

IN-HOUSE COUNSEL DRAFT OPINION

ISSUES:

(1) What conflicts of interest arise when an in-house lawyer moves from one company to another?

(2) What conflicts of interest are presented by a stock option agreement between in-house lawyer and the company?

(3) What conflicts of interests arise from in-house lawyer's representation of company shareholders in connection with a proposed acquisition by a third party via a stock purchase transaction where lawyer is a shareholder of company?

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"). There are approximately 75 salaried employees who own stock and/or stock options.

Company is a competitor of Old Company in that the software they both sell uses similar technology protected through several patents and other intellectual property rights. Old Company is publicly held, with several divisions. Old Company has a central legal department managed by a General Counsel, and is segregated into teams. Lawyer was assigned to the Labor and Employment team. Lawyer was not part of the team that advised Old Company concerning its technology and patent applications. However, Lawyer will be expected to advise Company on all legal issues, including those relating to Company's technology and patent applications.

Question 1: *Lawyer is concerned that Old Company and Company are technological competitors. 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 Company, Lawyer is presented with a stock option agreement that is offered to 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

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on the Company's Stock Incentive Plan. The agreement states that the securities will vest 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 Company offers to acquire Company through a stock purchase and Company would become a wholly-owned subsidiary of Public Company. Company's CEO asks Lawyer to advise the Company and 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. The CEO also expects Lawyer to handle the negotiations with Public Company's counsel.

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

"[C]ounsel working for a corporation in-house and private counsel engaged with respect to a specific matter or on retainer" are "bound by the same fiduciary and ethical duties to their clients." *PLCM Group, Inc. v. Drexler* (2000) 22 Cal. 4th 1084, 1094. In-house lawyers have attorney-client relationships with the organizations that employ them. *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." Rule 1.0.1(c) ("Firm' or 'law firm' means . . . 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. CRPC 1.13(a). In short, 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, in many circumstances, analysis of an in-house lawyer's fiduciary and ethical duties must be placed in the context of the employer-employee relationship. "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*

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77 *Client: The Finance and Incentives Behind Stock-Based Compensation for Corporate Attorneys*,
78 1999 Colum. Bus. L. Rev. 330. Accordingly, “[t]he dual status of in-house counsel—acting as
79 both employee and attorney—and the dual status of the company—acting as both employer
80 and client—can pose some challenging questions about when one role takes precedence over
81 another.” *Missakian v. Amusement Industry, Inc.* (2021) 69 Cal.App.5th 630, 652; *see also*,
82 *General Dynamics Corp. v. Superior Court (Rose)* (1994) 7 Cal.4th 1164 (recognizing this dynamic
83 in the employment law context).

84 Potential conflicts of interest arising from an in-house lawyer’s movement from one in-house
85 position to another¹ and an in-house lawyer’s ownership of stock or stock options in the
86 employer present challenging questions. As explained below, although the CRPC apply with
87 equal force to in-house lawyers as they do to independent lawyers, they must be analyzed in
88 the context of both the attorney-client and employer-employee relationships at issue.

APPLICATION

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

91 The question of whether a conflict of interest exists between Old Company and Company is
92 governed by CRPC 1.9 (Duties to Former Clients). As discussed above, an in-house lawyer
93 represents the organization itself as a client. CRPC 1.13(a). Thus, Lawyer’s former client is Old
94 Company, and Lawyer’s current client is Company.

95 CRPC 1.9(a) prohibits representation of a client, including an organization, whose interests are
96 materially adverse to those of the lawyer’s former client if the lawyer personally represented
97 the former client in the same or a substantially related matter. Even if the lawyer did not
98 personally represent the former client, a conflict of interest may exist under CRPC 1.9(b) based
99 on their association with their prior law firm or legal department, if the lawyer obtained
100 confidential information that is material to the same or substantially related matter in which
101 the two clients’ interests are adverse. Informed written consent from the former client is
102 required if CRPC 1.9(a) or 1.9(b) applies to a particular situation, unless CRPC 1.10’s screening
103 requirements are satisfied.

104 In short, a conflict of interest will exist based on a lawyer’s personal representation of a former
105 client *or* acquisition of confidential information material to a particular matter, provided that
106 the matters are the same or substantially related and the interests of the clients are materially
107 adverse.

¹ *See e.g.*, ABA Formal Opn. 99-415 (“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 this issue. Current and prospective employers as well as in-house counsel themselves have reason for concern.”)

Irrespective of whether CRPC 1.9(a) or (b) applies, CRPC 1.9(c)(1) and (2) prohibits the use and disclosure of confidential information unless certain exceptions apply or the information has become “generally known.”

These questions are uniquely challenging for the in-house lawyer given the lawyer’s relatively broad scope of employment. “Matters” are not as easily discernable as they are in a law firm setting. “Many corporate legal departments do not maintain the detailed time records customarily maintained by private law firms. In light of the factual nature of the determination of whether a lawyer has ‘represented’ the organization, it is desirable for in-house lawyers at least to maintain logs describing those matters on which they work.” ABA Formal Opn. 99-415, fn. 7. However, this does not mean CRPC 1.9 is inapplicable to in-house lawyers; indeed, the representation is akin to an independent lawyer who is hired on retainer. *PLCM Group, Inc. v. Drexler, supra*, 22 Cal. 4th 1084, 1093. The scope of the representation could encompass all legal issues or those limited to a particular subject matter, such as employment law issues.²

A. CRPC 1.9(a) –Personal Representation of Old Company

“The determination whether a lawyer ‘represented’ his former employer with respect to a matter requires inquiry into the responsibilities of the lawyer during his former employment.” ABA Form. Opn. 99-415. Moreover, “[a] distinction may be made between a lawyer who has been heavily involved in a matter and one who has dealt with issues and not with factual analysis.” *Ibid*. The same test applies whether the lawyer worked in the former client’s legal department or for the law firm retained by the former client. There must be a “direct, personal relationship with the former client in which the attorney personally provided legal advice and services on a legal issue that is closely related to the legal issue in the present representation.” *City and County of San Francisco v. Cobra Solutions, Inc.* (2006) 38 Cal.4th 839, 847 (*Cobra Solutions*). Here, Lawyer was not part of the team that advised Old Company concerning its technology and patent applications. Instead, Lawyer advised Old Company on labor and employment law issues. Thus, similar to a law firm lawyer who worked in a particular practice group and was not involved in the representation of firm clients on matters handled by lawyers in a different practice group, Lawyer’s handling of labor and employment issues does not establish that Lawyer personally represented Old Company regarding its patents and technology. [CITE-FIND SUPPORTING CA CASE OR OPINION] This is true even if Lawyer’s advice to, and representation of, Old Company related to employees who worked on Old Company’s technology and patents. To the extent Lawyer acquired confidential information, CRPC 1.9(b) and (c) govern Lawyer’s duties and conduct.

Accordingly, under the facts presented, Lawyer did not personally represent Old Company with respect to its patent and technology matters. Therefore, CRPC 1.9(a) would not prohibit Lawyer

² Of course, the scope of representation must be limited to the extent of the lawyer’s duty of competency under CRPC 1.1.

from representing Company on such matters. Lawyer must then consider whether CRPC 1.9(b) applies.³

B. CRPC 1.9(b) – Imputed Conflict of Interest Based on Lawyer’s Association with Old Company’s Legal Department

Although Lawyer did not personally represent Old Company in patent and technology matters, a conflict of interest may exist under CRPC 1.9(b) based on Lawyer’s association with Old Company’s legal department. CRPC 1.9(b) “prohibits an attorney whose firm represented a client on the same or substantially related matter from subsequently taking a position adverse to that client, but only *if* the lawyer had acquired confidential information ‘material to the matter.’” *Adams v. Aerojet-General Corp.* (2001) 86 Cal.App.4th 1324, 1337 (interpreting ABA Model Rule 1.9(b)). At bottom, the analysis encompasses a fact-specific, flexible inquiry designed to balance the competing interests of loyalty owed to the former client and choice of counsel of the new client. “[T]he client previously represented by the former firm must be reasonably assured that the principle of loyalty to the client is not compromised[,] . . . the Rule should not be so broadly cast as to preclude other persons from having reasonable choice of legal counsel. . . . If the concept of imputation were applied with unqualified rigor, the result would be radical curtailment of the opportunity of lawyers to move from one practice setting to another and of the opportunity of clients to change counsel.” *Adams v. Aerojet-General Corp.*, *supra*, 86 Cal.App.4th 1324, 1337-1338, quoting ABA Model Rule 1.7, Comment [3].

1. Possession of Confidential Information

Lawyer will serve as Company’s General Counsel with direct and managerial responsibility over all legal issues, including those relating to Company’s technology and intellectual property. Accordingly, Lawyer must consider whether they obtained confidential information relevant to this new, expansive role. *See e.g., H.F. Ahmanson & Co. v. Salomon Brothers, Inc.* (1991) 229 Cal. App. 3d 1445, 1454 (“substantial relationship” test evaluates “whether confidential information material to the current dispute would normally have been imparted to the attorney by virtue of the nature of the former representation.”); *Dieter Dieter v. Regents of the Univ. of Cal.* (E.D. Cal. 1997) 963 F.Supp.908, 911-912 (“California courts look to whether ‘confidential information material to the current dispute would normally have been imparted to the attorney by virtue of the nature of the former representation.’” [Citations omitted].) “Application of paragraph (b) depends on a situation’s particular facts, aided by inferences, deductions or working presumptions that reasonably may be made about the way in which lawyers work together.” ABA Model Rule 1.9(b), Comment [6]. “Whether confidential, material information would normally have been imparted to the attorney depends on three factors: (1) the factual similarities between the current and former representations, (2) the similarities between the

³ CRPC 1.9(a) may prohibit Lawyer from representing Company on labor and employment matters to the extent those matters are the same or substantially related to the matters Lawyer handled while employed at Old Company and the interests of Old Company and Company are materially adverse with respect to those matters.

legal questions posed, and (3) the nature and extent of the attorney's involvement with the former representation." *Dieter v. Regents of the Univ. of Cal.*, *supra*, 963 F.Supp.908, 911-912, citing *H.F. Ahmanson*, *supra*, 229 Cal. App. 3d at 1455. In the in-house context, "[d]epending on the size and structure of the legal department and the extent to which it limits access to confidential information to those lawyers working on a matter, the lawyer may have obtained information as the result of shared confidences, requiring disqualification under Rule 1.9(b)." ABA Form.Opn. 415-97.

Lawyer should examine their matters at Old Company; Old Company's legal department structure; and the overall culture within Old Company concerning the exchange of confidential or proprietary information, to determine whether they possess confidential information that may be material to Lawyer's new role as Company's General Counsel. For example, although Lawyer's representation was limited to labor and employment matters, it is reasonably plausible that during the course of relevant communications with Company employees and principals, technology issues and related facts may have been discussed.

However, knowledge of a company's "playbook" alone is not enough to disqualify a lawyer under Rule 1.9(b); 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, "'Under California law a law firm is not subject to disqualification because one of its attorneys possesses information concerning an adversary's general business practices or litigation philosophy" *Victaulic Co. v. American Home Assurance Co.* (2022) 80 Cal. App. 5th 485, 512, quoting, *Wu v. O'Gara Coach Co., LLC* (2019) 38 Cal.App.5th 1069, 1083. Here, no facts suggest that Lawyer gleaned information from Old Company's "playbook" regarding its technology or patent applications that would rise to the level of material importance to Lawyer's new legal matters. Thus, 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 the duties of loyalty or confidentiality to Old Company by accepting employment at Company.

2. "Same or Substantially Related" Matters

Under CRPC 1.9(a) and (b), two matters are "the same or substantially related" if they involve a substantial risk of a violation of the duty of loyalty or the duty of confidentiality. CRPC 1.9, Comment [3]. The duty of loyalty to a former client means that the lawyer must refrain from doing "anything that will injuriously affect the former client in any matter in which the lawyer represented the former client." CRPC 1.9, Comment [3]. The duty of confidentiality to a former client means that the lawyer must refrain from using against the former client "knowledge or information acquired by virtue of the previous relationship." CRPC 1.9, Comment [1], citing *Oasis West Realty, LLC v. Goldman* (2011) 51 Cal.4th 811, and *Wutchumna Water Co. v. Bailey* (1932) 216 Cal. 564.]

Examples of matters that are the same or substantially related include: “(i) if the matters involve the same transaction or legal dispute or other work performed by the lawyer for the former client; or (ii) if the lawyer normally would have obtained information in the prior representation that is protected by Business and Professions Code section 6068, subdivision (e) and rule 1.6, and the lawyer would be expected to use or disclose that information in the subsequent representation because it is material to the subsequent representation.” *Ibid.*

The fact that Old Company and Company are competitors with similar technologies and patents is insufficient alone to establish that Lawyer represented Old Company in the same or substantially related matter to the matter or matters that Lawyer is expected to handle at Company. Such a conclusion would effectively force lawyers to start anew each time they change jobs, drastically restricting their mobility. Indeed, Lawyers’ mobility—and the ability to leverage the expertise and knowledge gained along their career path—is increasingly important.

However, the “same or substantially related” standard may be met where the two representations involve competing patents. *See e.g., Nasdaq, Inc. v. Miami Int’l Holdings, Inc.* (2018) 2018 U.S. Dist. LEXIS 151813 (law firm disqualified from representing new client against former client in patent infringement case because “[a]ll of the patents at issue in this case relate to ‘methods and systems for automated securities trading, including options trading,’ and the accused technology is the same for all asserted patents.”)

3. Material Adversity

Ethics scholars “have generally concluded that ‘material adverseness’ includes, but is not limited to, matters where the lawyer is directly adverse on the same or a substantially related matter. While material adverseness is present when a current client and former client are directly adverse, material adverseness also can be present where direct adverseness is not.” ABA Form.Opn. 497-21. “However, ‘material adverseness’ does not reach situations in which the representation of a current client is simply harmful to a former client’s economic or financial interests, without some specific tangible direct harm.” *Ibid.* Here, at least at the time Lawyer was hired by Company, there was no direct adversity or “material adverseness” between Company and Old Company because they are merely economic competitors, with similar technology.

Material adverseness may arise in the future to the extent Lawyer is required to attack the work he performed on behalf of Old Company. ABA Form.Opn. 497-21: “Another type of ‘material adverseness’ exists when a lawyer attempts to attack her own prior work. For example, one court held that a lawyer cannot challenge a patent that the lawyer previously obtained for a former client.” ABA Form.Opn. 491-21, p. 5, and fn. 17 (citing *Sun Studs, Inc. v. Applied Theory Associates* (Fed.Cir. 1985) 772 F.2d 1557, 1566-68. *See also, Oasis West Realty, supra*, 51 Cal. 4th 811 (lawyer should not have lobbied against project that he earlier worked on).

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For example, in *Asyst Techs., v. Empack, Inc.* (N.D. Cal. 1997) 962 F.Supp. 1241, two attorneys, while partners at one law firm, represented Asyst Techs, Inc. in prosecuting and obtaining several patents. *Asyst Techs., v. Empack, Inc., supra*, 962 F.Supp. 1241. The attorneys then moved to another law firm, which represented Empack in defending Asyst infringement lawsuit over same patents and asserting a counterclaim challenging the validity of the patents. *Ibid.* Counsel for Asyst moved to disqualify the law firm representing Empack. The court granted the motion, reasoning that “[f]ew people are more likely to have confidential information with which to attack the validity of a patent than the lawyers who prosecuted it.” *Id.* at 1242.

No facts suggests that Lawyer was responsible for prosecuting patents on behalf of Old Company. However, to the extent Lawyer was involved in such activity as Labor & Employment counsel, a conflict may arise to the extent Old Company and Company assert patent infringement and/or validity claims arising from the that activity.

C. CRPC 1.9(c) – Duty of Confidentiality Even Absent Conflict of Interest

Even if Lawyer determines that no conflict of interest exists under CRPC 1.9(a) or (b), Lawyer must still maintain inviolate Old Company’s confidential information under CRPC 1.9(c). Nevertheless, CRPC 1.9(c) does not prohibit using information obtained through a prior representation where the information has become “generally known” (or where disclosure is otherwise authorized by the CRPC). “The fact that information can be discovered in a public record does not, by itself, render that information generally known under paragraph (c). (*See, e.g., In the Matter of Johnson* (Review Dept. 2000) 4 Cal. State Bar Ct. Rptr. 179.)” CRPC 1.9, Cmt. [5].

D. CRPC 1.10 – Screening

Based on the facts presented, there is no initial conflict of interest for Lawyer under CRPC 1.9(a) or (b), and therefore no informed written consent from Old Company is required before Lawyer agrees to accept the General Counsel position with Company. However, given that Old Company and Company are competitors, with similar technology and patents, a conflict of interest may arise in the future. For example, Company may elect to pursue a patent that directly challenges a patent held by Old Company for technology developed by its employees. Lawyer may have acquired confidential information concerning the technology through handling Labor & Employment matters at Old Company. Under these facts, a conflict of interest may arise under Rule 1.9(b), which may be imputed to Company’s Legal Department.

- (1) CRPC 1.10 provides that “[w]hile lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by rules 1.7 or 1.9” unless the following conditions are satisfied: The prohibited lawyer did not substantially participate in the same or substantially related matter;

- (2) The prohibited lawyer is timely screened from any participation in the matter and is apportioned no part of the fee therefrom; and

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- (3) Written notice is promptly given to the affected former client to enable it to ascertain compliance with the provisions of the rule, which shall include a description of the screening; procedures employed; and an agreement by the firm to respond promptly to any written inquiries or objections by the former client about the screening procedures.

Although Lawyer may have acquired confidential information, it is unlikely that Lawyer substantially participated in matters involving Old Company's patents and technology because Lawyer's work was limited to labor and employment. Therefore, screening may be appropriate with respect to Company's assuming it is timely implemented with the requisite notice to Old Company. Given Lawyer's position as General Counsel overseeing a legal department of just three lawyers, Company may also need to refer the matter to outside counsel to handle. Outside counsel should report to one of Company's constituents other than Lawyer.

Question 2: What are Lawyer's Ethical Duties Regarding Stock Options Offered by New Company as Compensation for Employment?

A. Potential Application of 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 CRPC 1.8.1, which governs when a lawyer knowingly acquires an ownership or other pecuniary interest adverse to a client. See CRPC 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."); 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."). If CRPC 1.8.1 applies, the lawyer must ensure that the following requirements are met:

(a) 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;

(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.

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The purpose of the rule is to address the inherently imbalanced relationship between attorney and client. *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. Yaspan* (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, 1369.⁴

However, these concerns are typically absent 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 may be reversed. [F]rom 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*, 7 Cal. 4th at 1172. In addition, the in-house lawyer’s employment agreement may be prepared and/or presented by the General Counsel, employment counsel, or other company counsel.

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, in the in-house context.⁵ 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 agreements to pay bonuses to Mr. Chism constituted modifications of his original employment agreement and thus were subject to RPC 1.8(a). 193 Wn.App. 818, 852. In so holding, the court of appeal reasoned that [SB adding footnote making distinctions b/w circumstances; offer vs. atty-client relationship]

⁴ 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.” *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.

⁵ Washington State Bar Rule of Professional Conduct [RPC] 1.8 is substantially similar to CRPC 1.8.1 and 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.

The trial court's conclusions regarding these agreements gloss over the essential differences between fee agreements and wage contracts. Under the trial court's interpretation of the rule, every compensation agreement entered into between a lawyer-employee and a current client-employer would be subject to RPC 1.8(a). This would include, for example, every agreement increasing a lawyer-employee's wages or benefits. . . . By 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.

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

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

In other words, the Washington State Bar and court of appeals take the position that when placed in the employment context, the in-house lawyer's initial employment agreement containing stock grants or options, as well as subsequent adjustments to the lawyer's salary or "wages," are substantively similar to a typical attorney fee agreement, which is presumed to be an arms-length transaction.⁶

⁶ See, Wa. RPC 1.8(a), Comment [1] ("[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

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The ABA Task Force on the Independent Lawyer [“Task Force”] reached a similar conclusion:

In the usual case, the receipt of equity-based compensation by in-house counsel would not appear to be the type of ‘business transaction with a client’ contemplated by Rule 1.8. Option or restricted stock grants (the usual forms of equity compensation paid to in-house attorneys) are merely a form of compensation and, like cash, are a facet of the general employment relationship rather than part of or related to any particular transaction or undertaking.

Lawyers Doing Business with Their Clients: Identifying and Avoiding Legal and Ethical Dangers 56 (2001) [hereafter “Independent Lawyer Report”]. The Task Force noted that the “timing, size and conditions” placed on stock grants are typically the result of unilateral decisions by the corporate employer, in consultation with outside advisors and counsel. In short, the Task Force concluded, such stock grants, under normal circumstances, should not create interests that are “adverse” to the company’s interests.

However, a distinction must be made between an employment agreement offered by an established company that contains stock grants or options as a general form of employment compensation to the potential in-house attorney, and other types of business transactions in which there is an inherent imbalance of power between attorney and client. For example, Rule 1.8.1 applies to situations where the attorney and an existing or new client form a business together as owners or shareholders, and the attorney provides legal services to the newly-formed business entity.⁷ See, *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, ____.

Likewise, an in-house attorney for an existing entity is required to comply with Rule 1.8.1 where stock is taken or increased as part of a specific transaction or undertaking rather than as part of the initial employment agreement or routine modifications. *Passante v. McWilliam* (1997) 53 Cal.App.4th 1240 is instructive. There, the company needed capital and the company’s corporate lawyer had arranged additional funding. The “grateful board” promised three percent of company stock to the lawyer for lawyer’s work on the particular transaction. The

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.” The comments to the CRPC are substantially similar. 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.”

⁷ It is irrelevant that the lawyer is not formally designated as “general counsel” or “in-house counsel” for the business entity, or whether the lawyer provides both legal and nonlegal services. “When a member performs both legal and non-legal professional services for a client, the member is subject to the California Rules of Professional Conduct with respect to all of those services.” Cal. Form. Opn. 1999-154.

CLEAN

lawyer sued the company after its board reneged on the promise. The court held that the lawyer was required to comply with former rule 3-300 given the lawyer's fiduciary relationship with the company as its corporate lawyer who should have given "all that reasonable advice against himself that he would have given him against a third person." *Passante, supra*, 53 Cal.App.4th 1240, ____ (internal quotations and citations omitted). Had he done so, "[i]ndependent counsel would likely have at least reminded the board members of the obvious—that a grant of stock to Passante might complicate future capital acquisition." *Id.*

Factors to consider in determining whether CRPC 1.8.1 applies to an in-house lawyer's compensation include (1) whether the lawyer was involved in advising on the organization's formation; (2) whether the proposed compensation agreement is drafted and proposed by the organization (or its counsel) or the lawyer; (3) whether the organization has independent counsel concerning the compensation agreement; (4) whether the compensation terms offered to the lawyer are substantively similar to those offered to employees at the same level; (5) whether the compensation is part of Lawyer's initial employment agreement, or modifications thereto, or related to Lawyer's work on a specific transaction.

Here, Lawyer is presented with a stock option agreement that is offered to the Company's key employees as part of the Company's Stock Incentive Plan. The securities vest incrementally over time. Thus, stock options are offered as a standard form of compensation in the proposed employment agreement and not in connection with a particular transaction or undertaking. It is an arms-length transaction that does not trigger the requirements under rule 1.8.1.

B. Potential Application of CRPC 1.7

Lawyer must separately consider whether the stock option provisions in the employment agreement present a "material limitation" conflict of interest under rule 1.7(b). Specifically, rule 1.7(b) prohibits representation of a client if there is a significant risk that the representation "will be materially limited . . . by the lawyer's own interests," without the informed written consent of the client. Further, the lawyer cannot represent the client even with the requisite consent from the client if the lawyer does not "reasonably believe[] that the lawyer will be able to provide competent and diligent representation to each affected client." CRPC 1.7(d)(1). Thus, where the lawyer has a personal interest in the subject matter of the representation, the lawyer must assess whether their independent judgment will be materially impacted to the detriment of the client. See, e.g., ABA Model Rule 1.7, Comment [10]: "For example, if the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give a client detached advice. . . . See Rule 1.8 for specific Rules pertaining to a number of personal interest conflicts, including business transactions with clients."

In ABA Formal Opn. 00-418, the Committee opined that although issuance of stock to outside counsel in lieu of fees mandated compliance with Model Rule 1.8(a) (the equivalent to CRPC 1.8.1), it "creates no inherent conflict of interest" under the "material limitation" conflict

CLEAN

provisions of Model Rule 1.7(b). The Committee explained: “Indeed, management's role primarily is to enhance the business's value for the stockholders. Thus, the lawyer's legal services in assisting management usually will be consistent with the lawyer's stock ownership. In some circumstances, such as the merger of one corporation in which the lawyer owns stock into a larger entity, the lawyer's economic incentive to complete the transaction may even be enhanced.”

However, this does not render CRPC 1.7(b) wholly inapplicable to an in-house lawyer who owns stock or stock options. *See also*, Independent Lawyer Report, p. 56 (“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.”) Indeed, the Committee envisions a number of scenarios where a material limitation conflict could arise:

For example, the lawyer might have a duty when rendering an opinion on behalf of the corporation in a venture capital transaction to call upon corporate management to reveal material adverse financial information that is being withheld, even though the revelation might cause the venture capital investor to withdraw. In that circumstance, the lawyer must evaluate her ability to maintain the requisite professional independence as a lawyer in the corporate client's best interest by subordinating any economic incentive arising from her stock ownership. The lawyer also must consider whether her stock ownership might create questions concerning the objectivity of her opinion. She must consult with her client and obtain consent if the representation may be materially limited by her stock ownership. . . . 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.

ABA Form.Opn. 00-418, p. 10.

Here, Company offers Lawyer participation in its Stock Incentive Plan, which includes stock options that vest incrementally over time. These are terms offered to other key employees. At the outset of the employment relationship, these provisions by themselves do not present a significant risk that Lawyer's independent judgment will be materially limited to the detriment of the Company. “Given the relatively limited equity stake of corporate counsel in most cases, 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.”
Independent Lawyer Report, p. 56.

However, the stock option agreement also provides 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. Given that such a merger is a mere potentiality, and lacking specificity as to any terms and timing, it is unlikely that it presents a significant risk at the outset of Lawyer’s employment that the acceleration provision will materially limit Lawyer’s representation. Lawyer may consider an advance conflict waiver if a reasonably comprehensive explanation of foreseeable scenarios in which Company may be adversely affected by the merger and acceleration of Lawyer’s stock vesting can be provided. *See generally*, CRPC 1.7, Comment [9]; *Sheppard, Mullin, Richter & Hampton LLP v. J-M Mfg. Co., Inc.* (2018) 6 Cal.5th 59. Even if an advance waiver is obtained, in the event of a merger, Lawyer should reassess whether a second “confirming” waiver is required depending on the specificity of the advance waiver and whether it reasonably predicted the materialized conflict. *See, Visa U.S.A., Inc. v. First Data Corp* (N.D. Cal. 2003) 241 F.Supp.2d 1100; *Western Sugar Coop. v. Archer-Daniels-Midland Co.* (C.D. 2015) 98 F.Supp.3d 1074 (material change may trigger need for new disclosure and informed written consent.)

Question 3: What are Lawyer’s Ethical Duties to Company and the Individual Shareholders Concerning the Sale?

A. Lawyer’s Duties to Company

“[B]ecause Rule 1.7(b) imposes an ongoing obligation to avoid conflicts, the attorney regularly must reexamine the investment for potential conflicts.” Independent Lawyer Report, p. 43. Three years into Lawyer’s role as in-house counsel, their stock options are 30% vested. Furthermore, Lawyer’s stock options will be treated as fully vested in the acquisition negotiations. These are the type of circumstances that rise to the level of a 1.7(b) conflict, requiring informed consent from the Company before Lawyer advises it about the propriety and terms of the potential acquisition deal. Lawyer should explain to Company that Lawyer’s status as a shareholder presents a significant risk that Lawyer’s role as General Counsel may be materially limited by Lawyer’s personal, financial interest in the merger deal. For example, the merger may present risks that Lawyer is willing to assume for Lawyer’s personal financial gain, but may not be advisable for Company to do the same. There may be other reasonably foreseeable consequences of the conflict that Lawyer must explain to obtain Company’s *informed* consent to permit Lawyer to advise Company regarding the merger. “ ‘Informed consent’ means a person’s agreement to a proposed course of conduct after the lawyer has communicated and explained (i) the relevant circumstances and (ii) the material risks, including any actual and reasonably foreseeable adverse consequences of the proposed course of conduct.” CRPC 1.0.1(e). Lawyer must also advise Company to consult with independent

CLEAN

outside counsel concerning the conflict, and provide Company sufficient time to do so before a decision is made whether to waive the conflict. CRPC 1.7(b). Finally, these disclosures and advice, and Company's consent must be in writing. CRPC 1.7(b); CRPC 1.0.1(e-1).

The Committee cautions that if Lawyer's fully vested stock options comprise a significant portion of Lawyer's assets, it may be unreasonably difficult, if not impossible, for Lawyer to give detached advice to Company. In other words, the conflict is not waivable unless Lawyer "reasonably believes that [they] will be able to provide competent and diligent representation to" the affected client, Company. CRPC 1.7(d)(1). In that event, Lawyer must explain to Company the basis for the conflict and that it is non-waivable, and recommend that Company retain outside counsel to advise Company and represent it in the merger negotiations. Lawyer may continue to represent Company on other matters unrelated to the merger.

A. Can Lawyer Advise Individual Shareholders?

Lawyer only represents Company through its authorized constituents. CRPC 1.13(a). Generally, a lawyer may advise and represent both the company and individual shareholders provided the proper disclosures are made and consent is given by each client. "A lawyer representing an organization may also represent any of its constituents, subject to the provisions of rules 1.7, 1.8.2, 1.8.6, and 1.8.7." CRPC 1.13(g).

In considering CEO's request that Lawyer represent both the Company and its shareholders regarding the merger, Lawyer must examine the extent of the alignment of interests between and among each of the shareholders (including Lawyer) and between the shareholders and Company. Given the likelihood that the individuals will have differing personal and financial interests in connection with the merger, it is also reasonable to assume that the joint representation will present a significant risk that Lawyer's ability to "recommend or advocate all possible positions that each might take" will be materially limited by Lawyer's "duty of loyalty to the other clients." CRPC 1.7(b), Comment [4] (discussing conflict in representing individuals in forming a joint venture); ABA Model Rule 1.7, Comment [8] (accord).

If Lawyer reasonably believes that they can provide competent and diligent representation to each shareholder and Company, then Lawyer may do so after obtaining informed written consent of each shareholder and CEO⁸ under CRPC 1.7(b), as discussed above.

If Lawyer does not reasonably believe they can competently and diligently represent Company and the shareholders regarding the merger, Lawyer should remind the shareholders (including CEO) that Lawyer's professional responsibility and allegiance is owed solely to Company, and

⁸ See, CRPC 1.13(g) ("If the organization's consent to the dual representation is required by any of these rules, the consent shall be given by an appropriate official, constituent, or body of the organization other than the individual who is to be represented, or by the shareholders.")

CLEAN

571 that Lawyer does not have a confidential, attorney-client relationship with any individual
572 constituents or shareholders regarding their personal interests.

573 [WHAT HAPPENS IF CEO DEMANDS THAT LAWYER ADVISE THE INDIVIDUALS? ADDRESS DUTY
574 TO WITHDRAW UNDER 1.16?]

575 **CONCLUSION**

REDLINE

IN-HOUSE COUNSEL DRAFT OPINION

ISSUES:

(1) What conflicts of interest arise when an in-house lawyer moves from one company to another?

(2) What conflicts of interest are presented by a stock option agreement between in-house lawyer and the company?

(3) What conflicts of interests arise from in-house lawyer's representation of company shareholders in connection with a proposed acquisition by a third party via a stock purchase transaction where lawyer is a shareholder of company?

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"). There are approximately 75 salaried employees who own stock and/or stock options.

Company is a competitor of Old Company in that the software they both sell uses similar technology protected through several patents and other intellectual property rights. Old Company is publicly held, with several divisions. Old Company has a central legal department managed by a General Counsel, and is segregated into teams. Lawyer was assigned to the Labor and Employment team. Lawyer was not part of the team that advised Old Company concerning its technology and patent applications. However, Lawyer will be expected to advise Company on all legal issues, including those relating to Company's technology and patent applications.

Question 1: *Lawyer is concerned that Old Company and Company are technological competitors. 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 Company, Lawyer is presented with a stock option agreement that is offered to 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

REDLINE

on the Company's Stock Incentive Plan. The agreement states that the securities will vest 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 Company offers to acquire Company through a stock purchase and Company would become a wholly-owned subsidiary of Public Company. Company's CEO asks Lawyer to advise the Company and 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. The CEO also expects Lawyer to handle the negotiations with Public Company's counsel.

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

"[C]ounsel working for a corporation in-house and private counsel engaged with respect to a specific matter or on retainer" are "bound by the same fiduciary and ethical duties to their clients." *PLCM Group, Inc. v. Drexler* (2000) 22 Cal. 4th 1084, 1094. In-house lawyers have attorney-client relationships with the organizations that employ them. *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." Rule 1.0.1(c) ("Firm' or 'law firm' means . . . 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. CRPC 1.13(a). In short, 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. **SB: Just a note that we should clean up eventually so cites are consistent to "Rule," "rule" or CRPC.**

However, in many circumstances, analysis of an in-house lawyer's fiduciary and ethical duties must be placed in the context of the employer-employee relationship. "For example, in-house

REDLINE

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; *see also*, *General Dynamics Corp. v. Superior Court (Rose)* (1994) 7 Cal.4th 1164 (recognizing this dynamic in the employment law context).

Potential conflicts of interest arising from an in-house lawyer’s movement from one in-house position to another¹ and an in-house lawyer’s ownership of stock or stock options in the employer present challenging questions. As explained below, although the CRPC apply with equal force to in-house lawyers as they do to independent lawyers, they ~~must~~ be analyzed in the context of both the attorney-client and employer-employee relationships at issue.

APPLICATION

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

The question of whether a conflict of interest exists between Old Company and Company is governed by CRPC 1.9 (Duties to Former Clients). As discussed above, an in-house lawyer represents the organization itself as a client. CRPC 1.13(a). Thus, Lawyer’s former client is Old Company, and Lawyer’s current client is Company.

CRPC 1.9(a) prohibits representation of a client, including an organization, whose interests are materially adverse to those of the lawyer’s former client if the lawyer personally represented the former client in the same or a substantially related matter. Even if the lawyer did not personally represent the former client, a conflict of interest may exist under CRPC 1.9(b) based on their association with their prior law firm or legal department, if the lawyer obtained confidential information that is material to the same or substantially related matter in which the two clients’ interests are adverse. Informed written consent from the former client is required if CRPC 1.9(a) or 1.9(b) applies to a particular situation, unless ~~the elements of~~ CRPC 1.10’s screening requirements ~~apply and~~ are satisfied, ~~as discussed below.~~

In short, a conflict of interest will exist based on a lawyer’s personal representation of a former client *or* acquisition of confidential information material to a particular matter, provided that the matters are the same or substantially related and the interests of the clients are materially adverse.

¹ *See e.g.*, ABA Formal Opn. 99-415 (“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 this issue. Current and prospective employers as well as in-house counsel themselves have reason for concern.”)

REDLINE

Irrespective of whether CRPC 1.9(a) or (b) applies, CRPC 1.9(c)(1) and (2) prohibits the use and disclosure of confidential information unless certain exceptions apply or the information has become “generally known.”

These questions are uniquely challenging for the in-house lawyer given the lawyer’s relatively broad scope of employment. “Matters” are not as easily discernable as they are in a law firm setting. “Many corporate legal departments do not maintain the detailed time records customarily maintained by private law firms. In light of the factual nature of the determination of whether a lawyer has ‘represented’ the organization, it is desirable for in-house lawyers at least to maintain logs describing those matters on which they work.” ABA Formal Opn. 99-415, fn. 7. However, this does not mean CRPC 1.9 is inapplicable to in-house lawyers; indeed, the representation is akin to an independent lawyer who is hired on retainer. *PLCM Group, Inc. v. Drexler, supra*, 22 Cal. 4th 1084, 1093. The scope of the representation could encompass all legal issues or those limited to a particular subject matter, such as employment law issues.²

A. CRPC 1.9(a) –Personal Representation of Old Company

“The determination whether a lawyer ‘represented’ his former employer with respect to a matter requires inquiry into the responsibilities of the lawyer during his former employment.” ABA Form. Opn. 99-415. Moreover, “[a] distinction may be made between a lawyer who has been heavily involved in a matter and one who has dealt with issues and not with factual analysis.” *Ibid*.

The same test applies whether the lawyer worked in the former client’s legal department or for the law firm retained by the former client. There must be a “direct, personal relationship with the former client in which the attorney personally provided legal advice and services on a legal issue that is closely related to the legal issue in the present representation.” *City and County of San Francisco v. Cobra Solutions, Inc.* (2006) 38 Cal.4th 839, 847 (*Cobra Solutions*). Here, Lawyer was not part of the team that advised Old Company concerning its technology and patent applications. Instead, Lawyer advised Old Company on labor and employment law issues. Thus, similar to a law firm lawyer who worked in a particular practice group and was not involved in the representation of firm clients on matters handled by lawyers in a different practice group, Lawyer’s handling of labor and employment issues does not establish that Lawyer personally representation Old Company regarding its patents and technology. [CITE-FIND SUPPORTING CA CASE OR OPINION] This is true even if Lawyer’s advice to, and representation of, Old Company related to employees who worked on Old Company’s technology and patents. To the extent Lawyer acquired confidential information, CRPC 1.9(b) and (c) govern Lawyer’s duties and conduct.

Accordingly, under the facts presented, Lawyer did not personally represent Old Company with respect to its patent and technology matters. Therefore, CRPC 1.9(a) would not prohibit Lawyer

² Of course, the scope of representation must be limited to the extent of the lawyer’s duty of competency under CRPC 1.1.

REDLINE

from representing Company on such matters. Lawyer must then consider whether CRPC 1.9(b) applies.³

B. CRPC 1.9(b) – Imputed Conflict of Interest Based on Lawyer’s Association with Old Company’s Legal Department

Although Lawyer did not personally represent Old Company in patent and technology matters, a conflict of interest may exist under CRPC 1.9(b) based on Lawyer’s association with Old Company’s legal department. CRPC 1.9(b) “prohibits an attorney whose firm represented a client on the same or substantially related matter from subsequently taking a position adverse to that client, but only *if* the lawyer had acquired confidential information ‘material to the matter.’” *Adams v. Aerojet-General Corp.* (2001) 86 Cal.App.4th 1324, 1337 (interpreting ABA Model Rule 1.9(b)). At bottom, the analysis encompasses a fact-specific, flexible inquiry designed to balance the competing interests of loyalty owed to the former client and choice of counsel of the new client. “[T]he client previously represented by the former firm must be reasonably assured that the principle of loyalty to the client is not compromised[,] . . . the Rule should not be so broadly cast as to preclude other persons from having reasonable choice of legal counsel. . . . If the concept of imputation were applied with unqualified rigor, the result would be radical curtailment of the opportunity of lawyers to move from one practice setting to another and of the opportunity of clients to change counsel.” *Adams v. Aerojet-General Corp.*, *supra*, 86 Cal.App.4th 1324, 1337-1338, quoting ABA Model Rule 1.7, Comment [3].

1. Possession of Confidential Information

Lawyer will serve as Company’s General Counsel with direct and managerial responsibility over all legal issues, including those relating to Company’s technology and intellectual property. Accordingly, Lawyer must consider whether they obtained confidential information relevant to this new, expansive role. *See e.g., H.F. Ahmanson & Co. v. Salomon Brothers, Inc.* (1991) 229 Cal. App. 3d 1445, 1454 (“substantial relationship” test evaluates “whether confidential information material to the current dispute would normally have been imparted to the attorney by virtue of the nature of the former representation.”); *Dieter Dieter v. Regents of the Univ. of Cal.* (E.D. Cal. 1997) 963 F.Supp.908, 911-912 (“California courts look to whether ‘confidential information material to the current dispute would normally have been imparted to the attorney by virtue of the nature of the former representation.’” [Citations omitted].) “Application of paragraph (b) depends on a situation’s particular facts, aided by inferences, deductions or working presumptions that reasonably may be made about the way in which lawyers work together.” ABA Model Rule 1.9(b), Comment [6]. “Whether confidential, material information would normally have been imparted to the attorney depends on three factors: (1) the factual similarities between the current and former representations, (2) the similarities between the

³ CRPC 1.9(a) may prohibit Lawyer from representing Company on labor and employment matters to the extent those matters are the same or substantially related to the matters Lawyer handled while employed at Old Company and the interests of Old Company and Company are materially adverse with respect to those matters.

REDLINE

legal questions posed, and (3) the nature and extent of the attorney's involvement with the former representation." *Dieter v. Regents of the Univ. of Cal.*, *supra*, 963 F.Supp.908, 911-912, citing *H.F. Ahmanson*, *supra*, 229 Cal. App. 3d at 1455. In the in-house context, "[d]epending on the size and structure of the legal department and the extent to which it limits access to confidential information to those lawyers working on a matter, the lawyer may have obtained information as the result of shared confidences, requiring disqualification under Rule 1.9(b)." ABA Form.Opn. 415-97.

Lawyer should examine their matters at Old Company; Old Company's legal department structure; and the overall culture within Old Company concerning the exchange of confidential or proprietary information, to determine whether they possess confidential information that may be material to Lawyer's new role as Company's General Counsel. For example, although Lawyer's representation was limited to labor and employment matters, it is reasonably plausible that during the course of relevant communications with Company employees and principals, technology issues and related facts may have been discussed.

However, knowledge of a company's "playbook" alone is not enough to disqualify a lawyer under Rule 1.9(b); 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.~~

[\(2006\) 143 Cal.App.4th 50, 65, "'Under California law a law firm is not subject to disqualification because one of its attorneys possesses information concerning an adversary's general business practices or litigation philosophy ...'" *Victaulic Co. v. American Home Assurance Co.* \(2022\) 80 Cal. App. 5th 485, 512, quoting, *Wu v. O'Gara Coach Co., LLC* \(2019\) 38 Cal.App.5th 1069, 1083.](#) Here, no facts suggest that Lawyer gleaned information from Old Company's "playbook" regarding its technology or patent applications that would rise to the level of material importance to Lawyer's new legal matters. Thus, 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 the duties of loyalty or confidentiality to Old Company by accepting employment at Company.

2. "Same or Substantially Related" Matters

Under CRPC 1.9(a) and (b), two matters are "the same or substantially related" if they involve a substantial risk of a violation of the duty of loyalty or the duty of confidentiality. CRPC 1.9, Comment [3]. The duty of loyalty to a former client means that the lawyer must refrain from doing "anything that will injuriously affect the former client in any matter in which the lawyer represented the former client." CRPC 1.9, Comment [3]. The duty of confidentiality to a former client means that the lawyer must refrain from using against the former client "knowledge or information acquired by virtue of the previous relationship." CRPC 1.9, Comment [1], citing *Oasis West Realty, LLC v. Goldman* (2011) 51 Cal.4th 811, and *Wutchumna Water Co. v. Bailey* (1932) 216 Cal. 564[.]

REDLINE

Examples of matters that are the same or substantially related include: “(i) if the matters involve the same transaction or legal dispute or other work performed by the lawyer for the former client; or (ii) if the lawyer normally would have obtained information in the prior representation that is protected by Business and Professions Code section 6068, subdivision (e) and rule 1.6, and the lawyer would be expected to use or disclose that information in the subsequent representation because it is material to the subsequent representation.” *Ibid.*

The fact that Old Company and Company are competitors with similar technologies and patents is insufficient alone to establish that Lawyer represented Old Company in the same or substantially related matter to the matter or matters that Lawyer is expected to handle at Company. Such a conclusion would effectively force lawyers to start anew each time they change jobs, drastically restricting their mobility. Indeed, Lawyers’ mobility—and the ability to leverage the expertise and knowledge gained along their career path—is increasingly important.

However, the “same or substantially related” standard may be met where the two representations involve competing patents. *See e.g., Nasdaq, Inc. v. Miami Int’l Holdings, Inc.* (2018) 2018 U.S. Dist. LEXIS 151813 (law firm disqualified from representing new client against former client in patent infringement case because “[a]ll of the patents at issue in this case relate to ‘methods and systems for automated securities trading, including options trading,’ and the accused technology is the same for all asserted patents.”)

3. Material Adversity

Ethics scholars “have generally concluded that ‘material adverseness’ includes, but is not limited to, matters where the lawyer is directly adverse on the same or a substantially related matter. While material adverseness is present when a current client and former client are directly adverse, material adverseness also can be present where direct adverseness is not.” ABA Form.Opn. 497-21. “However, ‘material adverseness’ does not reach situations in which the representation of a current client is simply harmful to a former client's economic or financial interests, without some specific tangible direct harm.” *Ibid.* [Here, at least at the time Lawyer was hired by Company, there was no direct adversity or “material adverseness” between Company and Old Company because they are merely economic competitors, with similar technology.](#)

Material adverseness may arise in the future to the extent Lawyer is required to attack the work ~~he~~ performed ~~by~~ [on behalf of](#) Old Company. ABA Form.Opn. 497-21: “Another type of ~~“material adverseness”~~ [adverseness](#) exists when a lawyer attempts to attack her own prior work. For example, one court held that a lawyer cannot challenge a patent that the lawyer previously obtained for a former client.” [ABA Form.Opn. 491-21, p. 5, and fn. 17 \(citing Sun Studs, Inc. v. Applied Theory Associates \(Fed.Cir. 1985\) 772 F.2d 1557, 1566-68.](#) *See also, Oasis West Realty, supra*, 51 Cal. 4th 811 (lawyer should not have lobbied against project that he earlier worked on).

For example, in *Asyst Techs., v. Empack, Inc.* (N.D. Cal. 1997) 962 F.Supp. 1241, two attorneys, while partners at one law firm, represented Asyst Techs, Inc. in prosecuting and obtaining several patents. *Asyst Techs., v. Empack, Inc., supra*, 962 F.Supp. 1241. The attorneys then moved to another law firm, which represented Empack in defending Asyst infringement lawsuit over same patents and asserting a counterclaim challenging the validity of the patents. *Ibid.* Counsel for Asyst moved to disqualify the law firm representing Empack. The court granted the motion, reasoning that “[f]ew people are more likely to have confidential information with which to attack the validity of a patent than the lawyers who prosecuted it.” *Id.* at 1242.

No facts suggests that Lawyer was responsible for prosecuting patents on behalf of Old Company. However, to the extent Lawyer was involved in such activity as Labor & Employment counsel, a conflict may arise to the extent Old Company and Company assert patent infringement and/or validity claims arising from the that activity.

C. CRPC 1.9(c) – Duty of Confidentiality Even Absent Conflict of Interest

Even if Lawyer determines that no conflict of interest exists under CRPC 1.9(a) or (b), Lawyer must still maintain inviolate Old Company’s confidential information under CRPC 1.9(c). Nevertheless, CRPC 1.9(c) does not prohibit using information obtained through a prior representation where the information has become “generally known” (or where disclosure is otherwise authorized by the CRPC). “The fact that information can be discovered in a public record does not, by itself, render that information generally known under paragraph (c). (See, e.g., *In the Matter of Johnson* (Review Dept. 2000) 4 Cal. State Bar Ct. Rptr. 179.)” CRPC 1.9, Cmt. [5].

D. CRPC 1.10 – Screening

Based on the facts presented, there is no initial conflict of interest for Lawyer under CRPC 1.9(a) or (b), and therefore no informed written consent from Old Company is required before Lawyer agrees to accept the General Counsel position with Company. However, given that Old Company and Company are competitors, with similar technology and patents, a conflict of interest may arise in the future. ~~In that event, Lawyer (and Company) may have the option of screening under CRPC 1.10(a)(2) if the following conditions are met:~~ For example, Company may elect to pursue a patent that directly challenges a patent held by Old Company for technology developed by its employees. Lawyer may have acquired confidential information concerning the technology through handling Labor & Employment matters at Old Company. Under these facts, a conflict of interest may arise under Rule 1.9(b), which may be imputed to Company’s Legal Department.

- (1) ~~Lawyer~~ CRPC 1.10 provides that “[w]hile lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by rules 1.7 or 1.9” unless the following conditions are satisfied: The prohibited lawyer did not substantially participate in the same or substantially related matter;

REDLINE

- (2) ~~Lawyer~~The prohibited lawyer is timely screened from any participation in the matter and is apportioned no part of the fee therefrom; and
- (3) Written notice is promptly given to ~~Old Company~~the affected former client to enable it to ascertain compliance with the provisions of the rule, which shall include a description of the screening; procedures employed; and an agreement by ~~Company~~the firm to respond promptly to any written inquiries or objections by ~~Old Company~~the former client about the screening procedures.

~~#Although Lawyer may have acquired confidential information, it~~ unlikely that Lawyer substantially participated in matters involving Old Company's patents and technology because Lawyer's work was limited to labor and employment. Therefore, screening may be appropriate ~~as with respect to those matters~~Company's assuming it is timely implemented with the requisite notice to Old Company. Given Lawyer's position as General Counsel overseeing a legal department of just three lawyers, Company may also need to refer the matter to outside counsel to handle. Outside counsel should report to one of Company's constituents other than Lawyer.

Question 2: What are Lawyer's Ethical Duties Regarding Stock Options Offered by New Company as Compensation for Employment?

A. Potential Application of 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 CRPC 1.8.1, which governs when a lawyer knowingly acquires an ownership or other pecuniary interest adverse to a client. *See* CRPC 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."); 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."). If CRPC 1.8.1 applies, the lawyer must ensure that the following requirements are met:

(a) 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;

(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

REDLINE

336 (c) the client thereafter provides informed written consent to the
337 terms of the transaction or acquisition, and to the lawyer's role in
338 it.

339 The purpose of the rule is to address the inherently imbalanced relationship between attorney
340 and client. *Beery v. State Bar* (1987) 43 Cal.3d 802, 812-813, quoting, *Felton v. Le Breton* (1891)
341 92 Cal. 457, 469 [28 P. 490], and citing, *Estate of Witt* (1926) 198 Cal. 407, 419; *Gold v.*
342 *Greenwald* (1966) 247 Cal. App. 2d 296, 305-306. "The law accordingly takes a jaundiced view
343 of business transactions between attorneys and their clients." *Ferguson v. Yaspan* (2014) 233
344 Cal.App.4th 676, 685. Indeed, "the law presumes" attorneys engaging in such transactions
345 "wear" a "black" hat. *Mayhew v. Benninghoff* (1997) 53 Cal.App^{4th} 1365, 1369.⁴

346 However, these concerns are typically absent in the in-house context, where the new lawyer is
347 offered the same general compensation terms, including stock and stock options, as those
348 offered to other key employees. Indeed, the power dynamic may be reversed. [F]rom an
349 economic standpoint, the dependence of in-house counsel is indistinguishable from that of
350 other corporate managers or senior executives who also owe their livelihoods and career goals
351 and satisfaction to a single organizational employer." *General Dynamics Corp. v. Superior Court*,
352 *supra*, 7 Cal. 4th at 1172. In addition, the in-house lawyer's employment agreement may be
353 prepared and/or presented by the General Counsel, employment counsel, or other company
354 counsel.

355 In *Chism v. Tri-State Construction Inc.* (2016) 193 Wn.App. 818, a Washington state court of
356 appeals addressed application of Washington State's version of rule 1.8.1, in the in-house
357 context.⁵ There, Mr. Chism, Tri-State Construction Inc.'s (Tri-State) general counsel, sued Tri-
358 State for breach of compensation contracts to recover allegedly unpaid bonuses, which were
359 drafted by Mr. Chism and negotiated during his tenure as general counsel. The court of appeals
360 reversed the trial court's decision finding that the agreements to pay bonuses to Mr. Chism

⁴ 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." *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.

⁵ Washington State Bar Rule of Professional Conduct [RPC] 1.8 is substantially similar to CRPC 1.8.1 and 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.

REDLINE

constituted modifications of his original employment agreement and thus were subject to RPC 1.8(a). 193 Wn.App. 818, 852. In so holding, the court of appeal reasoned that [SB adding footnote making distinctions b/w circumstances; offer vs. atty-client relationship]

The trial court's conclusions regarding these agreements gloss over the essential differences between fee agreements and wage contracts. Under the trial court's interpretation of the rule, every compensation agreement entered into between a lawyer-employee and a current client-employer would be subject to RPC 1.8(a). This would include, for example, every agreement increasing a lawyer-employee's wages or benefits. . . . By 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.

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

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

In other words, the Washington State Bar and court of appeals take the position that when placed in the employment context, the in-house lawyer's initial employment agreement containing stock grants or options, as well as subsequent adjustments to the lawyer's salary or

REDLINE

“wages,” are substantively similar to a typical attorney fee agreement, which is presumed to be an arms-length transaction.⁶

The ABA Task Force on the Independent Lawyer [“Task Force”] reached a similar conclusion:

In the usual case, the receipt of equity-based compensation by in-house counsel would not appear to be the type of ‘business transaction with a client’ contemplated by Rule 1.8. Option or restricted stock grants (the usual forms of equity compensation paid to in-house attorneys) are merely a form of compensation and, like cash, are a facet of the general employment relationship rather than part of or related to any particular transaction or undertaking.

Lawyers Doing Business with Their Clients: Identifying and Avoiding Legal and Ethical Dangers 56 (2001) [hereafter “Independent Lawyer Report”]. The Task Force noted that the “timing, size and conditions” placed on stock grants are typically the result of unilateral decisions by the corporate employer, in consultation with outside advisors and counsel. In short, the Task Force concluded, such stock grants, under normal circumstances, should not create interests that are “adverse” to the company’s interests.

However, a distinction must be made between an employment agreement offered by an established company that contains stock grants or options as a general form of employment compensation to the potential in-house attorney, and other types of business transactions in which there is an inherent imbalance of power between attorney and client. For example, Rule 1.8.1 applies to situations where the attorney and an existing or new client form a business together as owners or shareholders, and the attorney provides legal services to the newly-formed business entity.⁷ See, *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, ____.

⁶ See, Wa. RPC 1.8(a), Comment [1] (“[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.” The comments to the CRPC are substantially similar. 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.”

⁷ It is irrelevant that the lawyer is not formally designated as “general counsel” or “in-house counsel” for the business entity, or whether the lawyer provides both legal and nonlegal services. “When a member performs both legal and non-legal professional services for a client, the member is subject to the California Rules of Professional Conduct with respect to all of those services.” Cal. Form. Opn. 1999-154.

REDLINE

Likewise, an in-house attorney for an existing entity is required to comply with Rule 1.8.1 where stock is taken or increased as part of a specific transaction or undertaking rather than as part of the initial employment agreement or routine modifications. *Passante v. McWilliam* (1997) 53 Cal.App.4th 1240 is instructive. There, the company needed capital and the company's corporate lawyer had arranged additional funding. The "grateful board" promised three percent of company stock to the lawyer for lawyer's work on the particular transaction. The lawyer sued the company after its board reneged on the promise. The court held that the lawyer was required to comply with former rule 3-300 given the lawyer's fiduciary relationship with the company as its corporate lawyer who should have given "all that reasonable advice against himself that he would have given him against a third person." *Passante, supra*, 53 Cal.App.4th 1240, ____ (internal quotations and citations omitted). Had he done so, "[i]ndependent counsel would likely have at least reminded the board members of the obvious—that a grant of stock to Passante might complicate future capital acquisition." *Id.*

Factors to consider in determining whether CRPC 1.8.1 applies to an in-house lawyer's compensation include (1) whether the lawyer was involved in advising on the organization's formation; (2) whether the proposed compensation agreement is drafted and proposed by the organization (or its counsel) or the lawyer; (3) whether the organization has independent counsel concerning the compensation agreement; (4) whether the compensation terms offered to the lawyer are substantively similar to those offered to employees at the same level; ~~OTHERS? Whether~~; (5) whether the compensation is part of lawyer's Lawyer's initial employment agreement ~~of, or~~ or modifications thereto, or related to lawyer's Lawyer's work on a specific transaction¹.

Here, Lawyer is presented with a stock option agreement that is offered to the Company's key employees as part of the Company's Stock Incentive Plan. The securities vest incrementally over time. Thus, stock options are offered as a standard form of compensation in the proposed employment agreement and not in connection with a particular transaction or undertaking. It is an arms-length transaction that does not trigger the requirements under rule 1.8.1.

~~IF Refine, reach out to other jurisdictions/ABA to support argument, CC-1.5 applies to compensation agreements? Address where 1.5 goes/footnote~~

B. Potential Application of CRPC 1.7

Lawyer must separately consider whether the stock option provisions in the employment agreement present a "material limitation" conflict of interest under rule 1.7(b). Specifically, rule 1.7(b) prohibits representation of a client if there is a significant risk that the representation "will be materially limited . . . by the lawyer's own interests," without the informed written consent of the client. Further, the lawyer cannot represent the client even with the requisite consent from the client if the lawyer does not "reasonably believe[] that the lawyer will be able to provide competent and diligent representation to each affected client." CRPC 1.7(d)(1). Thus, where the lawyer has a personal interest in the subject matter of the representation, the

REDLINE

lawyer must assess whether their independent judgment will be materially impacted to the detriment of the client. See, e.g., ABA Model Rule 1.7, Comment [10]: “For example, if the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give a client detached advice. . . . See Rule 1.8 for specific Rules pertaining to a number of personal interest conflicts, including business transactions with clients.”

In ABA Formal Opn. 00-418, the Committee opined that although issuance of stock to outside counsel in lieu of fees mandated compliance with Model Rule 1.8(a) (the equivalent to CRPC 1.8.1), it “creates no inherent conflict of interest” under the “material limitation” conflict provisions of Model Rule 1.7(b). The Committee explained: “Indeed, management's role primarily is to enhance the business's value for the stockholders. Thus, the lawyer's legal services in assisting management usually will be consistent with the lawyer's stock ownership. In some circumstances, such as the merger of one corporation in which the lawyer owns stock into a larger entity, the lawyer's economic incentive to complete the transaction may even be enhanced.”

However, this does not render CRPC 1.7(b) wholly inapplicable to an in-house lawyer who owns stock or stock options. *See also*, Independent Lawyer Report, p. 56 (“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.”) Indeed, the Committee envisions a number of scenarios where a material limitation conflict could arise:

For example, the lawyer might have a duty when rendering an opinion on behalf of the corporation in a venture capital transaction to call upon corporate management to reveal material adverse financial information that is being withheld, even though the revelation might cause the venture capital investor to withdraw. In that circumstance, the lawyer must evaluate her ability to maintain the requisite professional independence as a lawyer in the corporate client's best interest by subordinating any economic incentive arising from her stock ownership. The lawyer also must consider whether her stock ownership might create questions concerning the objectivity of her opinion. She must consult with her client and obtain consent if the representation may be materially limited by her stock ownership. . . . 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. ~~CC: When 1.7 conflict waiver would be required. SB: Is this a block~~

quotes from the Independent Lawyer Report? If so, we should add a cite to the end.

[ABA Form.Opn. 00-418, p. 10.](#)

Here, Company offers Lawyer participation in its Stock Incentive Plan, which includes stock options that vest incrementally over time. These are terms offered to other key employees. At the outset of the employment relationship, these provisions by themselves do not present a significant risk that Lawyer's independent judgment will be materially limited to the detriment of the Company. "Given the relatively limited equity stake of corporate counsel in most cases, 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."

Independent Lawyer Report, p. 56.

However, the stock option agreement also provides 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. Given that such a merger is a mere potentiality, and lacking specificity as to any terms and timing, it is unlikely that it presents a significant risk at the outset of Lawyer's employment that the acceleration provision will materially limit Lawyer's representation. Lawyer may consider an advance conflict waiver if a reasonably comprehensive explanation of foreseeable scenarios in which Company may be adversely affected by the merger and acceleration of Lawyer's stock vesting can be provided. *See generally*, CRPC 1.7, Comment [9]; *Sheppard, Mullin, Richter & Hampton LLP v. J-M Mfg. Co., Inc.* (2018) 6 Cal.5th 59. Even if an advance waiver is obtained, in the event of a merger, Lawyer should reassess whether a second "confirming" waiver is required depending on the specificity of the advance waiver and whether it reasonably predicted the materialized conflict. *See, Visa U.S.A., Inc. v. First Data Corp* (N.D. Cal. 2003) 241 F.Supp.2d 1100; *Western Sugar Coop. v. Archer-Daniels-Midland Co.* (C.D. 2015) 98 F.Supp.3d 1074 (material change may trigger need for new disclosure and informed written consent.)

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

A. Lawyer's Duties to Company

"[B]ecause Rule 1.7(b) imposes an ongoing obligation to avoid conflicts, the attorney regularly must reexamine the investment for potential conflicts." Independent Lawyer Report, p. 43. Three years into Lawyer's role as in-house counsel, their stock options are 30% vested. Furthermore, Lawyer's stock options will be treated as fully vested in the acquisition negotiations. These are the type of circumstances that rise to the level of a 1.7(b) conflict,

REDLINE

539 requiring informed consent from the Company before Lawyer advises it about the propriety
540 and terms of the potential acquisition deal. Lawyer should explain to Company that Lawyer's
541 status as a shareholder presents a significant risk that Lawyer's role as General Counsel may be
542 materially limited by Lawyer's personal, financial interest in the merger deal. For example, the
543 merger may present risks that Lawyer is willing to assume for Lawyer's personal financial gain,
544 but may not be advisable for Company to do the same. There may be other reasonably
545 foreseeable consequences of the conflict that Lawyer must explain to obtain Company's
546 *informed* consent to permit Lawyer to advise Company regarding the merger. " 'Informed
547 consent' means a person's agreement to a proposed course of conduct after the lawyer has
548 communicated and explained (i) the relevant circumstances and (ii) the material risks, including
549 any actual and reasonably foreseeable adverse consequences of the proposed course of
550 conduct." CRPC 1.0.1(e). Lawyer must also advise Company to consult with independent
551 outside counsel concerning the conflict, and provide Company sufficient time to do so before a
552 decision is made whether to waive the conflict. CRPC 1.7(b). Finally, these disclosures and
553 advice, and Company's consent must be in writing. CRPC 1.7(b); CRPC 1.0.1(e-1). **SB: The facts**
554 **don't address the amount of value of stock options, which I believe is a relevant factor in**
555 **evaluating whether there is a material limitation conflict.**

556
557
558 The Committee cautions that if Lawyer's fully vested stock options comprise a significant
559 portion of Lawyer's assets, it may be unreasonably difficult, if not impossible, for Lawyer to give
560 detached advice to Company. In other words, the conflict is not waivable unless Lawyer
561 "reasonably believes that [they] will be able to provide competent and diligent representation
562 to" the affected client, Company. CRPC 1.7(d)(1). In that event, Lawyer must explain to
563 Company the basis for the conflict and that it is non-waivable, and recommend that Company
564 retain outside counsel to advise Company and represent it in the merger negotiations. Lawyer
565 may continue to represent Company on other matters unrelated to the merger.

A. Can Lawyer Advise Individual Shareholders?

568 Lawyer only represents Company through its authorized constituents. CRPC 1.13(a). Generally,
569 a lawyer may advise and represent both the company and individual shareholders provided the
570 proper disclosures are made and consent is given by each client. "A lawyer representing an
571 organization may also represent any of its constituents, subject to the provisions of rules 1.7,
572 1.8.2, 1.8.6, and 1.8.7." CRPC 1.13(g).

573 In considering CEO's request that Lawyer represent both the Company and its shareholders
574 regarding the merger, Lawyer must examine the extent of the alignment of interests between
575 and among each of the shareholders (including Lawyer) and between the shareholders and
576 Company. Given the likelihood that the individuals will have differing personal and financial
577 interests in connection with the merger, it is also reasonable to assume that the joint
578 representation will present a significant risk that Lawyer's ability to "recommend or advocate

REDLINE

579 all possible positions that each might take” will be materially limited by Lawyer’s “duty of
580 loyalty to the other clients.” CRPC 1.7(b), Comment [4] (discussing conflict in representing
581 individuals in forming a joint venture); ABA Model Rule 1.7, Comment [8] (accord).

582 If Lawyer reasonably believes that they can provide competent and diligent representation to
583 each shareholder and Company, then Lawyer may do so after obtaining informed written
584 consent of each shareholder and CEO⁸ under CRPC 1.7(b), as discussed above.

585 If Lawyer does not reasonably believe they can competently and diligently represent Company
586 and the shareholders regarding the merger, Lawyer should remind the shareholders (including
587 CEO) that Lawyer’s professional responsibility and allegiance is owed solely to Company, and
588 that Lawyer does not have a confidential, attorney-client relationship with any individual
589 constituents or shareholders regarding their personal interests.

590 [WHAT HAPPENS IF CEO DEMANDS THAT LAWYER ADVISE THE INDIVIDUALS? ADDRESS DUTY
591 TO WITHDRAW UNDER 1.16?]

CONCLUSION

⁸ See, CRPC 1.13(g) (“If the organization’s consent to the dual representation is required by any of these rules, the consent shall be given by an appropriate official, constituent, or body of the organization other than the individual who is to be represented, or by the shareholders.”)