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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:

It is common for in-house lawyers to move from one company to another, often within the same industry. And, although conflicts rules apply equally to in-house lawyers as to law firm lawyers, the conflicts analysis must take into account the unique characteristics of the in-house role, which is typically both an attorney-client and employer-employee relationship.

A former client conflict of interest under CRPC 1.9 does not arise simply because an in-house lawyer moves between companies that are economic competitors. A conflict of interest will arise if the lawyer was personally involved in representing their former employer on a matter that is factually and legally identical or similar to a matter the lawyer is to handle for their new employer, and in which the companies are adverse. Alternatively, a conflict of interest will also arise if there was no personal representation, but the lawyer obtained confidential information during their prior employment concerning the same or substantially similar, adverse matter. The conflict may be imputed to the entire legal department of the new employer, unless screening measures may be implemented under CRPC 1.10.

In-house lawyers are often offered employee stock options as part of their compensation package. In a typical attorney-client relationship - - which is inherently imbalanced in favor of the attorney - - taking stock in a client requires compliance with CRPC 1.8.1: the transaction must be fair and reasonable; the lawyer's role in the transaction is fully and plainly disclosed to the client in writing; the client is advised in writing to consult with independent counsel about the transaction; and the client thereafter provides informed written consent to it. However, the in-house context, where the new lawyer is offered the same general compensation terms as those offered to other key employees, this generally does not present the same conditions of unequal bargaining power, and thus, compliance with CRPC 1.8.1 would not be required absent an indicia of inequality. 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)

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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; and (5) whether the compensation is part of the lawyer's initial employment agreement, or modifications thereto, or related to the lawyer's work on a specific transaction.

Even if compliance with CRPC 1.8.1 is not required, stock ownership may still trigger a material limitation conflict under CRPC 1.7(b) if there is a significant risk that the in-house lawyer's representation will be materially limited by their financial interest in connection with their stock ownership. Such a conflict could arise if the lawyer is asked to advise the company concerning a transaction that affects the character or price of the stock, such as a merger or acquisition. If so, the lawyer must obtain informed written consent from an authorized constituent of the company. If the lawyer does not reasonably believe they can competently represent the company due to the conflict, or if the company refuses to consent to the conflict, the lawyer must refer the matter to nonconflicted in-house counsel or outside counsel.

Assuming there is no conflict under CRPC 1.7(b), or the conflict is waived, the lawyer may advise individual shareholders regarding a merger or acquisition as long as the lawyer obtains informed written consent from each shareholder and the company concerning the representation.

### 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"), formed by three founders ("Founders"). The Founders 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.

#### **Lawyer's Scope of Employment with Old Company and Company**

Company is a competitor of Old Company in that they both sell 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. The legal department 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.

#### **Lawyer's Employment Agreement with Company**

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As part of Lawyer's employment agreement with Company, Lawyer is presented with a stock option agreement that is offered to Company's salaried employees. The agreement states that Lawyer has an option to purchase a certain number of shares of the Company's common stock at an exercise price equal to the fair market value of such shares on the date of the grant, based on the Company's Stock Incentive Plan. The agreement 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 and become fully vested.

### Lawyer's Possible Conflicts During Employment with Company

Lawyer begins working for Company. Three years later, after Lawyer's securities are 30% vested, comprising of about 20% of Lawyer's personal net worth, 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 Founders (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.

## ISSUES PRESENTED

1. Is there a conflict of interest between Old Company and Company with respect to Lawyer's anticipated employment with Company?
2. Does the stock option agreement present any conflicts of interest under CRPC 1.8.1 and/or 1.7, and if so, how and when should such conflicts of interest be addressed with the Company?

Does Lawyer's status as a stockholder in the Company present a conflict of interest in connection with CEO's request for Lawyer to advise and represent Company and the shareholders concerning the proposed acquisition deal? **DO: I think #3 can be removed, with its analysis to streamline and shorten the opinion. This issue can be raised in a note that references a summary of the analysis.**

## 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." California Rules of Professional Conduct (CRPC) 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

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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 by 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 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 another<sup>1</sup> 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. Is There a Conflict of Interest between Old Company and Company with respect to Lawyer’s Anticipated Scope of Employment with Company?

The question 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 in the same or substantially related matter to those of the lawyer’s former client if the lawyer personally represented the former client in the 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

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<sup>1</sup> 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.”)

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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 (b) applies to the scope of employment, unless CRPC 1.10's screening requirements are satisfied.

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 regarding the new matter.<sup>2</sup>

The analysis involves an examination of the matter handled for the former client and the proposed scope of representation for the matter to be handled for the new client. This exercise may be 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. 4<sup>th</sup> 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.<sup>3</sup>

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

"Even if the matter involved in the potential conflict was being handled by the legal department of the former employer prior to the in-house lawyer's departure, Rule 1.9(a) does not apply unless the in-house lawyer personally represented the former client." ABA Form. Opn. 99-415. Thus, , "[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*. In this respect, 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*).

The inquiry involves an examination of the lawyer's duties with their former employer. ABA Form. Opn. 99-415. Here, Lawyer was not part of the team that advised Old Company

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<sup>2</sup> Regardless 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." (See also Bus. & Prof. Code section 6068(e).)

<sup>3</sup> Of course, the scope of representation must be limited to the extent of the lawyer's duty of competency under CRPC 1.1.

concerning its technology and patent applications. 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 representing 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. (See *e.g., Dieter v. Regents* (ED CA 1997) 963 F.Supp. 908 (disqualification improper where lawyers who moved to new firm worked out of different offices and had no personal involvement in representing former client on substantially related, adverse matter.) 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 from representing Company on such matters. Lawyer must then consider whether CRPC 1.9(b) applies.<sup>4</sup>

#### **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 still exist under CRPC 1.9(b). 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)). Thus, "[e]ven if a former in-house lawyer did not represent his former employer in the same or substantially related matter in which a new client is materially adverse, he still may be disqualified from representing the new client if he acquired protected information that is material to the new matter he wishes to undertake." ABA Form. Opn. 99-415. **DO: Some parts like this that don't relate specifically to in-house questions, while generally correct, should probably be deleted to make the opinion more focused, and shorter**

#### **1. 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

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<sup>4</sup> 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.

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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.*, *supra*, 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 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. 99-415..

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.

DO: 1. Or whether they ‘normally would have obtained’? 2. I think we should explain that this standard is objective. Not whether it was, but whether it normally would be. 3. Why “reasonably plausible”? Not sure where that phrase comes from.

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 possess or had access to confidential information material to their anticipated new role as Company's general counsel. .

## 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*.

Again, 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. "Playbook" knowledge does not create similarities between the two representations or a probability that the lawyer possesses confidential information material to the subsequent representation. 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.

The inquiry involves a comparison of the specific facts and legal issues in the two matters. ABA Form. Opn. 99-415; *Farris v. Fireman's Fund Ins. Co.* (2004) 119 Cal.App.4th 671, 681. Thus, for example, 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.")



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Here, based on the facts presented, Lawyer's role in the labor and employment department at Old Company is similar to their anticipated role as general counsel for Company only to the extent that both companies are economic competitors the same technology space. This type of "playbook" knowledge does not render the representations the same or substantially similar to trigger a conflict under CRPC 1.9(a) or (b). As discussed below, a conflict may arise post-employment if, for example, a legal dispute or issue arises between the two companies concerning intellectual property rights, or other proprietary interests, and Lawyer possesses confidential information from their time at Old Company that is material to the dispute or issue.

CC: What if Lawyer is in possession of proprietary methods from Old Company that may be useful to Company in developing a new product that avoids infringement on Old Company's IP or patent rights but creates a competitive edge?

### 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 she 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).

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 the 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 and 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 and 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.

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:

- (1) 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
- (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 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 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 for handling. Outside counsel should report to one of Company’s constituents other than Lawyer, and other screening measures should be implemented to “wall off” Lawyer from the infringement matter.

**II. Does the stock option agreement present any conflicts of interest under CRPC 1.8.1 and/or 1.7, and if so, how and when should such conflicts of interest be addressed with the Company?**

**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.

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. “The law accordingly takes a

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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<sup>4</sup>th 1365, 1369.<sup>5</sup>

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.<sup>6</sup> 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

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-

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<sup>5</sup> 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.

<sup>6</sup> 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.

## CLEAN

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 1045 (1986) (concluding that lawyer's arms-length negotiation concerning in-house lawyer's compensation in the form of shares in the employer, a publicly traded corporation, did not violate RPC 1.8).

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.<sup>7</sup>

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

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<sup>7</sup> 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."

## CLEAN

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.<sup>8</sup> See, *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, 1169.

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, 1248(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

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<sup>8</sup> 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

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 CRPC 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, CRPC 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 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, such as advising corporate management on the duty to disclose materially adverse financial information. “[T]he 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.” ABA Form.Opn. 00-418, p. 10. If the lawyer reasonably believes that her representation may be materially limited by her stock ownership she must consult with the client and obtain consent before continuing the representation. *Ibid.*

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.5<sup>th</sup> 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.)

### **III. Does Lawyer’s status as a stockholder in the Company present a conflict of interest in connection with CEO’s request for Lawyer to advise and represent Company and the shareholders concerning the proposed acquisition deal?**

**DO: 1.** I think this highlighted section should be reduced to a note or quick summary. **2.** I think we can reduce this highlighted section to a summary paragraph or footnote.

#### **A. Lawyer’s Duties to Company**



578  
579 “[B]ecause Rule 1.7(b) imposes an ongoing obligation to avoid conflicts, the attorney regularly  
580 must reexamine the investment for potential conflicts.” Independent Lawyer Report, p. 43.  
581 Three years into Lawyer’s role as in-house counsel, her stock options are 30% vested,  
582 comprising of approximately 20% of their net worth. Furthermore, Lawyer’s stock options will  
583 be treated as fully vested in the acquisition negotiations, which will likely increase the  
584 percentage of Lawyer’s net worth comprising of Company’s stock by 30%. These are the type  
585 of circumstances that rise to the level of a 1.7(b) conflict, requiring informed consent from the  
586 Company before Lawyer advises it about the propriety and terms of the potential acquisition  
587 deal. Lawyer should explain to Company that Lawyer’s status as a shareholder presents a  
588 significant risk that Lawyer’s role as General Counsel may be materially limited by Lawyer’s  
589 personal, financial interest in the merger deal. For example, the merger may present risks that  
590 Lawyer is willing to assume for Lawyer’s personal financial gain, but may not be advisable for  
591 Company to do the same. There may be other reasonably foreseeable consequences of the  
592 conflict that Lawyer must explain to obtain Company’s *informed* consent to permit Lawyer to  
593 advise Company regarding the merger. “ ‘Informed consent’ means a person’s agreement to a  
594 proposed course of conduct after the lawyer has communicated and explained (i) the relevant  
595 circumstances and (ii) the material risks, including any actual and reasonably foreseeable  
596 adverse consequences of the proposed course of conduct.” CRPC 1.0.1(e). Lawyer must also  
597 advise Company to consult with independent outside counsel concerning the conflict, and  
598 provide Company sufficient time to do so before a decision is made whether to waive the  
599 conflict. CRPC 1.7(b). Finally, these disclosures and advice, and Company’s consent must be in  
600 writing. CRPC 1.7(b); CRPC 1.0.1(e-1).

601  
602 The Committee cautions that if Lawyer’s fully vested stock options account for a significant  
603 portion of Lawyer’s assets, it may be unreasonably difficult, if not impossible, for Lawyer to give  
604 detached advice to Company. In other words, the conflict is not waivable unless Lawyer  
605 “reasonably believes that [they] will be able to provide competent and diligent representation  
606 to” the affected client, Company. CRPC 1.7(d)(1). In that event, Lawyer must explain to  
607 Company the basis for the conflict and that it is non-waivable, and recommend that Company  
608 retain outside counsel to advise Company and represent it in the merger negotiations. Lawyer  
609 may continue to represent Company on other matters unrelated to the merger.

#### 611 **B. Can Lawyer Advise Individual Founders?**

612 Lawyer only represents Company through its authorized constituents. CRPC 1.13(a). Generally,  
613 a lawyer may advise and represent both the company and individual shareholders provided the  
614 proper disclosures are made and consent is given by each client. “A lawyer representing an  
615 organization may also represent any of its constituents, subject to the provisions of rules 1.7,  
616 1.8.2, 1.8.6, and 1.8.7.” CRPC 1.13(g).

## CLEAN

617 In considering CEO's request that Lawyer represent both the Company and the Founders  
618 regarding the merger, Lawyer must examine the extent of the alignment of interests between  
619 and among each of the Founders and between the Founders and Company. Given the  
620 likelihood that the individuals will have differing personal and financial interests in connection  
621 with the merger, it is also reasonable to assume that the joint representation will present a  
622 significant risk that Lawyer's ability to "recommend or advocate all possible positions that each  
623 might take" will be materially limited by Lawyer's "duty of loyalty to the other clients." CRPC  
624 1.7(b), Comment [4] (discussing conflict in representing individuals in forming a joint venture);  
625 ABA Model Rule 1.7, Comment [8] (accord).

626 If Lawyer reasonably believes that she can provide competent and diligent representation to  
627 each Founder and Company, then Lawyer may do so after obtaining informed written consent  
628 of each Founder and CEO<sup>9</sup> under CRPC 1.7(b), as discussed above.

629 If Lawyer does not reasonably believe she can competently and diligently represent Company  
630 and the Founders regarding the merger, Lawyer should remind the them (including CEO) that  
631 Lawyer's professional responsibility and allegiance is owed solely to Company, and that Lawyer  
632 does not have a confidential, attorney-client relationship with any individual constituents or  
633 Founders regarding their personal interests.

## CONCLUSION

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<sup>9</sup> 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.")

## 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:

It is common for in-house lawyers to move from one company to another, often within the same industry. And, although conflicts rules apply equally to in-house lawyers as to law firm lawyers, the conflicts analysis must take into account the unique characteristics of the in-house role, which is typically both an attorney-client and employer-employee relationship.

A former client conflict of interest under CRPC 1.9 does not arise simply because an in-house lawyer moves between companies that are economic competitors. A conflict of interest will ~~only~~ arise if the lawyer was personally involved in representing their former employer on a matter that is factually and legally identical or similar to a matter the lawyer is to handle for their new employer, and in which the companies are adverse. Alternatively, a conflict of interest will also arise if there was no personal representation, but the lawyer obtained confidential information during their prior employment concerning the same or substantially similar, adverse matter, ~~a conflict of interest will also arise~~. The conflict may be imputed to the entire legal department of the new employer, unless screening measures may be implemented under CRPC 1.10.

In-house lawyers are often offered employee stock options as part of their compensation package. In a typical attorney-client relationship - - which is inherently imbalanced in favor of the attorney - - taking stock in a client requires compliance with CRPC 1.8.1: the transaction must be fair and reasonable; the lawyer's role in the transaction is fully and plainly disclosed to the client in writing; the client is advised in writing to consult with independent counsel about the transaction; and the client thereafter provides informed written consent to it. However, the in-house context, where the new lawyer is offered the same general compensation terms as those offered to other key employees, this generally does not present the same conditions of unequal bargaining power, and thus, compliance with CRPC 1.8.1 would not be required absent an indicia of inequality. 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)

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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; and (5) whether the compensation is part of the lawyer's initial employment agreement, or modifications thereto, or related to the lawyer's work on a specific transaction. \_\_\_\_\_

Even if compliance with CRPC 1.8.1 is not required, stock ownership may still trigger a material limitation conflict under CRPC 1.7(b) if there is a significant risk that the in-house lawyer's representation will be materially limited by their financial interest in connection with their stock ownership. Such a conflict could arise if the lawyer is asked to advise the company concerning a transaction that affects the character or price of the stock, such as a merger or acquisition. If so, the lawyer must obtain informed written consent from an authorized constituent of the company. If the lawyer does not reasonably believe they can competently represent the company due to the conflict, or if the company refuses to consent to the conflict, the lawyer must refer the matter to nonconflicted in-house counsel or outside counsel.

Assuming there is no conflict under CRPC 1.7(b), or the conflict is waived, the lawyer may advise individual shareholders regarding a merger or acquisition as long as the lawyer obtains informed written consent from each shareholder and the company concerning the representation. {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"), ~~formed owned~~ by three ~~founders shareholders~~ ("FoundersShareholders"). The ~~Founders 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.

#### Lawyer's Scope of Employment with Old Company and Company

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. ~~The legal department, 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.

## REDLINE

~~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.~~

### Lawyer's Employment Agreement with Company

As part of Lawyer's employment agreement with Company, Lawyer is presented with a stock option agreement that is offered to Company's salaried key employees. The agreement states that Lawyer has an option to purchase a certain number of shares of the Company's common stock at an exercise price equal to the fair market value of such shares on the date of the grant, based on the Company's Stock Incentive Plan. The agreement 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~~ and 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's Possible Conflicts During Employment with Company

Lawyer begins working for Company. Three years later, after Lawyer's securities are 30% vested, comprising of about 20% of Lawyer's personal net worth, 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~~ Founders (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.~~

## ISSUES PRESENTED

1. 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. Is there a conflict of interest between Old Company and Company with respect to Lawyer's anticipated employment with Company?

## REDLINE

2. Does the stock option agreement present any conflicts of interest under CRPC 1.8.1 and/or 1.7, and if so, how and when should such conflicts of interest be addressed with the Company?

Does Lawyer's status as a stockholder in the Company present a conflict of interest in connection with CEO's request for Lawyer to advise and represent Company and the shareholders concerning the proposed acquisition deal?

DO: I think #3 can be removed, with its analysis to streamline and shorten the opinion. This issue can be raised in a note that references a summary of the analysis.

## 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.” [California Rules of Professional Conduct \(CRPC\) 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 by 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 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 another<sup>1</sup> and an in-house lawyer’s ownership of stock or stock options in the

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<sup>1</sup> 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

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156 employer present challenging questions. As explained below, although the CRPC apply with  
157 equal force to in-house lawyers as they do to independent lawyers, they- must be analyzed in  
158 the context of both the attorney-client and employer-employee relationships at issue.

## APPLICATION

### 160 I. ~~What is the Scope of Lawyer's Duties To Their Former Employer, Old Company? Is~~ 161 There a Conflict of Interest between Old Company and Company with respect to 162 Lawyer's Anticipated Scope of Employment with Company?

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

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

177 In short, a conflict of interest will exist based on a lawyer's personal representation of a former  
178 client ~~or~~ acquisition of confidential information material to a particular matter, provided that  
179 the matters are the same or substantially related and the interests of the clients are materially  
180 adverse regarding the new matter.<sup>2</sup>

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

184 The analysis involves an examination of the matter handled for the former client and the  
185 proposed scope of representation for the matter to be handled for the new client. This  
186 exercise ~~ese questions are uniquely~~ may be challenging for the in-house lawyer given the  
187 lawyer's relatively broad scope of employment. "Matters" are not as easily discernable as they  
188 are in a law firm setting. "Many corporate legal departments do not maintain the detailed time

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resulted in a greater focus on this issue. Current and prospective employers as well as in-house counsel themselves have reason for concern.")

<sup>2</sup> Regardless 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." (See also Bus. & Prof. Code section 6068(e).)



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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. 4<sup>th</sup> 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.<sup>3</sup>

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

“Even if the matter involved in the potential conflict was being handled by the legal department of the former employer prior to the in-house lawyer’s departure, Rule 1.9(a) does not apply unless the in-house lawyer personally represented the former client.” ABA Form. Opn. 99-415. Thus, ~~“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.* In this respect, 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*).

The inquiry involves an examination of the lawyer’s duties with their former employer. ABA Form. Opn. 99-415. 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~~ representing ~~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 ~~representation~~ Old Company regarding its patents and technology. (See *e.g., Dieter v. Regents* (ED CA 1997) 963 F.Supp. 908 (disqualification improper where lawyers who moved to new firm worked out of different offices and had no personal involvement in representing former client on substantially related, adverse matter.) ~~[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.

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<sup>3</sup> Of course, the scope of representation must be limited to the extent of the lawyer’s duty of competency under CRPC 1.1.



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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 from representing Company on such matters. Lawyer must then consider whether CRPC 1.9(b) applies.<sup>4</sup>

### 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 still 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)). Thus, “[e]ven if a former in-house lawyer did not represent his former employer in the same or substantially related matter in which a new client is materially adverse, he still may be disqualified from representing the new client if he acquired protected information that is material to the new matter he wishes to undertake.” ABA Form. Opn. 99-415.

DO: Some parts like this that don’t relate specifically to in-house questions, while generally correct, should probably be deleted to make the opinion more focused, and shorter

~~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

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<sup>4</sup> 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.

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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.*, ~~*supra*, (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 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. [99-415](#).~~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](#) ~~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.

DO: 1. Or whether they ‘normally would have obtained’? 2. I think we should explain that this standard is objective. Not whether it was, but whether it normally would be. 3. Why “reasonably plausible”? Not sure where that phrase comes from.

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

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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 possess or had access to confidential information material to their anticipated new role as Company's general counsel. ~~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*.

Again, the~~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. "Playbook" knowledge does not create similarities between the two representations or a probability that the lawyer possesses confidential information material to the subsequent representation. 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.

The inquiry involves a comparison of the specific facts and legal issues in the two matters. ABA Form. Opn. 99-415; *Farris v. Fireman's Fund Ins. Co.* (2004) 119 Cal.App.4th 671, 681. Thus,~~However, for example,~~ 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.")

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Here, based on the facts presented, Lawyer's role in the labor and employment department at Old Company is similar to their anticipated role as general counsel for Company only to the extent that both companies are economic competitors the same technology space. This type of "playbook" knowledge does not render the representations the same or substantially similar to trigger a conflict under CRPC 1.9(a) or (b). As discussed below, a conflict may arise post-employment if, for example, a legal dispute or issue arises between the two companies concerning intellectual property rights, or other proprietary interests, and Lawyer possesses confidential information from their time at Old Company that is material to the dispute or issue.

CC: What if Lawyer is in possession of proprietary methods from Old Company that may be useful to Company in developing a new product that avoids infringement on Old Company's IP or patent rights but creates a competitive edge?

### 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 she performed on behalf of ~~by~~ 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).

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 the 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 and 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 and 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.

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: ~~In that event, Lawyer (and Company) may have the option of screening under CRPC 1.10(a)(2) if the following conditions are met:~~

- (1) The prohibited lawyer ~~Lawyer~~ did not substantially participate in the same or substantially related matter;
- (2) The prohibited lawyer ~~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 the affected former client ~~Old Company~~ to enable it to ascertain compliance with the provisions of the rule, which shall include a description

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of the screening; procedures employed; and an agreement by the firm ~~Company~~ to respond promptly to any written inquiries or objections by the former client ~~Old Company~~ 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 to those matters~~ 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~~ for handling. Outside counsel should report to one of Company's constituents other than Lawyer, and other screening measures should be implemented to "wall off" Lawyer from the infringement matter.

**II. Does the stock option agreement present any conflicts of interest under CRPC 1.8.1 and/or 1.7, and if so, how and when should such conflicts of interest be addressed with the Company?** ~~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



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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.

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.<sup>5</sup>

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. <sup>6</sup> There, Mr. Chism, Tri-State Construction Inc.'s (Tri-State) general counsel, sued Tri-

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<sup>5</sup> 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.

<sup>6</sup> 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.

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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

~~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 [1045 \(1986\) \(concluding that lawyer's arms-length negotiation concerning in-house lawyer's compensation in the form of shares in the employer, a publicly traded corporation, did not violate RPC 1.8\).](#) ÷

~~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



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“wages,” are substantively similar to a typical attorney fee agreement, which is presumed to be an arms-length transaction.<sup>7</sup>

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.<sup>8</sup> See, *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, [1169](#).

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<sup>7</sup> 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.”

<sup>8</sup> 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.

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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, 1248 (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. ~~—[OTHERS? Whether the compensation is part of lawyer's initial employment agreement of 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 CRPC~~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, CRPC~~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

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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, such as advising corporate management on the duty to disclose materially adverse financial information. "[T]he 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." ABA Form.Opn. 00-418, p. 10. If the lawyer reasonably believes that her representation may be materially limited by her stock ownership she must consult with the client and obtain consent before continuing the representation. *Ibid.*

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~~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~~

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616 ~~providing the opinion even were the client to consent. CC: When 1.7 conflict waiver would be~~  
617 ~~required.~~

618  
619 Here, Company offers Lawyer participation in its Stock Incentive Plan, which includes stock  
620 options that vest incrementally over time. These are terms offered to other key employees. At  
621 the outset of the employment relationship, these provisions by themselves do not present a  
622 significant risk that Lawyer's independent judgment will be materially limited to the detriment  
623 of the Company. "Given the relatively limited equity stake of corporate counsel in most cases,  
624 the lawyer's ownership interest usually would not materially limit the representation. Indeed,  
625 equity-based compensation grants generally are made in small increments over time and, at  
626 the time made, are restricted in ways that give them only contingent, future value."

627 Independent Lawyer Report, p. 56.

628  
629 However, the stock option agreement also provides that in the event of a merger with or  
630 acquisition by another company, the vesting of the Lawyer's option will immediately accelerate  
631 so as to become fully vested. Given that such a merger is a mere potentiality, and lacking  
632 specificity as to any terms and timing, it is unlikely that it presents a significant risk at the outset  
633 of Lawyer's employment that the acceleration provision will materially limit Lawyer's  
634 representation. Lawyer may consider an advance conflict waiver if a reasonably comprehensive  
635 explanation of foreseeable scenarios in which Company may be adversely affected by the  
636 merger and acceleration of Lawyer's stock vesting can be provided. *See generally*, CRPC 1.7,  
637 Comment [9]; *Sheppard, Mullin, Richter & Hampton LLP v. J-M Mfg. Co., Inc.* (2018) 6 Cal.5th 59.  
638 Even if an advance waiver is obtained, in the event of a merger, Lawyer should reassess  
639 whether a second "confirming" waiver is required depending on the specificity of the advance  
640 waiver and whether it reasonably predicted the materialized conflict. *See, Visa U.S.A., Inc. v.*  
641 *First Data Corp* (N.D. Cal. 2003) 241 F.Supp.2d 1100; *Western Sugar Coop. v. Archer-Daniels-*  
642 *Midland Co.* (C.D. 2015) 98 F.Supp.3d 1074 (material change may trigger need for new  
643 disclosure and informed written consent.)

644  
645 **III. ~~Question 3: Does Lawyer's status as a stockholder in the Company present a~~**  
646 **~~conflict of interest in connection with CEO's request for Lawyer to advise and~~**  
647 **~~represent Company and the shareholders concerning the proposed acquisition~~**  
648 **~~deal? What are Lawyer's Ethical Duties to Company and the Individual~~**  
649 **~~Shareholders Concerning the Sale?~~**

650 **DO: 1. I think this highlighted section should be reduced to a note or quick summary. 2. I think**  
651 **we can reduce this highlighted section to a summary paragraph or footnote.**

652  
653 **A. ~~A.~~—Lawyer's Duties to Company**

654  
655 **"[B]ecause Rule 1.7(b) imposes an ongoing obligation to avoid conflicts, the attorney regularly**  
656 **must reexamine the investment for potential conflicts."** Independent Lawyer Report, p. 43.

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Three years into Lawyer's role as in-house counsel, ~~her~~their stock options are 30% vested, comprising of approximately 20% of their net worth. Furthermore, Lawyer's stock options will be treated as fully vested in the acquisition negotiations, which will likely increase the percentage of Lawyer's net worth comprising of Company's stock by \$30%. 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 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~~account for 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.~~B. Can Lawyer Advise Individual ~~Shareholders~~Founders?

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~~the Founders regarding the merger, Lawyer must examine the extent of the alignment of interests between and among each of the Founders ~~shareholders (including Lawyer)~~ and between the

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697 Founders ~~shareholders~~ and Company. Given the likelihood that the individuals will have  
698 differing personal and financial interests in connection with the merger, it is also reasonable to  
699 assume that the joint representation will present a significant risk that Lawyer's ability to  
700 "recommend or advocate all possible positions that each might take" will be materially limited  
701 by Lawyer's "duty of loyalty to the other clients." CRPC 1.7(b), Comment [4] (discussing conflict  
702 in representing individuals in forming a joint venture); ABA Model Rule 1.7, Comment [8]  
703 (accord).

704 If Lawyer reasonably believes that ~~she~~they can provide competent and diligent representation  
705 to each Founder ~~shareholder~~ and Company, then Lawyer may do so after obtaining informed  
706 written consent of each Founder ~~shareholder~~ and CEO<sup>9</sup> under CRPC 1.7(b), as discussed above.

707 If Lawyer does not reasonably believe ~~she~~they can competently and diligently represent  
708 Company and the Founders ~~shareholders~~ regarding the merger, Lawyer should remind the  
709 ~~them~~ ~~shareholders~~ (including CEO) that Lawyer's professional responsibility and allegiance is  
710 owed solely to Company, and that Lawyer does not have a confidential, attorney-client  
711 relationship with any individual constituents or ~~shareholders~~ Founders regarding their personal  
712 interests.

713 ~~{WHAT HAPPENS IF CEO DEMANDS THAT LAWYER ADVISE THE INDIVIDUALS? ADDRESS DUTY~~  
714 ~~TO WITHDRAW UNDER 1.16?}~~

## CONCLUSION

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<sup>9</sup> 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.")