspan, *supra*, at 684-685; see also, *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, 1140. “The presumption is rebuttable, and the attorney’s inability to do so renders the transaction voidable at the client’s option.” *Ferguson v. Yaspan*, *supra* at 685.

³ Washington State Bar Rule of Professional Conduct [RPC] 1.8 provides, in pertinent part:

(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 an independent lawyer on 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.

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273 *Chism v. Tri-State Construction Inc., supra*, 193 Wn.App. 818, 853. *See also*, Washington State Bar
274 Association Advisory Opinion:

275 A lawyer negotiated with corporate management over an employment
276 contract to serve as legal counsel. The contract provided that part of the
277 lawyer's compensation would be shares in the publicly traded
278 corporation. The Committee was of the opinion that negotiations as
279 described by you in working out an employment contract for the full
280 time job of legal counsel for a corporation does not violate RPC 1.8. It
281 appeared to be an arm's length transaction, and it did not appear that
282 you were in any way giving legal advice to the corporation.

283 In other words, the Washington State Bar and court of appeals take the position that where the
284 employment contract between lawyer/employee and client/employer, which contains stock and/or
285 bonus provisions, was the result of an arms-length deal, the contract is substantively similar to a typical
286 attorney-client fee agreement, which is not subject to RPC 1.8(a).⁴ The ABA Task Force on the
287 Independent Lawyer in its report, *Lawyers Doing Business with Their Clients: Identifying and Avoiding*
288 *Legal and Ethical Dangers* 56 (2001) [hereafter "Independent Lawyer Report"] reached a similar
289 conclusion:

290 In the usual case, the receipt of equity-based compensation by in-house
291 counsel would not appear to be the type of "business transaction with a
292 client" contemplated by Rule 1.8. Option or restricted stock grants (the
293 usual forms of equity compensation paid to in-house attorneys) are
294 merely a form of compensation and, like cash, are a facet of the general
295 employment relationship rather than part of or related to any particular
296 transaction or undertaking. The timing, size, and conditions placed on
297 the grants are determined unilaterally by the corporate employer as
298 part of company-wide, formal compensation plans. The grants normally
299 are made by way of a written agreement and the plans normally are
300 adopted upon the advice of outside advisors and counsel and with
301 required stockholder approval. And, as noted above, the grants
302 generally are made in small increments over time and usually are
303 restricted in ways that give them contingent, future value only.
304 Moreover, the grants are made for the express purpose of aligning the

⁴ See, rule 1.8.1, Comment [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." See also, rule 1.8.1, Comment [6] "This rule does not apply . . . 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." Wa. RPC 1.8(a), Comment [1] is similar: "[RPC 1.8(a)] 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 addition, the Rule does not apply to standard commercial transactions between the lawyer and the client for products or services that the client generally markets to others, for example, banking or brokerage services, medical services, products manufactured or distributed by the client, and utilities' services. In such transactions, the lawyer has no advantage in dealing with the client, and the restrictions in paragraph (a) are unnecessary and impracticable."

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305 employee's interests with those of the corporation and its stockholders;
306 as such, under normal circumstances, they should not create interests
307 that are "adverse" to the company's interests under Rule 1.8(a).

308 The question of whether rule 1.8.1 applies to offers of employment of in-house lawyers has not been
309 addressed by the California courts. [DISCUSS *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, 1140 AND
310 *Missakian v. Amusement Industry, Inc.* (2021) 69 Cal. App. 5th 630, 652 – applying B&P 6147 requiring
311 contingency contract be in writing to in-house lawyer handling litigation on behalf of company.]

312 [DISCUSS DEBATE AMONG COMMENTATORS?]

313 B. CRPC 1.7

314 Rule 1.7(b) prohibits representation of a client if the representation "may be materially limited . . . by
315 the lawyer's own interests," without the informed written consent of the client. Further, the lawyer
316 cannot represent the client even with the requisite consent from the client if the lawyer does not
317 "reasonably believe[] that the lawyer will be able to provide competent and diligent representation to
318 each affected client." Rule 1.7(d)(1). Thus, where the lawyer has a personal interest in the subject
319 matter of the representation, the lawyer must assess whether their independent judgment will be
320 materially impacted to the detriment of the client. See, e.g., Model Rule 1.7, Comment [10]: "For
321 example, if the probity of a lawyer's own conduct in a transaction is in serious question, it may be
322 difficult or impossible for the lawyer to give a client detached advice. . . . See Rule 1.8 for specific Rules
323 pertaining to a number of personal interest conflicts, including business transactions with clients."

324 In ABA Formal Opn. 00-418, the Committee opined that ownership of stock in a client "creates no
325 inherent conflict of interest" under Model Rule 1.7(b). The Committee explained: "Indeed,
326 management's role primarily is to enhance the business's value for the stockholders. Thus, the lawyer's
327 legal services in assisting management usually will be consistent with the lawyer's stock ownership. In
328 some circumstances, such as the merger of one corporation in which the lawyer owns stock into a larger
329 entity, the lawyer's economic incentive to complete the transaction may even be enhanced."
330 Nevertheless, the Committee also cautioned:

331 There may, however, be other circumstances in which the lawyer's
332 ownership of stock in her corporate client conflicts with her
333 responsibilities as the corporation's lawyer. For example, the lawyer
334 might have a duty when rendering an opinion on behalf of the
335 corporation in a venture capital transaction to call upon corporate
336 management to reveal material adverse financial information that is
337 being withheld, even though the revelation might cause the venture
338 capital investor to withdraw. In that circumstance, the lawyer must
339 evaluate her ability to maintain the requisite professional independence
340 as a lawyer in the corporate client's best interest by subordinating any
341 economic incentive arising from her stock ownership. The lawyer also
342 must consider whether her stock ownership might create questions
343 concerning the objectivity of her opinion. She must consult with her
344 client and obtain consent if the representation may be materially
345 limited by her stock ownership.

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The conflict could be more severe. For example, the stock of the client might be the lawyer's major asset so that the failure of the venture capital opportunity could create a serious financial loss to her. The lawyer's self-interest in such a case probably justifies a reasonable belief that her representation of the corporation would be affected adversely. This would disqualify her under Rule 1.7(b) from providing the opinion even were the client to consent.

The ABA Committee's suggested approach for minimizing conflicts has little relevance to the in-house context and would be impracticable. Specifically, the Committee noted that "some law firms" have adopted policies limiting client investments and percentages of stock ownership in any single client, or requiring other lawyers at the firm with no stock ownership to handle decision-making or supervisory responsibility for the matter. A company's general counsel should not be expected to eschew investment opportunities offered by the company, which are also offered to the company's other employees and managers. Nor should the company be required to seek independent legal advice regarding financial issues simply because its lawyers own a significant share of company stock.

However, this does not render rule 1.7(b) wholly inapplicable to an in-house lawyer who owns stock or stock options. "To the extent . . . that the receipt of such compensation or the ownership of equity in the employer company might raise a question as to a potential conflict of interest or impairment of the representation, Rule 1.7 would govern." Independent Lawyer Report, p. 56. Furthermore, "because Rule 1.7(b) imposes an ongoing obligation to avoid conflicts, the attorney regularly must reexamine the investment for potential conflicts." *Id.* at 43.

PLACEHOLDER – HELPFUL EXCERPT FROM INDEPENDENT LAWYER REPORT: *Stock options, restricted stock and other equity-based financial incentives have become commonplace as part of compensation and benefits packages for corporate employees, including in-house legal counsel. For example, more than half of all companies reportedly offer stock options or some other type of long-term financial incentives to their legal staff. A PricewaterhouseCoopers survey found that in 1998 the median earnings for general counsel from their corporate equity-based compensation was \$236,000.⁷⁸ Notwithstanding the popularity and growing use of these forms of compensation, ethical rules, while urging caution in attorney-client business transactions generally, provide little specific guidance as to any ethical issues that may arise when an in-house attorney is also a shareholder in the employer corporation. Applying general ethics rules and principles, it is clear that such a relationship is generally permissible, even where there may be a potential conflict, so long as certain precautions are taken. The very limited case law on point generally has approved of such a relationship for public corporations but, in one reported case, has disapproved of such a relationship in a closely-held corporation under the special facts presented. . . .*

Rule 1.7(b) states that "a lawyer shall not represent a client if the representation of that client may be materially limited . . . by the lawyer's own interests." However, the rule allows a lawyer to represent a client in a matter in which the lawyer has a personal interest if "the lawyer reasonably believes the representation will not be adversely affected" and "the client consents after consultation." Thus, in-house counsel's receipt or ownership of equity or equity-based compensation is not problematic as long as the lawyer reasonably believes that the representation of the client will not be materially limited by the lawyer's own interest. Given the relatively limited equity stake of corporate counsel in most cases,

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the lawyer's ownership interest usually would not materially limit the representation. Indeed, equity-based compensation grants generally are made in small increments over time and, at the time made, are restricted in ways that give them only contingent, future value. In most circumstances, the lawyer's equity interest, even over time, is but a small facet of his or her general employment interest which, like an outside attorney's general interest in retaining a good corporate client, normally would not be viewed as raising a Rule 1.7 issue. In the unusual case, however, where the magnitude of the in-house counsel's stock ownership is great, such an equity interest could be sufficiently substantial to require consent under Rule 1.7(b). In those cases, it would be the lawyer's obligation to advise the corporation on the implications of the lawyer's equity interest on the rendering of legal advice to the entity, and to obtain an informed client consent.

As an example, the lawyer's own interests could be a material limitation if the lawyer has a large personal equity interest and is asked to advise his or her employer, a publicly-held company, on the timing of public announcements required under the securities laws. Depending, again, on the magnitude of the lawyer's ownership interest in the company, it might be difficult for the attorney to recommend fully meeting the company's disclosure requirements, if doing so might result in an adverse effect on the value of the lawyer's own equity holdings. The difficulty lies in determining the ownership level and other circumstances that render the conflict potential significant enough to warrant client consent under Rule 1.7(b). After all, any attorney – whether in-house or outside – would experience some difficulty in recommending public disclosures that would have a substantially adverse impact on his or her client's share price, regardless of whether the lawyer owned stock in the client company.⁵

[APPLICATION TO FACTS]

III. Question 3: What are Lawyer's Ethical Duties to New Company and the Individual Shareholders Concerning the Sale?

A. Can Lawyer Advise Individual Shareholders?

Generally, a lawyer may advise and represent both the company and individual shareholders provided the proper disclosures are provided and consent is given by each client. Rule 1.13(g).

B. If Lawyer Declines to Advise Individual Shareholders, Does Lawyer Have Any Duties of Disclosure?

CONCLUSION

⁵ Fn. 81 from Independent Lawyer Report: As a practical matter, such situations are seldom encountered. The number of inside counsel dealing with disclosure issues at all is very small and disclosure issues of this nature do not occur frequently; those lawyers who would be responsible for rendering advice on such disclosure questions normally would be subject to restrictions and reporting requirements as to any trading in the company's stock. Moreover, the best interests of all shareholders, including the employee attorney, ultimately are served by proper and timely disclosures under the securities laws. Not only would contrary advice disserve the interests of both the company and its shareholders, but the only plausible reason for doing so would be to trade out of the stock before the inevitable disclosure – conduct that in itself would give rise to criminal liability and ethical concerns well beyond Rule 1.7.