

**Rule 1.8.1 [3-300]<sup>1</sup> Business Transactions with a Client and Acquiring Adverse Pecuniary Interests<sup>2</sup>**

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.<sup>3</sup>

***Comment*<sup>4</sup>**

[1]<sup>5</sup> A lawyer's legal skill and training, together with the relationship of trust and confidence between lawyer and client, create the possibility of overreaching when the lawyer participates in a business, property or financial transaction with a client, for example, a loan or sales transaction or a lawyer investment on behalf of a client.<sup>6</sup>

[2]<sup>7</sup> The requirements of rule 1.8.1 must be met even when the transaction or acquisition is not closely related to the subject matter of the representation, as when a lawyer drafting a will for a client learns that the client needs money for unrelated expenses and offers to make a loan to the client. 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.<sup>8</sup>

[3] Rule 1.8.1 is not intended to apply to ordinary agreements by which a lawyer is retained by a client. Such agreements are governed, in part, by rule 4-200 [rule 1.5].<sup>9</sup> However, Rule 1.8.1 is intended to apply when the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client, such as when the lawyer obtains an interest in the client's property to secure the amount of the lawyer's past due or future fees. (See *Fletcher v. Davis*

(2004) 33 Cal.4<sup>th</sup> 61, [14 Cal. Rptr.3d 58] [lawyer’s agreement with client, authorizing a lien for payment of hourly attorney fees to be imposed against any recovery in litigation, must comply with rule 1.8.1].<sup>10</sup> An agreement to pay a lawyer a sum to be applied to fees or costs the lawyer incurs in the future is not an ownership, possessory, security, or other pecuniary interest adverse to client for purposes of rule 1.8.1.<sup>11</sup> Rule 1.8.1 is not intended to apply to an agreement with a client for a reasonable contingent fee in a civil case.<sup>12</sup>

[4] An ownership, possessory, security or other pecuniary interest adverse to a client arises when a lawyer acquires an interest in a client’s property where it is reasonably foreseeable that the acquisition may become detrimental to the client, even when the lawyer’s interest is to aid the client. (*Hawk v. State Bar* (1988) 45 Cal.3d 589 247 Cal. Rptr. 599.) Such an adverse interest arises when the lawyer’s personal financial interest conflicts with the client’s interest in the property, when the lawyer obtains an interest in the cause of action or subject matter of litigation or other matter the lawyer is conducting for the client and when the interest can be used to summarily extinguish the client’s interest in the client’s property. (See *Fletcher v. Davis* (2004) 33 Cal.4<sup>th</sup> 61, [14 Cal. Rptr.3d 58].)<sup>13</sup> Rule 1.8.1 is not intended to apply when a lawyer has a pre-existing interest in the subject matter of the matter in which the lawyer is representing the client; however, the lawyer is required to disclose the interest to the client under rule 1.7. (Rule 3-310(b)(4).)<sup>14</sup>

[5] Under rule 1.8.1, a pecuniary interest adverse to a client also arises when a lawyer acquires an interest in an obligation owned to a client or acquires an interest in an entity indebted to a client. (See *Rodgers v. State Bar* (1989) 48 Cal.3d 300 [256 Cal.Rptr. 381]; *Kapelus v. State Bar* (1987) 44 Cal.3d 179 [242 Cal. Rptr. 196].)<sup>15</sup>

[6] Rule 1.8.1 is intended to apply to transactions that arise out of the lawyer-client relationship or the trust and confidence reposed by the client in the lawyer as a result of the lawyer-client relationship. See, e.g., *Beery v. State Bar* (1987) 43 Cal.3d 802, 813, [239 Cal.Rptr. 121].<sup>16</sup> In such transactions, the lawyer has no advantage in dealing with the client, and the requirements of rule 1.8.1 are unnecessary or impractical.<sup>17</sup> Therefore, Rule 1.8.1 would not 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 1.8.1 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.<sup>18</sup>

[7]<sup>19</sup> The requirement for full disclosure in writing in rule 1.8.1(A) requires a lawyer to provide the client with the same advice regarding the transaction or acquisition that the lawyer would provide to the client in the transaction with a third party. (*Beery v. State Bar* (1987) 43 Cal.3d 802 [239 Cal. Rptr. 121].) It requires a lawyer to truthfully inform the client of all of the terms and all relevant facts of the transaction or acquisition, including the nature and extent of the lawyer's role and compensation in connection the transaction or acquisition. It also requires the lawyer to fully inform the client of the risks of the transaction or acquisition and facts that might discourage the client from engaging in the transaction or acquisition. (See *Rodgers v. State Bar* (1989) 48 Cal.3d 300 [256 Cal. Rptr. 381]; *Clancy v. State Bar* (1969) 71 Cal.2d 140 [77 Cal. Rptr. 657]; *Brockway v. State Bar* (1991) 53 Cal.3d 51 [278 Cal. Rptr. 836].)

[8] The risk to a client is greatest when the client expects the lawyer to represent the client in the transaction or acquisition itself or when the lawyer's financial interest otherwise poses a significant risk that the lawyer's representation of the client will be materially limited by the lawyer's financial interest in the transaction or acquisition. Under rule 1.8.1, the lawyer must disclose the risks associated with the lawyer's dual role as both legal adviser and participant in the transaction or acquisition, such as the risk that the lawyer will structure the transaction or acquisition or give legal advice in a way that favors the lawyer's interests at the expense of the client.<sup>20</sup> The lawyer must also disclose the potential adverse affect on the lawyer-client relationship that may result from the lawyer's interests in the transaction or acquisition. The client consent requirement in rule 1.8.1(C) includes a requirement that the client consent to the risks to the lawyer's representation of the client, which the lawyer has disclosed to the client as required by rule 1.8.1.<sup>21</sup>

[9] In some cases, the lawyer's interest may be such that will preclude the lawyer from obtaining the client's consent to the transaction or acquisition, such as when the lawyer cannot continue to competently represent the client as a result of the transaction or acquisition. When a lawyer is precluded from obtaining a client's consent, the lawyer cannot enter into the transaction or acquisition with the client.<sup>22</sup>

[10] Under rule 1.8.1(b), a lawyer must encourage the client to seek the advice of an independent lawyer and may not imply that such advice is unnecessary. Independent lawyer is a lawyer who does not have a financial interest in the transaction or acquisition or is affiliated with the lawyer seeking the client's

consent. Once the lawyer has advised the client to seek the advice of an independent lawyer, the lawyer must afford the client a reasonable period of time to obtain such advice.<sup>23</sup>

[11] If the client is represented by an independent lawyer in the transaction or acquisition, rule 1.8.1(b) is inapplicable; however, the lawyer is still required to make full disclosure to the client in writing in rule 1.8.1(a). The fact that the client was independently represented in the transaction or acquisition is relevant in determining whether the terms of the transaction or acquisition are fair and reasonable to the client as rule 1.8.1(a) requires.<sup>2425</sup>

## Drafters' Notes

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<sup>1</sup> At the 2/4/05 meeting, rule 3-300 was designated rule 1.8.1.

<sup>2</sup> I am suggesting the title “Business Transactions with Clients and Acquiring Adverse Pecuniary Interests.” In my opinion, it provides more clarity than “Avoiding Interests Adverse to a Client,” which does not tell you what is covered by the rule. The title is more inclusive than “Business Transactions with a Client.” In my opinion, the current title is not helpful. It does not tell you that it is talking about business transactions and adverse pecuniary interests. It could just as easily be referring to accepting representations adverse to a client.

<sup>3</sup> At the 2/4/05 meeting, the RRC voted 7 to 0 (no abstentions) to retain the current language of rule 3-300.

<sup>4</sup> “Discussion” renamed “Comment” per RRC vote at 11/19/04 meeting.

<sup>5</sup> Comments [1] and [2] are derived from Comment [1] to Model Rule 1.8. I felt that Comment [1] is the Model Rule is too long and embraces too many concepts, which makes it hard to follow. I think the Comment would be easier to follow if broken up in to more management bites, which is the reason for the separate paragraphs.

<sup>6</sup> Comment [1] is verbatim of the first sentence in Comment [1] to the Model Rule.

<sup>7</sup> Comment [2] is verbatim of the second and third sentence in Comment [1] to the Model Rule, except for the reference to the rule and the reference to a transaction “or acquisition,” which tracks the current form in the 3-300 Discussion and picks up both business transactions and acquisition of pecuniary interests adverse to a client. The third sentence in the Model Rule makes a reference to M.R. 5.7, which I have also omitted.

<sup>8</sup> The fourth sentence of Model Rule 1.8 Comment [1] relates to purchasing property from a client’s estate, which is now covered under rule 4-300. I did not include it in the Comment for that reason. The remaining sentences in Model Rule 1.8 Comment [1] deal with fee arrangements and the like and “standard transactions”, which are picked up in Comments [3] and [6].

<sup>9</sup> At the 2/4/05 meeting, it was agreed to rewrite the second sentence to remove the ambiguous language “such an agreement,” which could refer to either of the two agreements referenced in the first sentence of the current Discussion paragraph. KEM rewrote both sentences to remove the ambiguity, but noted that the RRC may disagree with this approach. The current language emphasizes that rule 3-300 is not intended to apply to retainer agreements. KEM noted that emphasis was somewhat lost in the approach KEM took I have taken. An alternative formulation might be:

“Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client. Those agreements generally are governed, in part, by rule 4-200. However, rule 3-300 does apply where the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client.”

I agree with KEM’s concerns and have adopted the first two sentences of his formulation with one exception. I have changed the reference from “the agreement by which a lawyer is retained” to “ordinary agreements” by which a lawyer is retained. The term “ordinary” comes from Comment [1] to the Model Rule and provides some consistency with what we are going to say in the third sentence.

In addition, KEM's April 1, 2005, draft notes, At the 2/4/05 meeting, at the request of the Chair, Tony Voogd agreed to continue to work on language similar to the language in his 8/9/04 memo concerning the inherent conflict of interest in client-lawyer fee negotiations. It was the RRC's consensus that this was not a rule 3-300 issue. It was suggested that the concept might be placed in rule 4-200.

<sup>10</sup> This first part of the third sentence tracks the current language of the 3-300 Comment, but places it in a separate sentence as KEM suggested in Endnote 9. I have appended to that sentence the reference to *Fletcher* that was in Comment [3] of our prior draft. What we are saying about *Fletcher* is an example of a security interest in a fee agreement that would trigger the rule. I have left in the citation and explanation of *Fletcher* that was in the prior draft; however,

KEM's notes on the prior draft note, "At the 2/4/05 meeting, the RRC voted 5 to 2 (1 abstention) to direct the drafting team to tinker with *Fletcher* to identify problems in the case and, in essence, invite the Supreme Court to overrule it by adoption of this rule. One suggestion was to give the Supreme Court a mechanism for doing this by identifying that the problem *Fletcher* sought to solve was not a 3-300 problem, but rather a 4-100 problem. In the alternative, the drafting was directed to cite to *Fletcher* with a brief description of its holding. That is the purpose of the added language in comment [3]." However, I recommend deleting the reference to *Fletcher* given the debate over its application to contingent fee arrangements. I propose we address *Fletcher* as I have in Comment [4].

<sup>11</sup> At the 2/4/05 meeting, the drafting team agreed to include a comment addressing an "advance fee" to the effect that it is not a security interest and so not subject to rule 3-300. It was suggested that this would help address the issue not addressed by Baranowski (1979) 24 Cal.3d 153, 593 P.2d 613, 154 Cal.Rptr. 752 and misaddressed in T&R Foods (1996) 47 Cal.App.4th Supp. 1, 56 Cal.Rptr.2d 41. This sentence deals with the advance fee issue.

<sup>12</sup> This sentence deals with contingent fees. It tracks Model Rule 1.8(i).

<sup>13</sup> The first two sentences are taken from *Fletcher*, which, in turn, cites *Hawk*. The second sentence has been revised a bit over the discussion in *Fletcher* in that it refers to when the lawyer obtains an interest in the cause of action or subject matter of litigation or other matter the lawyer is conducting for the client so that it is not limited to litigation situations.

<sup>14</sup> The last sentence deals with the relationship between 1.8 and the interest in the subject matter rule in 3-310(B)(4), which will be in new rule 1.7. Basically it says if you are entering into the transaction by which you are acquiring the interest, it is rule 1.8. If it is pre-existing, it is 1.7. This will cause a difference between our rule and the Model Rules. It appears from Comment [3] in the Model Rule that the lawyer who enters into a transaction or acquires an interest that gives the lawyer an interest in the subject matter must comply with both 1.8 and 1.7. Our jurisprudence has put all of it under 3-300 (1.8.1), see *Matter of Lane* (Rev. Dept. 1994) 2 State Bar Bar Ct. Rptr. 735.

We could go either way on this one and the practical result would be the same. I prefer to keep the two rules separate so that we don't end up with people trying to push 1.8.1 beyond where it should go or pushing 1.7 (3-310(B)(4)) beyond where it should go as was the case at COPRAC at one time.

<sup>15</sup> This Comment is intended to pick up *Kapelus* and *Rodgers*, which are adverse pecuniary interest cases that do not squarely fall under the general rule described in Comment [4]. I added

this in the interest of full disclosure. If we are going to tell people what an adverse pecuniary interest is, we need to pick up these cases.

<sup>16</sup> At the 2/4/05 meeting, the RRC’s consensus was to include the language from State Bar Formal Opn. 1994-141, concerning the kinds of transactions to which 3-300 is intended to apply, with a cite to Beery. See my 9/20/04 memo, at page 1. It was suggested that this would also obviate the proposed definition of “client” in the OCTC’s 9/27/2001 memo.

<sup>17</sup> This sentence is taken verbatim from the last sentence of Comment [1] to the Model Rule.

<sup>18</sup> The remainder of the Comment is from the current Discussion. It generally tracks the concepts in Comment [1] in the Model Rule, but is not the same.

<sup>19</sup> This Comment is intended to address what is encompassed by full disclosure in writing. I added it as a prelude to the lawyer interest in the representation discussion that follows.

<sup>20</sup> This Comment addresses the lawyer conflict issues resulting in the transaction. The first two sentences are the first and third sentences of Comment [3] to the Model Rule. I did not include the second sentence of Comment [3] of the Model Rule, which treats these issues under 1.7. For the reasons explained above, I believe these issues should continue to be addressed under 1.8.1.

<sup>21</sup> The last two sentences deal with the affect on the lawyer-client relationship issues that were mentioned in *Matter of Lane*. There is nothing in the Model Rule Comment that addresses this.

<sup>22</sup> This Comment addresses the unwaiveable conflict situation. It is adapted from the last sentence of Comment [3] to the Model Rule.

<sup>23</sup> This Comment addresses the independent lawyer issues. It is intended to tract *Rose v. State Bar* (1989) 49 Cal.3d 663 and *Conner v. State Bar* (1990) 50 Cal.3d 1047. This Comment also serves as a preface to the next Comment.

<sup>24</sup> KEM’s notes from the last draft indicate, “At the 2/4/05 meeting, the drafting team agreed to include a comment addressing the situation in which a sophisticated client is already represented by a lawyer when the member is retained by the client and whether the member may negotiate directly with the client notwithstanding rule 2-100.” This Comment addresses the first of these issues.

This Comment is an adaptation of Comment [4] to the Model Rule. This Comment differs from Comment [4] in the Model Rule in that Comment [4] states that “the requirement for full disclosure is satisfied either by a written disclosure by the lawyer involved in the transaction or by the client’s independent counsel.” Our Comment says “the lawyer is still required to make full disclosure to the client in writing in rule 1.8.1(a).” In my view, a lawyer should still be required to disclosure what he or she knows and not be able to have a defense to his or her concealment based on the fact that the client had another lawyer who either was not in a position to know what the lawyer knew and failed to find the information or give the advice for any reason.

I do not think we should address the 2-100 issue here. A lawyer who is a party to a matter may communicate directly with a represented party. If we are going change the rule when it comes to negotiating a fee agreement, the place to do it is not in this rule, but in rule –2-100.

<sup>25</sup> Imputation: I have not addressed imputation in this draft. In my opinion, I don’t think there should be imputation for this rule. If there is no lawyer-client relationship between the client and the lawyer in the firm, I don’t see the potential for overreaching that occurs when there is a direct relationship. If the client reasonably believes that that lawyer is also acting as the client’s

lawyer, the rule should apply. Our rule is broad enough to pick that up. But if the expectation is not there, why are we imputing the rule? I fail to see the purpose it would serve.

**Rule 1.8.1 [3-300]<sup>1</sup> . ~~Avoiding Interests Adverse to a Client Business Transactions with a Client and Acquiring Adverse Pecuniary Interests~~<sup>2</sup>**

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.<sup>3</sup>

*Comment*<sup>4</sup>

[1]<sup>5</sup> ~~Rule 1.8.1 applies to~~ **A lawyer's legal skill and training, together with the relationship of trust and confidence between lawyer and client, create the possibility of overreaching when the lawyer participates in a business, property or financial transaction with a client, for example, a loan or sales transaction or a lawyer investment on behalf of a client.**<sup>6</sup>

[2]<sup>7</sup> **The requirements of rule 1.8.1 must be met even when the transaction or acquisition is not closely related to the subject matter of the representation, as when a lawyer drafting a will for a client learns that the client needs money for unrelated expenses and offers to make a loan to the client. 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.**<sup>8</sup>

[3] **Rule 1.8.1 is not intended to apply to ordinary** agreements by which a member lawyer is retained by a client, ~~only where the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client.~~ **Other Such** agreements by which a member is retained by a client are governed, in part, by rule 4-200 [rule 1.5].<sup>9</sup> **However, Rule 1.8.1 is intended to apply when the agreement confers on the member an ownership,**

possessory, security, or other pecuniary interest adverse to the client, such as when the lawyer obtains an interest in the client's property to secure the amount of the lawyer's past due or future fees. (See *Fletcher v. Davis* (2004) 33 Cal.4<sup>th</sup> 61, [14 Cal. Rptr.3d 58] [lawyer's agreement with client, authorizing a lien for payment of hourly attorney fees to be imposed against any recovery in litigation, must comply with rule 1.8.1].)<sup>10</sup> An agreement to pay a lawyer a sum to be applies to fees or costs the lawyers incurs in the future is not an ownership, possessory, security, or other pecuniary interest adverse to client for purposes of rule 1.8.1.<sup>11</sup> Rule 1.8.1 is not intended to apply to an agreement with a client for a reasonable contingent fee in a civil case.<sup>12</sup>

[4] An ownership, possessory, security or other pecuniary interest adverse to a client arises when a lawyer acquires an interest in a client's property where it is reasonably foreseeable that the acquisition may become detrimental to the client, even when the lawyer's interest is to aid the client. (*Hawk v. State Bar* (1988) 45 Cal.3d 589 247 Cal. Rptr. 599[.]) Such an adverse interest arises when the lawyer's personal financial interest conflicts with the client's interest in the property, when the lawyer obtains an interest in the cause of action or subject matter of litigation or other matter the lawyer is conducting for the client and when the interest can be used to summarily extinguish the client's interest in the client's property. (See *Fletcher v. Davis* (2004) 33 Cal.4<sup>th</sup> 61, [14 Cal. Rptr.3d 58].)<sup>13</sup> Rule 1.8.1 is not intended to apply when a lawyer has a pre-existing interest in the subject matter of the matter in which the lawyer is representing the client; however, the lawyer is required to disclosure the interest to the client under rule 1.7. (Rule 3-310(b)(4).)<sup>14</sup>

[5] Under rule 1.8.1, a pecuniary interest adverse to a client also arises when a lawyer acquires an interest in an obligation owned to a client or acquires an interest in an entity indebted to a client. (See *Rodgers v. State Bar* (1989) 48 Cal.3d 300 [256 Cal.Rptr. 381]; *Kapelus v. State Bar* (1987) 44 Cal.3d 179 [242 Cal. Rptr. 196].)<sup>15</sup>

[6[2] Rule 1.8.1 is intended to apply to transactions that arise out of the lawyer-client relationship or the trust and confidence reposed by the client in the lawyer as a result of the lawyer-client relationship. See, e.g., *Beery v. State Bar* (1987) 43 Cal.3d 802, 813, [239 Cal.Rptr. 121].<sup>16</sup> In such transactions, the lawyer has no advantage in dealing with the client, and the requirements of rule 1.8.1 are unnecessary or impractical.<sup>17</sup> Therefore, Rule 1.8.1 would not 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 1.8.1 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.<sup>18</sup>

[3] ~~Rule 1.8.1 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. See *Fletcher v. Davis* (2004) 33 Cal.4th 61, [14 Cal.Rptr.3d 58] (attorney's agreement with client, authorizing a lien for payment of hourly attorney fees to be imposed against any recovery in the litigation, must comply with rule 3-300 [the predecessor to rule 1.8.1].) 7]~~<sup>19</sup> **The requirement for full disclosure in writing in rule 1.8.1(A) requires a lawyer to provide the client with the same advice regarding the transaction or acquisition that the lawyer would provide to the client in the transaction with a third party. (*Beery v. State Bar* (1987) 43 Cal.3d 802 [239 Cal. Rptr. 121].) It requires a lawyer to truthfully inform the client of all of the terms and all relevant facts of the transaction or acquisition, including the nature and extent of the lawyer's role and compensation in connection the transaction or acquisition. It also requires the lawyer to fully inform the client of the risks of the transaction or acquisition and facts that might discourage the client from engaging in the transaction or acquisition. (See *Rodgers v. State Bar* (1989) 48 Cal.3d 300 [256 Cal. Rptr. 381]; *Clancy v. State Bar* (1969) 71 Cal.2d 140 [77 Cal. Rptr. 657]; *Brockway v. State Bar* (1991) 53 Cal.3d 51 [278 Cal. Rptr. 836].)**

[4]

[8] **The risk to a client is greatest when the client expects the lawyer to represent the client in the transaction or acquisition itself or when the lawyer's financial interest otherwise poses a significant risk that the lawyer's representation of the client will be materially limited by the lawyer's financial interest in the transaction or acquisition. Under rule 1.8.1, the lawyer must disclose the risks associated with the lawyer's dual role as both legal adviser and participant in the transaction or acquisition, such as the risk that the lawyer will structure the transaction or acquisition or give legal advice in a way that favors the lawyer's interests at the expense of the client.**<sup>20</sup> **The lawyer must also disclose the potential adverse affect on the lawyer-client relationship that may result from the lawyer's interests in the transaction or acquisition. The client consent requirement in rule 1.8.1(C) includes a requirement that the client consent to the risks to the lawyer's representation**

of the client, which the lawyer has disclosed to the client as required by rule 1.8.1.<sup>21</sup>

[9] In some cases, the lawyer's interest may be such that will preclude the lawyer from obtaining the client's consent to the transaction or acquisition, such as when the lawyer cannot continue to competently represent the client as a result of the transaction or acquisition. When a lawyer is precluded from obtaining a client's consent, the lawyer cannot enter into the transaction or acquisition with the client.<sup>22</sup>

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**RRC – Rule 1.8.1 [3-300]**  
**Draft 1 (1/13/2006) – Following 4/1/2005 Meeting**  
**Drafters’ Notes**

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<sup>1</sup> At the 2/4/05 meeting, rule 3-300 was designated rule 1.8.1.

<sup>2</sup> I am suggesting the title “Business Transactions with Clients and Acquiring Adverse Pecuniary Interests.” In my opinion, it provides more clarity than “Avoiding Interests Adverse to a Client,” which does not tell you what is covered by the rule. The title is more inclusive than “Business Transactions with a Client.” In my opinion, the current title is not helpful. It does not tell you that it is talking about business transactions and adverse pecuniary interests. It could just as easily be referring to accepting representations adverse to a client.

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<sup>5</sup> Comments [1] and [2] are derived from Comment [1] to Model Rule 1.8. I felt that Comment [1] is the Model Rule is too long and embraces too many concepts, which makes it hard to follow. I think the Comment would be easier to follow if broken up in to more management bites, which is the reason for the separate paragraphs.

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“Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client. Those agreements generally are governed, in part, by rule 4-200. However, rule 3-300 does apply where the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client.”

I agree with KEM’s concerns and have adopted the first two sentences of his formulation with one exception. I have changed the reference from “the agreement by which a lawyer is retained” to “ordinary agreements” by which a lawyer is retained. The term “ordinary” comes from Comment [1] to the Model Rule and provides some consistency with what we are going to say in the third sentence.

In addition, KEM's April 1, 2005, draft notes, At the 2/4/05 meeting, at the request of the Chair, Tony Voogd agreed to continue to work on language similar to the language in his 8/9/04 memo concerning the inherent conflict of interest in client-lawyer fee negotiations. It was the RRC's consensus that this was not a rule 3-300 issue. It was suggested that the concept might be placed in rule 4-200.

<sup>10</sup> This first part of the third sentence tracks the current language of the 3-300 Comment, but places it in a separate sentence as KEM suggested in Endnote 9. I have appended to that sentence the reference to *Fletcher* that was in Comment [3] of our prior draft. What we are saying about *Fletcher* is an example of a security interest in a fee agreement that would trigger the rule. I have left in the citation and explanation of *Fletcher* that was in the prior draft; however,

KEM's notes on the prior draft note, "At the 2/4/05 meeting, the RRC voted 5 to 2 (1 abstention) to direct the drafting team to tinker with *Fletcher* to identify problems in the case and, in essence, invite the Supreme Court to overrule it by adoption of this rule. One suggestion was to give the Supreme Court a mechanism for doing this by identifying that the problem *Fletcher* sought to solve was not a 3-300 problem, but rather a 4-100 problem. In the alternative, the drafting was directed to cite to *Fletcher* with a brief description of its holding. That is the purpose of the added language in comment [3]." However, I recommend deleting the reference to *Fletcher* given the debate over its application to contingent fee arrangements. I propose we address *Fletcher* as I have in Comment [4].

<sup>11</sup> At the 2/4/05 meeting, the drafting team agreed to include a comment addressing an "advance fee" to the effect that it is not a security interest and so not subject to rule 3-300. It was suggested that this would help address the issue not addressed by Baranowski (1979) 24 Cal.3d 153, 593 P.2d 613, 154 Cal.Rptr. 752 and misaddressed in T&R Foods (1996) 47 Cal.App.4th Supp. 1, 56 Cal.Rptr.2d 41. This sentence deals with the advance fee issue.

<sup>12</sup> This sentence deals with contingent fees. It tracks Model Rule 1.8(i).

<sup>13</sup> The first two sentences are taken from *Fletcher*, which, in turn, cites *Hawk*. The second sentence has been revised a bit over the discussion in *Fletcher* in that it refers to when the lawyer obtains an interest in the cause of action or subject matter of litigation or other matter the lawyer is conducting for the client so that it is not limited to litigation situations.

<sup>14</sup> The last sentence deals with the relationship between 1.8 and the interest in the subject matter rule in 3-310(B)(4), which will be in new rule 1.7. Basically it says if you are entering into the transaction by which you are acquiring the interest, it is rule 1.8. If it is pre-existing, it is 1.7. This will cause a difference between our rule and the Model Rules. It appears from Comment [3] in the Model Rule that the lawyer who enters into a transaction or acquires an interest that gives the lawyer an interest in the subject matter must comply with both 1.8 and 1.7. Our jurisprudence has put all of it under 3-300 (1.8.1), see *Matter of Lane* (Rev. Dept. 1994) 2 State Bar Ct. Rptr. 735.

We could go either way on this one and the practical result would be the same. I prefer to keep the two rules separate so that we don't end up with people trying to push 1.8.1 beyond where it should go or pushing 1.7 (3-310(B)(4)) beyond where it should go as was the case at COPRAC at one time.

<sup>15</sup> This Comment is intended to pick up *Kapelus* and *Rodgers*, which are adverse pecuniary interest cases that do not squarely fall under the general rule described in Comment [4]. I added

this in the interest of full disclosure. If we are going to tell people what an adverse pecuniary interest is, we need to pick up these cases.

<sup>16</sup> At the 2/4/05 meeting, the RRC’s consensus was to include the language from State Bar Formal Opn. 1994-141, concerning the kinds of transactions to which 3-300 is intended to apply, with a cite to Beery. See my 9/20/04 memo, at page 1. It was suggested that this would also obviate the proposed definition of “client” in the OCTC’s 9/27/2001 memo.

<sup>17</sup> This sentence is taken verbatim from the last sentence of Comment [1] to the Model Rule.

<sup>18</sup> The remainder of the Comment is from the current Discussion. It generally tracks the concepts in Comment [1] in the Model Rule, but is not the same.

<sup>19</sup> This Comment is intended to address what is encompassed by full disclosure in writing. I added it as a prelude to the lawyer interest in the representation discussion that follows.

<sup>20</sup> This Comment addresses the lawyer conflict issues resulting in the transaction. The first two sentences are the first and third sentences of Comment [3] to the Model Rule. I did not include the second sentence of Comment [3] of the Model Rule, which treats these issues under 1.7. For the reasons explained above, I believe these issues should continue to be addressed under 1.8.1.

<sup>21</sup> The last two sentences deal with the affect on the lawyer-client relationship issues that were mentioned in *Matter of Lane*. There is nothing in the Model Rule Comment that addresses this.

<sup>22</sup> This Comment addresses the unwaiveable conflict situation. It is adapted from the last sentence of Comment [3] to the Model Rule.

<sup>23</sup> This Comment addresses the independent lawyer issues. It is intended to tract *Rose v. State Bar* (1989) 49 Cal.3d 663 and *Conner v. State Bar* (1990) 50 Cal.3d 1047. This Comment also serves as a preface to the next Comment.

<sup>24</sup> KEM’s notes from the last draft indicate, “At the 2/4/05 meeting, the drafting team agreed to include a comment addressing the situation in which a sophisticated client is already represented by a lawyer when the member is retained by the client and whether the member may negotiate directly with the client notwithstanding rule 2-100.” This Comment addresses the first of these issues.

This Comment is an adaptation of Comment [4] to the Model Rule. This Comment differs from Comment [4] in the Model Rule in that Comment [4] states that “the requirement for full disclosure is satisfied either by a written disclosure by the lawyer involved in the transaction or by the client’s independent counsel.” Our Comment says “the lawyer is still required to make full disclosure to the client in writing in rule 1.8.1(a).” In my view, a lawyer should still be required to disclosure what he or she knows and not be able to have a defense to his or her concealment based on the fact that the client had another lawyer who either was not in a position to know what the lawyer knew and failed to find the information or give the advice for any reason.

I do not think we should address the 2-100 issue here. A lawyer who is a party to a matter may communicate directly with a represented party. If we are going change the rule when it comes to negotiating a fee agreement, the place to do it is not in this rule, but in rule –2-100.

<sup>25</sup> Imputation: I have not addressed imputation in this draft. In my opinion, I don’t think there should be imputation for this rule. If there is no lawyer-client relationship between the client and the lawyer in the firm, I don’t see the potential for overreaching that occurs when there is a direct relationship. If the client reasonably believes that that lawyer is also acting as the client’s

lawyer, the rule should apply. Our rule is broad enough to pick that up. But if the expectation is not there, why are we imputing the rule? I fail to see the purpose it would serve.