

RE: Rule 3-300
8/27-28/04 Commission Meeting
Open Session Item III.O.

-----Original Message-----

From: Mark Tuft [mailto:MTuft@cwclaw.com]

Sent: Friday, July 30, 2004 6:45 PM

To: slamport@ccnlaw.com; avoogd@technip.com

Cc: kemohr@comcast.net; hbsondheim@earthlink.net; pwwapnek@townsend.com; Yen, Mary; McCurdy, Lauren; Difuntorum, Randall

Subject: RE: Agenda Item III.O [Rule 3-300]

The following are my comments and suggestions regarding Rule 3-300 [ABA Model Rule 1.8(a)(d)(i)(k)]

1. We should maintain rule 3-300 as a separate rule and not combine it with other conflict rules. ABA Model Rule 1.8 combines too many conflict situations into one rule and is confusing. The heading: "Conflicts of Interest: Current Clients: Specific Rules" is vague and not helpful. The title of rule 3-300 "Avoiding the Representation of Adverse Interests" is clear and should be retained.
2. The requirements in rule 3-300 should be retained without modification. The ABA has recently moved closer to the California rule. Rule 1.8(a)(2) was revised in 2002 by E2k to require that the client be told *in writing* that the client may seek the advice of independent counsel. The changes to rule 1.8(a)(3) in 2002 may have improved the ABA rule but are too verbose and not as crisp as the wording in rule 3-300(C).
3. Even as amended in 2002 to an effort to come closer to the California rule, rule 1.8(a) is still less stringent than rule 3-300. Rule 3-300 requires that the terms of the transaction be transmitted to the client in writing "in a manner that should reasonably *have been* understood by the client" rather than "in a manner that *can be* reasonably understood by the client." I prefer the more objective standard in rule 3-300 over the ABA rule.
4. Model Rule 1.8(d) is a transaction with a client that typically would come under rule 3-300, except, perhaps in the case of a criminal defendant where the court can conduct a voir dire of the client as in Maxwell v. Sup. Ct. or where the literary rights represent the lawyer's fee, are not shared with the client and are negotiated at the outset of the representation. In any event, I do not believe this situation requires a separate rule. An issue for the Commission is whether it should be included as part of the discussion to the rule.
5. The provisions in Model Rule 1.8(i) should be addressed, if at all, in the discussion section and not as part of the rule. An issue for discussion is whether there is a consensus among the commission members on the application of the Supreme Court's decision in Fletcher in contingent and fixed fee cases.

6. A significant issue for consideration by the Commission, either in regard to this rule, or when we consider the other conflict rules, is the concept in new rule 1.8(k). I recommend we take up the imputation issue at least with respect to this rule. I agree with the concept expressed in comment 20 to rule 1.8 as it applies to rule 3-300. However, I do not like the phrase "lawyers associated in a firm."

7. I would retain the current discussion to rule 3-300. I would also include comments 1 and 3 to rule 1.8 with some fine tuning. I would not include comments 2 or 4.

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(August 2, 2004)

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NOTE: Refer to comment no. 2002-29 (William Wells) included in the clear public comment binder.

RULE AMENDMENT HISTORY (2004)

Rule 3-300. Avoiding Interests Adverse to a Client

Current Rule

Rule 3-300. Avoiding Interests Adverse to a Client

A member 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 each of the following requirements has been satisfied:

(A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and

(B) The client is advised in writing that the client may 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 consents in writing to the terms of the transaction or the terms of the acquisition.

Discussion:

Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client, unless the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client. Such an agreement is governed, in part, by rule 4-200.

Rule 3-300 is not intended to apply where the member and client each make an investment on terms offered to the general public or a significant portion thereof. For example, rule 3-300 is not intended to apply where A, a member, invests in a limited partnership syndicated by a third party. B, A's client, makes the same investment. Although A and B are each investing in the same business, A did not enter into the transaction "with" B for the purposes of the rule.

Rule 3-300 is intended to apply where the member wishes to obtain an interest in client's property in order to secure the amount of the member's past due or future fees. (Amended by order of Supreme Court, operative September 14, 1992.)

Amendments Operative 1992 (Comparison of Current Rule to Former Rule)

Rule 3-300. Avoiding ~~Adverse Interests~~ Adverse to a Client.

[Note: Only the title changed with this Amendment.]

[December, 1991 green bound rule filing, enc. 2]

RULE AMENDMENT HISTORY (2004)

Summary of 1991 Amendments

The proposed amendment to the title is intended to better distinguish rule 3-300 from 3-310 (Avoiding the Representation of Adverse Interests). No substantive change is intended.

[December, 1991 green bound rule filing pg. 13.]

Amendments Operative 1989 (Comparison of Current Rule to Former Rule)

Rule 3-300. ~~5-401~~. Avoiding Adverse Interests

A member ~~of the State Bar~~ shall not enter into a business transaction with a client₁; or knowingly acquire an ownership, possessory, security₁, or other pecuniary interest adverse to a client₁, unless each of the following requirements has been satisfied:

(1) (A) ~~† The transaction or acquisition and its terms and terms in which the member of the State Bar acquires the interest~~ are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner and terms which should reasonably have reasonably been understood by the client; ; and

(2) (B) ~~† The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek the advice of independent counsel of the client's choice on the transaction that advice;~~ ; and

(3) (C) ~~† The client thereafter consents in writing thereto to the terms of the transaction or the terms of the acquisition.~~

Discussion:

Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client, unless the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client. Such an agreement is governed, in part, by rule 4-200.

Rule 3-300 is not intended to apply where the member and client each make an investment on terms offered to the general public or a significant portion thereof. For example, rule 3-300 is not intended to apply where A, a member, invests in a limited partnership syndicated by a third party. B, A's client, makes the same investment. Although A and B are each investing in the same business, A did not enter into the transaction "with" B for the purposes of the rule.

Rule 3-300 is intended to apply where the member wishes to obtain an interest in client's property in order to secure the amount of the member's past due or future fees.

[December, 1987 gray bound ruling filing, enc. 2.]

RULE AMENDMENT HISTORY (2004)

Summary of 1989 Amendments

Proposed rule 3-300 continues the regulation of attorneys entering into business transactions with their clients or acquiring certain pecuniary interests adverse to the client found in current rule 5-101.

It is proposed that the rule be divided into paragraphs to make it easier to follow.

To eliminate confusion, the concepts of “business transaction” and “ownership, possessory, security or other pecuniary interest” have been set apart in the precatory language to make clear that they are two distinct kinds of activities which are both subject to regulation.

Paragraph (A), like current rule 5-101, requires that the transaction or acquisition be fair and reasonable to the client and then terms fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client.

An amendment is also proposed to the concept in paragraph (B) to make clear that when an attorney seeks to acquire the informed consent of the client, the attorney must inform the client in writing of the client’s right to seek the advice of independent counsel.

Finally, an amendment is proposed to the concept in paragraph (C) to clarify that the client may not consent to the transaction or acquisition of the adverse pecuniary interest until after paragraphs (A) and (B) are satisfied.

[December, 1987 grey bound rule filing at pgs. 32-33.]

Excerpt from 1972 Final Report of the Special Committee to Study the ABA Code of Professional Responsibility (Proposed Rule 5-101)

Rule 5-101. Avoiding Adverse Interests

1. A member of the State Bar shall not accept professional employment without first disclosing his relation, if any, with the adverse party, and his interest, if any, in the subject matter of the employment.
2. A member of the State Bar shall not acquire an interest adverse to a client.

RULE AMENDMENT HISTORY (2004)

Comment:

Rule 5-101(A) carries forward the identical text of present Rule 6, Rules of Professional Conduct.

Rule 5-101(B) carries forward the identical text of present Rule 4, Rules of Professional Conduct.

Excerpt from September 27, 2001 Memorandum

DATE: September 27, 2001

TO: The Commission for the Revision of the Rules of Professional Conduct

FROM: Mike Nisperos, Jr., Chief Trial Counsel

SUBJECT: Recommendations for Changes to the Rules of Professional Conduct

17. Rule 3-300. Avoiding Interests Adverse to a Client.

OCTC recommends clarifying the duties of an attorney when entering into a business transaction with a client. The recommendations further resolve issues that have developed in the application of the current rule.

Add:

(A) For purposes of this rule “client” means an individual or entity who the member is representing in a legal matter or other person or entity to whom the member owes a fiduciary duty as prescribed by law or a former client or other person or entity to whom the member owed a fiduciary duty and who expects the member to exercise professional judgment for the protection of the client. For purposes of paragraph (B) of this rule, a member shall be conclusively found to be a client’s lawyer for three years after the relationship has terminated. However, this shall not prevent a finding that even after three years the person or entity expects the member to exercise professional judgment for the protection of the client.

And revise the current language as follows:

(B) A member or his or her agents shall must not directly or indirectly enter or attempt to enter into a business transaction with a client or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

(A) (1) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in a clear and conspicuous writing to the client in

a manner which should reasonably have been understood by the client. *This disclosure shall be made in a separate document, appropriately entitled, in 12-point print with one inch of space on all borders, signed by the client or the client's conservator, guardian, or agent under a valid durable power of attorney. It shall also be presented to the client at least three days prior to the parties entering into the transaction;* and

(B) (2) The client is advised in writing ~~that the client may~~ *that he or she should* seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(C) (3) The client thereafter ~~consents~~ *gives informed consent* in a writing *signed by the client* to the terms of the transaction or the terms of the acquisition *and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction is clearly explained. This document will be separate from the disclosure document required in paragraph (B)(1) of this rule.*

OCTC COMMENTS:

OCTC recommends that this rule have a definition section. In that definition section, the rule should expressly state that the rule applies to fiduciary relationships as well as traditional attorney-client relationships. This is already the law. (See *e.g. In the Matter of Hultman* (Review Dept. 1995) 3 Cal. State Bar Ct. Rptr. 297, 307.)

Paragraph (A) should also state that the rule applies when a former client or fiduciary expects that the attorney will exercise professional judgment on behalf of the client or other person or entity to whom the member owes a fiduciary duty as prescribed by law. In *Hunnecutt v. State Bar* (1988) 44 Cal.3d 362, 371, the California Supreme Court held that "if there is evidence that the client placed his trust in the attorney because of the representation, an attorney-client relationship exists for the purposes of [former] rule 5-101 [the predecessor of current rule 3-300] even if the representation has otherwise ended." Thus, this provision is codifying existing law.

OCTC also recommends that a member shall be conclusively found to be a client's lawyer for three years after the relationship has terminated. However, this shall not prevent a finding that even after three years the person or entity expects the member to exercise professional judgment for the protection of the client. By requiring the rule to apply for at least three years after the relationship terminates, the rule will protect the client's understanding of the relationship and make it less likely that an attorney will use information obtained in his representation for the attorney's own advantage. It will also

emphasize to attorneys that this rule still applies after the termination of the relationship. Further, this change would adopt what the legislature has mandated in Business & Professions Code section 6175.3. That statute requires an attorney to comply with the conditions imposed in that statute (many of which are similar to the requirements of rule 3-300) when the attorney sells financial products to an elder or dependent adult with whom the lawyer has or has had an attorney-client relationship. Thus, we are only extending a protection already provided for some clients to all clients.

OCTC recommends that the rule apply not just to the member but also to the member's agents and to direct and indirect transactions. This would require of attorneys no more than what is already required of real estate brokers - that they can not do indirectly or thorough relatives and others what they are prohibited from doing for themselves directly. In *In the Matter of Fandey* (Review Dept. 1994) 2 Cal. State Bar Ct. 767, 777, the Review Department held that former rule 5-101 did not apply to transactions between the member's parents and the member's client because there was no evidence that the member was a party to or benefitted financially from the property transactions. However, the California Supreme Court has held that "[t]he rule that an agent employed to sell the principal's property may not, without the principal's full knowledge and consent, become the purchaser, is aimed at an indirect or collusive sale or transfer, as well as a direct sale or transfer to the agent, and extends to a relative of the agent, or to his partner or employee. The rule also applies where the sale or transfer is made to a corporation in which the agent has a large concealed interest, or indirectly to the agent in the name of a third person." *Batson v. Strehlow* (1968) 68 Cal.2d 662, 675-676. In *Marlowe v. State Bar* (1965) 63 Cal.2d 304, the California Supreme Court held that an attorney could not avoid the consequences of discipline if his wife, instead of himself, purchased a client's property. To protect clients from unscrupulous attorneys and to protect attorneys from challenges of misconduct, this rule should be revised so that it imposes discipline when the attorney indirectly or thorough agents or close relatives engages in conduct, which if done by the attorney, would require compliance with rule 3-300. The rule should also apply to attempts by attorneys to enter into transactions with a client without full compliance with the appropriate conditions.

OCTC recommends that section 1 of the rule be revised to include much of the language and conditions required by Business & Professions Code section 6175.3. Not only must the transaction be fair and reasonable to the client, but the terms should be provided in a clear and conspicuous writing separate from any other document, appropriately entitled, in at least 12 point type, signed by the client and presented at least three days prior to the parties entering into the transaction. This is necessary to ensure that the client understands the transaction, has time to review and evaluate it, and to allow for the client to consult an independent lawyer. It provides a cooling off period where the client can reconsider the transaction outside the influence of the attorney. By requiring a separate

document, the terms will not be lost or missed by the client and it helps to ensure that the transaction is only entered into after reasoned consideration by the client. These requirements seem particularly appropriate given the nature of the relationship and the trust that clients often place in their attorneys.

Section 2 eliminates a confusing aspect of the current rule. The current rule states that the attorney is to advise the client in writing that the client “may” seek the advice of an independent lawyer. However, the California Supreme Court has held that the member “must” advise the client to seek independent counsel. OCTC’s proposal eliminates any doubt that the lawyer must advise the client to seek the advice of an independent lawyer.

In section 3, the proposed new language adds to the rule a requirement that the client’s written consent must be informed consent. This is a codification of existing case law. Case law requires that the lawyer provide the client with all the information he or she would provide if another person instead of the member was attempting to negotiate this transaction with the client. That informed consent should require that the client consent in writing to the terms of the transaction, the risks, the lawyer’s role in the transaction, whether the lawyer is representing the client in the transaction, and any other relevant information.

DATE: August 2, 2004
TO: MEMBERS OF THE COMMISSION
FROM: ETHICS HOTLINE STAFF
SUBJECT: RULE 3-300

Rule 3-300. Avoiding Interests Adverse to a Client

1. **Proposed Amendment:** Specify whether rule 3-300 applies to changes in the initial fee agreement. (Cf. Bar Assn. of San Francisco Formal Opn. No. 1997-1 and authorities cited therein.).

Question(s) to the Hotline that this proposed amendment would address:

An attorney has an hourly fee agreement with a plaintiff that, in part, provides for advance costs paid by the attorney and reimbursed at the conclusion of the client's matter. While this case is pending, the attorney seeks to modify the agreement to eliminate the provision for advanced costs. Does this modification require compliance with rule 3-300?

2. **Proposed Amendment:** Establish a time frame for 3-300(B) regarding client's reasonable opportunity to seek advice.

Question(s) to the Hotline that this proposed amendment would address:

To comply with rule 3-300(B), how long must an attorney wait to assure that a client has been given a "reasonable opportunity" to seek the advice of an independent lawyer?

CA Rule 3-300 – Avoiding Interests Adverse to a Client	ABA Model Rule 1.8 (a) and (i) – Conflict of Interest: Current Clients: Specific Rules	Comments
A member 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 each of the following requirements has been satisfied:	(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:	The ABA and CA language are nearly identical.
(A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client;	(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;	Almost identical again, but CA adds transaction or acquisition.
(B) The client is advised in writing that the client may seek the advice of an independent lawyer of the client’s choice and is given a reasonable opportunity to seek that advice, and	(2) The client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and	Wording is a little different between the two rules, but it is the same rule.
(C) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.	(3) The client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.	The ABA rule requires more in the writing. The CA rule just says terms of the transaction while the ABA rule spells out certain aspects of the terms that need to be included in the writing.
DISCUSSION: [1] Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client, unless the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client. Such an	1.8(a) [1] The Rule applies to lawyers engaged in the sale of goods or services related to the practice of law, for example, the sale of title insurance or investment services to existing clients of the lawyer's legal practice. See Rule 5.7. It does not apply to	The CA rule discussion is more concise than the ABA rule. The ABA provisions that are similar to the CA provision can be found in 1.8(a) discussion and in the text of rule 1.8(i). Concerning the subject matter of 1.8(i), see <i>Fletcher v. Davis</i> (2004) 33 Cal.4th 61, 90 P.3d

CA Rule 3-300 – Avoiding Interests Adverse to a Client	ABA Model Rule 1.8 (a) and (i) – Conflict of Interest: Current Clients: Specific Rules	Comments
<p>agreement is governed, in part, by Rule 4-200.</p>	<p>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 non-monetary property as payment of all or part of a fee.</p> <p>1.8(i) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:</p> <p>(1) Acquire a lien authorized by law to secure the lawyer's fee or expenses; and</p> <p>(2) Contract with a client for a reasonable contingent fee in a civil case.</p>	<p>1216, 14 Cal.Rptr.3d 58 (attorney lien must comply with rule 3-300).</p>
<p>[2] Rule 3-300 is not intended to apply where the member and client each make an investment on terms offered to the general public or a significant portion thereof. For example, rule 3-300 is not intended to apply where A, a member, invests in a limited partnership syndicated by a third party. B, A's client, makes the same investment. Although A and B are each investing in the same business, A did not enter into the transaction "with" B for the purposes of the rule.</p>		<p>No ABA equivalent.</p>
<p>[3] Rule 3-300 is intended to apply where the member wishes to obtain an interest in client's property in order to secure the amount of the member's past due or future fees.</p>	<p>[16] ...paragraph (i) sets forth exceptions for liens authorized by law to secure the lawyer's fees or expenses and contracts for reasonable contingent fees....When a lawyer acquires by contract a security</p>	

CA Rule 3-300 – Avoiding Interests Adverse to a Client	ABA Model Rule 1.8 (a) and (i) – Conflict of Interest: Current Clients: Specific Rules	Comments
	<p>interest in property other than that recovered through the lawyer’s efforts in the litigation, such an acquisition is a business or financial transaction with a client and is governed by the requirements of paragraph (a).</p>	