NINETEENTH ANNUAL STATEWIDE

ETHICS SYMPOSIUM

THOMAS JEFFERSON SCHOOL OF LAW, SAN DIEGO

Brave New World: Legal Ethics for Today

- **The Net: Law Firm Cybersecurity**
- **Déjà vu All Over Again: Brainstorming the New California Rules Project**
- **The Color of Money: Alternative Litigation Funding**
- **Liar, Liar: Negotiation Ethics**

April 2015

This program is presented by The State Bar of California
Committee on Professional Responsibility and Conduct.

NINETEENTH ANNUAL STATEWIDE ETHICS SYMPOSIUM
SATURDAY, APRIL 25, 2015
THOMAS JEFFERSON SCHOOL OF LAW, SAN DIEGO

Program Schedule

Registration	8:30	–	9:30 am
Welcoming Remarks	9:30	–	9:45 am
Panel 1	9:45	–	11:00 am
Break	11:00	–	11:15 am
Panel 2	11:15	–	12:30 pm
Networking Lunch	12:30	–	1:30 pm
Panel 3	1:30	–	2:45 pm
Break	2:45	–	3:00 pm
Panel 4	3:00	–	4:15 pm

WELCOMING REMARKS

Scott B. Garner: Chair, Committee on Professional Responsibility and Conduct
Professor Steven Berenson: Professor of Law, Thomas Jefferson School of Law
Heather L. Rosing: Vice-President, State Bar of California

- **PANEL ONE**
  THE NET: LAW FIRM CYBERSECURITY

- **PANEL TWO**
  DÉJÀ VU ALL OVER AGAIN: BRAINSTORMING THE NEW CALIFORNIA RULES PROJECT

LUNCH

- **PANEL THREE**
  THE COLOR OF MONEY: ALTERNATIVE LITIGATION FUNDING

- **PANEL FOUR**
  LIAR, LIAR: NEGOTIATION ETHICS

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Scott Garner, Chair **Irvine, CA**

Scott Garner is a partner in the Irvine office of Morgan, Lewis & Bockius LLP. He serves as a deputy leader of the Southern California Litigation Group and as one of the firm's loss prevention partners. His practice focuses on complex business litigation, with an emphasis on attorney liability defense. He also has significant experience in the areas of securities litigation, intellectual property litigation, corporate governance, and hospital and health care law. Mr. Garner currently serves as Chair of the State Bar's Committee on Professional Responsibility and Conduct and is the Co-Chair of the Orange County Bar Association's Professionalism and Ethics Committee. He also serves as a member of the Board of Directors of the Orange County Bar Association and as Vice President of the Orange County Chapter of the Association of Business Trial Lawyers. He is a frequent author of ethics-related articles. Mr. Garner graduated cum laude from Harvard Law School in 1991, and received his B.A. degree with distinction from Stanford University in 1988.

Merri A. Baldwin, Vice Chair **San Francisco, CA**

Merri Baldwin is a shareholder in the San Francisco office of Rogers Joseph O'Donnell, P.C. Ms. Baldwin's practice focuses on business litigation and attorney liability and conduct. She is vice-chair of the State Bar's Standing Committee on Professional Responsibility and Conduct and is a certified legal specialist in Legal Malpractice Law, California Board of Legal Specialization. Ms. Baldwin is a member of the executive committee of the Bar Association of San Francisco's Legal Malpractice section and is a vice-chair of the American Bar Association Litigation Section's Professional Services Litigation Committee. She is an adjunct professor at Golden Gate University School of Law, and speaks and writes frequently on legal ethics and professional responsibility matters. She co-edited The Law of Lawyers' Liability (2012, First Chair Press.) Ms. Baldwin received her law degree from the UC Berkeley School of Law, where she was co-editor-in-chief of the Berkeley Women's Law Journal. She graduated magna cum laude from Smith College, and was a Fulbright Scholar at the London School of Economics. Ms. Baldwin is the Treasurer of the Bar Association of San Francisco for 2015.

Wendy Wen Yun Chang, Advisor **Los Angeles, CA**

Wendy Wen Yun Chang, Partner, Hinshaw & Culbertson LLP, Los Angeles, represents businesses in all types of business litigation, with particular emphasis in high exposure complex litigation, trials and appeals. She also represents lawyers in all types of complex matters that involve the practice of the law, including risk management counseling, ethics, crises management, fee related issues, discipline defense, and litigation defense. Ms. Chang is the immediate past Chair of, and the current Advisor to, the State Bar of California Standing Committee on Professional Responsibility & Conduct (COPRAC). Ms. Chang is also an Advisor to the State Bar of California's Commission for the Revisions of the Rules of Professional Conduct. Ms. Chang is a Certified Specialist in Legal Malpractice Law by the State Bar of California's Board of Legal Specialization. Ms. Chang also serves as Co-Chair of the Judiciary Committee for the National Asian Pacific American Bar Association. In addition, Ms. Chang serves on the Professional Responsibility and Ethics Committee (PREC) and the State Appellate Judicial Evaluation Committee for the Los Angeles County Bar Association. Ms. Chang received her J.D. from Loyola Law School, Los Angeles, and her B.A. from the University of California, at Los Angeles.

SPECIAL GUESTS

Heather L. Rosing, Vice-President **Irvine, CA**

Ms. Rosing is a shareholder and CFO for Klinedinst PC in San Diego. A graduate of the University of Illinois and Northwestern University School of Law, she is Chairperson of her firm's Professional Liability Team, which litigates complex malpractice and fraud cases and advises in the areas of ethics and risk management. Ms. Rosing currently serves as Vice-President of the State Bar of California. She previously served as the organization's Treasurer and Chair of the Regulations, Admissions, and Discipline Oversight Committee. In 2008 she served as President of the San Diego County Bar Association, where she established a nationally recognized pro bono program to assist active duty military personnel under the Servicemembers Civil Relief Act. A certified specialist in legal malpractice and a former member of the ABA Standing Committee on Lawyers' Professional Liability, Ms. Rosing donates much of her time to speaking and teaching free of charge on ethics and professionalism across the state and country. Also the recipient of numerous accolades, Ms. Rosing was most recently awarded Lawyer of the Year by the San Diego Defense Lawyers <http://sddl.org> (2015), the Exemplary Service Award by the San Diego Volunteer Lawyer Program <http://www.sdvlp.org> (2014), and # 1 Attorney in San Diego County by Southern California Super Lawyers® (2014).

Steven Berenson, Professor of Law, Thomas Jefferson School of Law **San Diego, CA**

Following graduation from law school, where he served as Trial Operations Director of the Harvard Defenders, Professor Berenson clerked for Justice Edith W. Fine of the Massachusetts Appeals Court. He then spent more than five years as an Assistant Massachusetts Attorney General, where he focused on civil litigation in the areas of administrative, constitutional and consumer protection law. During that time, Professor Berenson also served as a Supreme Court Fellow with the National Association of Attorneys General. He then spent two years as a teaching fellow in Harvard Law School's Lawyering Program, while at the same time earning an LL.M. degree at Harvard University. Professor Berenson spent four years at Nova Southeastern University's Shepard Broad Law Center, teaching in the school's Lawyering Skills and Values Program and its Children and Family Law Clinic, in addition to teaching traditional courses in Professional Responsibility and Elder Law. He has published articles on topics including attorney professional role, access to justice and clinic legal education in journals such as the Fordham Law Review, the Boston College Law Review, the San Diego Law Review, the Rutgers Law Journal and the Elder Law Journal. Professor Berenson is a member of the state bars of Massachusetts, Florida and California. He currently teaches Family Law and Professional Responsibility at Thomas Jefferson School of Law in San Diego, and is the law school's director of the Veterans Legal Assistance Clinic. LL.M., Harvard University; J.D., Harvard University, magna cum laude; B.A., Franklin and Marshall College, magna cum laude.

TAB 1

The Net: Law Firm Cybersecurity

THE NET: LAW FIRM CYBERSECURITY

Wendy Wen Yun Chang, Panel Moderator **Los Angeles, CA**

Wendy Wen Yun Chang, Partner, Hinshaw & Culbertson LLP, Los Angeles, represents businesses in all types of business litigation, with particular emphasis in high exposure complex litigation, trials and appeals. She also represents lawyers in all types of complex matters that involve the practice of the law, including risk management counseling, ethics, crises management, fee related issues, discipline defense, and litigation defense. Ms. Chang is the immediate past Chair of, and the current Advisor to, the State Bar of California Standing Committee on Professional Responsibility & Conduct (COPRAC). Ms. Chang is also an Advisor to the State Bar of California's Commission for the Revisions of the Rules of Professional Conduct. Ms. Chang is a Certified Specialist in Legal Malpractice Law by the State Bar of California's Board of Legal Specialization. Ms. Chang also serves as Co-Chair of the Judiciary Committee for the National Asian Pacific American Bar Association. In addition, Ms. Chang serves on the Professional Responsibility and Ethics Committee (PREC) and the State Appellate Judicial Evaluation Committee for the Los Angeles County Bar Association. Ms. Chang received her J.D. from Loyola Law School, Los Angeles, and her B.A. from the University of California, at Los Angeles.

Richard Egger **Ontario, CA**

Richard Egger is the managing partner of Best Best & Krieger's Ontario office and serves as the firm's General Counsel. The firm has 175 lawyers in offices in California and the District of Columbia. His practice includes representing clients in litigation in the areas of contract and real estate disputes, as well as and trust and estate matters. He is a member of the California State Bar Committee on Professional Responsibility and Competency (COPRAC). He has authored articles on "Ethical Rules for Selling a Law Practice," *California Bar Journal*, June 2013 and "Ethically Resolving Fee Disputes Using a Release That Encompasses Potential Malpractice Claims," *California Bar Journal*, April 2013. Mr. Egger has also spoken on various topics including "Email: The Client Mandate on Security," and "Complex Issues with Attorney-Client Privilege."

Tanya L. Forsheit **Los Angeles, CA**

Tanya Forsheit works with clients to address legal requirements and best practices for protection of customer and employee information. Tanya advises organizations across disciplines, from multinationals to startups, in compliance, transactions, and litigation matters involving the use, sharing, and protection of sensitive information, and serves as outside privacy counsel to a number of organizations. She also negotiates cloud computing arrangements on behalf of enterprise customers and service providers, has advised on more than 100 data security breaches, and represents clients in FTC investigations involving privacy and data security. Tanya brings more than 17 years of experience litigating complex disputes, as well as her cloud computing and social media knowledge, to bear in counseling clients on thorny issues in data management, information protection, and e-discovery. She is certified as an information privacy professional by the International Association of Privacy Professionals (IAPP).

Scott Garner **Irvine, CA**

Scott Garner is a partner in the Irvine office of Morgan, Lewis & Bockius LLP. He serves as a deputy leader of the Southern California Litigation Group and as one of the firm's loss prevention partners. His practice focuses on complex business litigation, with an emphasis on attorney liability defense. He also has significant experience in the areas of securities litigation, intellectual property litigation, corporate governance, and hospital and health care law. Mr. Garner currently serves as Chair of the State Bar's Committee on Professional Responsibility and Conduct and is the Co-Chair of the Orange County Bar Association's Professionalism and Ethics Committee. He also serves as a member of the Board of Directors of the Orange County Bar Association and as Vice President of the Orange County Chapter of the Association of Business Trial Lawyers. He is a frequent author of ethics-related articles. Mr. Garner graduated cum laude from Harvard Law School in 1991, and received his B.A. degree with distinction from Stanford University in 1988.

Wesley L. Hsu **Los Angeles, CA**

Wesley L. Hsu is the Chief of the Cyber and Intellectual Property Crimes Section at the United States Attorney's Office in Los Angeles. Wes has prosecuted a number of "first of its kind" and high profile cases, including the first prosecution in the nation for hacking an industrial control system, the first computer hacking jury trial convictions in the Central District of California, and the first convictions in the nation under the CAN-SPAM Act; he prosecuted cybercrimes against Erin Andrews, Scarlett Johansson, and is investigating the recent Sony Pictures Entertainment hack. Under Wes's leadership, his section has led the nation in prosecuting crimes against women involving the Internet, including prosecuting a previously uncharged crime: "sextortion." Wes teaches Cybercrimes at Loyola Law School. He was a law clerk for the Honorable Mariana R. Pfaelzer and attended both Yale College and Yale Law School.

THE NET: LAW FIRM CYBERSECURITY

LIST OF WRITTEN MATERIALS

1. Panel Outline

2. *Ethics "In The Breach,"* Steven M. Puiszis

3. *Ethical Rules Require Reasonable Care When Using Technology in the Practice of Law*, Wendy Wen Yun Chang, County Bar Update, Los Angeles County Bar, February 2012

Written materials can be downloaded at:
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State Bar of California
Nineteenth Annual Ethics Symposium 2015
"Brave New World: Legal Ethics for Today"
April 25, 2015
Thomas Jefferson School of Law, San Diego, CA

Panel 1: The Net: Law Firm Cyber Security[1]

1. The Ethics Rules

    a. Duty of Competence

        i. Rule 3-110[2]

        "(A) A member shall not intentionally, recklessly, or repeatedly fail to perform legal services with competence."

        "(B) . . . '[C]ompetence' . . . shall mean to apply the 1) diligence, 2) learning and skill, and 3) mental, emotional and physical ability reasonably necessary for the performance of such service."

        "(C) If a member does not have sufficient learning and skill when the legal service is undertaken, the member may nonetheless perform such services competently by 1) professional consulting another lawyer reasonable believed to be competent, or 2) by acquiring sufficient learning and skill before performance is required."

    b. Duty to Supervise

        i. Rule 3-110 Discussion: Duties set forth in rule 3-310 include the duty to supervise the work of subordinate attorney and non-attorney employees or agents.

            1. This includes clients and vendors.

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[1] ©Wendy Wen Yun Chang, Richard Egger, Tanya Forsheit, Scott Garner, Wesley Hsu, and David Majchrzak.

[2] All references herein to "Rules" are to the California Rules of Professional Conduct, unless otherwise noted.

ii. Model Rule 1.1 comment [8] – duty of competence requires lawyers to keep abreast of changes in the law including the risks and benefits of technology used in the delivery of legal services.

c. Duty of Confidentiality

i. Bus. & Prof. Code § 6068(e)(1): It is the duty of an attorney "[t]o maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client."

ii. Rule 3-100: Member may not reveal information protected by Section 6068(e)(1) without client's informed consent.

iii. The duty of confidentiality extends to former clients. *People v. SpeeDee Oil Change Sys., Inc.*, 20 Cal. 4th 1135, 1147 (1999); *see also* Model Rule 1.6, cmt. [20].

d. Duty of Confidentiality and Duty of Competence as Applied to Use of Technology

i. As applied to the use of technology, the duties of competence and confidentiality are somewhat blended, as the duty of competence requires attorney to safeguard the client's confidential information. ("[T]he manner in which an attorney acts to safeguard confidential client information is governed by the duty of competence." Cal. State Bar Formal Opn. No. 2010-179.)

ii. Attorney "must take reasonable precautions to prevent the information from coming into the hands of unintended recipients." (Cal. State Bar Formal Opn. No. 2010-179.

1. See also Model Rule 1.6(c).

iii. Factors to consider in determining reasonableness of precautions include "the sensitivity of the information and the extent to which the privacy of the communication is protected by law or by a confidentiality agreement." (Cal. State Bar Formal Opn. No. 2010-179).

iv. Opinion 2010-179 listed the following factors to consider before using a specific technology:

1. The attorney's ability to assess the level of security afforded by the technology.

a. How does the particular technology differ from other media used. (*E.g.*, mail vs. email.)

b. Whether reasonable precautions may be taken when using the technology. (*E.g.*, encrypting emails, password protection on mobile devices.)

c. Limitations on who is permitted to monitor the use of the technology. (*E.g.*, is outside service provider contractually permitted to access confidential information and/or disclose it?)

2. Legal ramifications to third parties of intercepting or accessing confidential information.

3. The degree of sensitivity of the information. (The greater the sensitivity, the less risks attorney should take.)

4. Possible impact on the client of an inadvertent disclosure, including possible waiver of privileges.

v. Evidence Code section 917(b) states that a communication "does not lose its privileged character for the sole reason that it is communicated by electronic means or because persons involved in the delivery, facilitation, or storage of electronic communication may have access to the content of the communication."

vi. Model Rule 1.6 cmt. [18]

1. Inadvertent disclosure does not constitute a violation of the rule "if the lawyer has made reasonable efforts to prevent the access or disclosure."

2. Factors to consider in determining whether the lawyer made reasonable efforts, including:

a. the sensitivity of the information,

b. the likelihood of disclosure if additional safeguards are not employed,

c. the cost of employing additional safeguards,

d. the difficulty of implementing the safeguards, and

e. the extent to which the safeguards adversely affect the lawyer's ability to represent clients (e.g., by making a device or important piece of software excessively difficult to use).

f. The urgency of the situation.

g. Client instructions and circumstances.

vii. State Bar Formal Opn. 2012-184 (VLO Opinion) discusses need to consult with someone more versed in technology, or to educate herself, if attorney lacks necessary competence to understand security issues.

1. This reasoning arguably applies as to all outsourced cloud based technology vendors.

2. Attorney should determine that the VLO vendor selected by her employs policies and procedures that at a minimum equal what Attorney herself would do on her own to comply with her duty of confidentiality.

3. *See also* Arizona Ethics Opinion No. 0904 (2009) ("[I]t is also important that lawyer recognize their own competence limitations regarding computer security measures and take the necessary time and energy to become competent or alternatively to consult available experts in the field.")

viii. State Bar Opn. 2012-184 discusses factors to consider when selecting a cloud-based vendor:

1. Credentials of vendor.

2. How secure is data.

a. What are vendor's protocols re data security.

b. Whether vendor transmits information in the cloud across jurisdictional boundaries.

c. Is client information subject to seizure by a foreign government?

i. What legal rights/remedies do you/client have in the event of such a seizure?

3. Attorney's ability to supervise vendor.

4. Terms of service with the vendor.

ix. Attorney needs to periodically reassess all of these factors as technologies and circumstances change. (State Bar Opn. 2012-184.)

x. *See also* Oregon Ethics Opinion No. 2011-188 ("As technology advances, the third party vendor's protective measures may become less secure.")

e. Duty to Maintain Client Files

i. Cal. Bus. & Prof. Code § 6068(e)(1)

Duty to "maintain inviolate the confidence, and at every peril to himself or herself, preserve the secrets of his or her client."

ii. Rule 4-100(B)(3)

Duty to maintain complete records of all funds, securities and other properties of a client coming in the possession of the member.

iii. Rule 3-110 (A) (See discussion above)

iv. Cal Formal Ethics Opinion 2010-179 (See discussion above)

v. Model Rules of Professional Conduct MRPC 1.6 Comment 18

Paragraph (c) [of Rule 1.6] requires a lawyer to act competently to safeguard information relating to the representation of a client against unauthorized access by third parties and against inadvertent or unauthorized disclosure by the lawyer or other persons who are participating in the representation of the client or who are subject to the lawyer's supervision.

f. Duty to Communicate

i. Rule 3-500

A member shall keep a client reasonably informed about significant developments relating to the employment or representation, including promptly complying with reasonable requests for information and copies of significant documents when necessary to keep the client so informed.

ii. *Neel v. Magana, Olney, Levy, Cathcart & Gelfand* (1971) 6 Cal.3d 176

1. attorneys have fiduciary obligation to disclose material facts to their clients;

2. “the fact that a client lacks awareness of a practitioner’s malpractice implies, in many cases, a second breach of duty by the fiduciary, namely, a failure to disclose material facts to his client.”

iii. Civil Code section 1798.29

Any agency that owns or licenses computerized data that includes personal information shall disclose any breach of the security of the system following discovery or notification of the breach in the security of the data to any resident of California whose unencrypted personal information was, or is reasonably believed to have been, acquired by an unauthorized person. The disclosure shall be made in the most expedient time possible and without unreasonable delay, consistent with the legitimate needs of law enforcement, as provided in subdivision (c), or any measures necessary to determine the scope of the breach and restore the reasonable integrity of the data system.

g. Conflicts of Interest

i. Rule 3-310(b)

(B) A member shall not accept or continue representation of a client without providing written disclosure to the client where:

(1) The member has a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; or

(2) The member knows or reasonably should know that:

(a) the member previously had a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; and

(b) the previous relationship would substantially affect the member's representation; or

(3) The member has or had a legal, business, financial, professional, or personal relationship with another person or entity the member knows or reasonably should know would be affected substantially by resolution of the matter; or

(4) The member has or had a legal, business, financial, or professional interest in the subject matter of the representation.

ii. Disclosure is defined as "informing the client or former client of the relevant circumstances and the actual and reasonably foreseeable consequences to the client or former client." Rule 3-310(A).

iii. ABA Formal Opinion 08-453

1. Applying the provisions of Model Rule 1.7, which defines a conflict as including a situation where "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person, or by a personal interest of the lawyer." Model Rule 1.7(a)(2).

2. The ABA opined that "[a] lawyer's effort to conform her conduct to applicable ethical standards is not an interest that will materially limit the lawyer's ability to represent the client.... In situations ... where the lawyer is seeking prophylactic advice to assist in her representation of the client, there is no significant risk that the lawyer's ability to consider, recommend, or carry out an appropriate course of action for the client will be materially limited by the lawyer's interest in avoiding ethical misconduct."

iv. Rule 1-100(A)

"The following rules are intended to regulate professional conduct of members of the State Bar through discipline. They have been adopted . . . to protect the public and to promote respect and confidence in the legal profession. . ."

v. New York State Bar Association Opinion 789 (2005)

"Clients are entitled to counsel who comply with applicable standards of professional responsibility. Those lawyers are entitled to seek advice on how best to comply with those standards, and to do so without apprehending that seeking the advice is itself a violation of those standards. The Code does not obligate a lawyer to tell a client how the lawyer has reached a conclusion concerning a particular matter of professional responsibility."

h. Is written consent required for continued representation?

i. Rule 3-310(c)

(C) A member shall not, without the informed written consent of each client:

(1) Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or

(2) Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or

(3) Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter.

ii. *Thelen Reid & Priest v. Marland* (N.D. Cal. 2007) 2007 U.S.Dist. LEXIS 17482

1. Recognizing that law firms "should and do seek advice about their legal and ethical obligations in connection with representing a client and that firms normally seek this advice from their own lawyers."

2. "[W]hile consultation with an in-house ethics advisor is confidential, once the law firm learns that a client may have a claim against the firm or that the firm needs client consent in order to commence or continue another client representation, then the firm should disclose to the client the firm's conclusions with respect to those ethical issues."

iii. ABA Formal Opinion 08-453 - "[C]lient consent may be sought only when the firm reasonably believes that one or more lawyers in the firm can provide competent and diligent representation to the client notwithstanding the consulting lawyer's conflict."

iv. Massachusetts Supreme Court, *RFF Family Partnership v. Burns & Levinson LLP* (2013) 465 Mass. 702, 991 N.E.2d 1066 - "It may not always be clear when the interests of the client and the law firm have become so adverse that withdrawal is required in the absence of client waiver. . . . Soliciting such advice, whether from an in-house counsel at the law firm or from an attorney at another law firm, is not in and of itself adverse to the client, and doing so may ultimately benefit the client. . . . [A] law firm is not disloyal to a client by seeking legal advice to determine how best to address the potential conflict, regardless of whether the legal advice is given by inhouse counsel or outside counsel."

v. *Edwards Wildman Palmer LLP v. Superior Court* (2014) 231 Cal. App. 4th 1214 - it is not a foregone conclusion that an attorney's consultation with in-house counsel in regard to a client dispute will always be adverse to the client. A law firm is not necessarily disloyal to a client "by seeking legal advice to determine how best to address the potential conflict, regardless of whether the legal advice is given by in-house counsel or outside counsel." (citing *RFF Family Partnership v. Burns & Levinson LLP*, *supra*, 991 N.E.2d at p. 1078.) The attorney's and client's interests are likely to dovetail insofar as the attorney seeks to resolve the dispute to the client's satisfaction, or determine through consultation with counsel what his or her ethical and professional responsibilities are in order to comply with them. Recognition of the attorney-client privilege under these in-house circumstances does not undercut the firm's duty to keep a client apprised of developments in the case. Should an attorney's consultation with in-house counsel reveal that the attorney, or the firm, has committed malpractice, the attorney or firm would be obliged to report the malpractice to the client, although the confidential communication itself would remain privileged.

vi. General "fiduciary duty" principles.

2. Practical Considerations

a. Protecting the Firm

i. External risks

ii. Internal risks

1. Mobile technology.

2. Remote technology.

3. BYOD.

4. Angry and/or departing employees.

b. Security and Control

i. Asses/Inventory

1. What information do you have.

2. Do your clients have industry regulated privacy obligations.

3. What are your client's instructions re your security measures, if any

4. Is there consent needed to your technology use.

ii. Protect

1. Duty to exercise "reasonable care" in technology use (see discussion above).

2. Prevent unauthorized access client data.

a. Protecting your infrastructure.

b. Firm policies to control risk factors.

c. Passwords.

d. Two Factor Authentication.

e. Networks.

f. Wifi.

g. Prevent unauthorized and unintentional alteration or deletion.

h. Availability: Maintain availability to authorized users.

i. Encryption.

j. VPN.

k. Kill Switches/Remote Wipe.

3. "As needed" file access restrictions.

4. Response.

c. Accountability and Education

i. Communicate and educate.

1. Employees.

2. Vendors.

ii. Establish goals and measure performance.

1. Monitor for compliance.

2. Set procedures to address requests, complaints and disputes

3. Create culture of compliance and self reporting.
4. Make this a management priority, not just IT instructions.
5. Enforcement and corrective action.

iii. Monitor and Review.

Monitor and evaluate for necessity of revision brought on by evolution of technology and changes in vendor structure.

d. What Does a Law Firm Breach Look Like?

i. Who is responsible?

1. Malicious Actor?
2. Insider?
3. Hacktivist?
4. Foreign government?

ii. What kind of breach occurred?

1. Theft of information
2. Destruction of information
3. Blocking access to information

iii. Common Types of Law Firm Breach.

1. Phishing, Spear Phishing, Whaling.
2. Hacking for Hire.
3. CryptoViral extortion.
4. Compromised Vendors.
5. Password Resetting.

iv. Costs of Incident Response.

1. Forensics .
    a. Legal fees.

i. Ethics counsel.

ii. Privacy Counsel.

2. Notification costs.

v. Costs relating to privacy law compliance.

1. Credit monitoring.

2. Call center.

vi. Crisis response.

vii. Civil Liability; defense costs/settlement expenses.

viii. Infrastructure repairs/adjustments.

3. Anatomy of Breach Response – Privacy Laws

a. Discovery of a Data Breach: Theft, loss, or Unauthorized Disclosure of Personally Identifiable Non-Public Information or Third Party Corporate Information that is in the care, custody or control of the Organization, or a third party for whom the Organization is legally liable.

i. Evaluation of the Data Breach.

1. Forensic Investigation.

2. Legal Review.

3. Notification Laws.

a. 47 states, D.C., & U.S. territories.

b. HIPAA.

c. Laws vary between jurisdictions.

d. Varying levels of enforcement by state AG.

4. Limited precedent.

a. What does “access” mean?

b. What is a reasonable notice time?

5. Other Challenges.

        a. FTC enforcement priorities.

    6. State laws.

        a. Reasonable security & expanding scope of notification law.

        b. Active enforcement.

    7. Legislative.

4. Managing the Short-Term Crisis

    a. Determining what happened.

    b. Securing your infrastructure; preventing further breach.

    c. Re-compiling records (if needed); meeting immediate client deadlines.

    d. Breach Notification.

        i. Ethics Disclosures.

        ii. Privacy Disclosures.

            1. Credit Monitoring.

        iii. Public Relations.

5. Handling the Long-Term Consequence

    a. Civil lawsuits.

        i. Consumer litigation and/or class actions.

        ii. Client lawsuits for breach of fiduciary duties and legal malpractice.

        iii. Regulatory Fines, Penalties and Consumer Redress.

        iv. Discipline.

        v. Reputational Damage.

        vi. Infrastructural Damage.

        vii. Income Loss.

6. Objectives for a Data Breach Incident Response Plan

    a. “Living Document.

    i. Routinely updated to keep current.
    ii. Forming your Incident Response Team (IRT).
        1. Internal.
        2. External.

b. Clear and easy to use in the midst of a crisis incident.
    i. Succinct.
    ii. Organized by sections.

c. Not a “phone book” but not a “leaflet”.
    i. Background information on regulations and laws.
    ii. Detailed procedures and steps on incident management.
    iii. Contact details of the Incident Response Team (IRT).

d. Document investigation for evidentiary needs.
    i. What does law enforcement want and when do they want it.
    ii. What will your clients allow.

e. Practice for events.

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Ethics "In The Breach"

By Steven M. Puiszis

Introduction

Law firms are regularly entrusted with some of their clients' most sensitive and valuable information. Law firms can possess a client's trade secrets or intellectual property, information concerning a high-stakes business transaction, a merger or acquisition, or a new product line. Information about a client's physical, mental, or financial condition and personal information that could be used to steal a client's identity are routinely provided as part of many engagements. Clients expect their lawyers to protect the information they provide.

The global technology revolution has complicated the statutory and ethical duties owed by a lawyer to protect information provided by a client. Innovative technologies, the popularity of the internet and the proliferation of mobile devices have created new and challenging risks for law firms. Rapidly evolving technology provides the means to bypass locked doors and filing cabinets and can be readily used to circumvent traditional methods to protect confidential communications between a lawyer and the client. Thus, data protection today presents a far more complex and difficult problem for lawyers and law firms than ever before.

Large scale data breaches are becoming more frequent, and it is clear that law firms have become a target of hackers. In November of 2011, the FBI held a meeting with 200 law firms in New York where it explained that hackers consider law firms to be the "backdoor of valuable data of their corporate clients." Mandiant, a cyber-security firm, estimated that in 2011 at least 80 major law firms in the U.S. had been hacked. Michael Riley & Sophia Person, *China-Based Hackers Target Law Firms to get Secret Deal Data*, Bloomberg, Jan. 31, 2012, available at www. bloomberg.com/news/2012-01-31/China-based-hackers-target-law-firms.html.

The former Director of the FBI, Robert S. Mueller III, in the keynote address provided a sobering assessment of the state of cyber-security: "there are only two types of companies: Those that have been hacked and those that will be. And even they are converging into one category: companies that have been hacked and will be hacked again. *Combating Threats in the Cyber World Outsmarting Terrorists, Hackers and Spies*, available at www.fbi.gov/news/speeches/combating-threats-in-the-cyber0-world-outsmarting-terrorists-hackers-and-spies. That law firms have become a target of hackers should come as no surprise. Hackers target law firms for two reasons, the concentration of valuable information accumulated by law firms and because law firms' cyber defenses are perceived to be weaker than our clients. As a result, the computer networks of law firms are routinely probed for vulnerabilities, and hackers are repeatedly sending socially engineered emails with attachments containing malware, or with links to malicious web sites.

Today, no law firm is immune from being hacked. All firms are potential targets of cyber criminals seeking access to a firm's banking or trust account information, and any personally identifying information in their possession that can be sold to identity thieves. Industrial or state-sponsored hackers seek trade secrets,

patents, intellectual property and other high-value information about new products, or information about high-stakes business deals.

While hackers' motives are understood and their attack strategies are known, preventing successful hacks has proven to be difficult. Contributing factors include the inability to effectively patch network vulnerabilities, the failure to properly monitor network activity for the presence of malware, the growing use of mobile devices and bring your own device ("BYOD") policies, which have created new attack vectors to guard, the popularity of social media, which enables more sophisticated social engineering schemes to be directed at law-firm personnel, and the failure of law firm personnel to follow the firm's security guidelines. The unfortunate reality is that many successful hacks could have been avoided if a vendor-issued patch for a vulnerability had been timely applied, or if an employee had simply avoided clicking on a link in an email from a person he or she did not know. While there are technological solutions that can strengthen the perimeter and internal security of a law firm's network, frequently the weakest link in the security of a law firm is its personnel.

Another difficulty with data security is that threats are never static, they are constantly evolving. Spam filters will capture some phishing emails, but hackers are trying new methods to evade those filters. And, hackers are refining malware to evade detection. Additionally, every time a law firm alters its network architecture, installs a new program, changes a server, a router, a switch or a firewall, a new vulnerability may be introduced. If a firewall is not properly configured, if systems that were once segregated become open, or group access rules are modified, new vulnerabilities to a firm's network can be created. As a result, periodic review of threats and vulnerabilities to a law firm's network are becoming increasingly important.

Strong data security measures are more than simply a cost of doing business. A law firm that is successfully hacked will suffer reputational harm and may lose clients as a result. There is significant administrative time and expense involved in determining how a data breach occurred and in reestablishing the integrity of a network. State and federal laws frequently require that notice be provided to government officials and any affected individuals following a data breach. Fines and penalties can be imposed on law firms under these statutes, and civil litigation following a data breach is becoming increasingly common. Thus, data security has strategic and risk management implications for all law firms.

While data breaches resulting from malicious hackers have grabbed headlines, more data breaches are the result of human error, lost or stolen mobile devices, bad disposal practices and computer glitches than the work of hackers. *2013 Cost of Data Breach Study: Global Analysis*, Ponemon Institute, available at www.symantec.com/mktginfo/whitepaper/053013_GL_NA_WP__Ponemon-2013-Cost-of-a-Data-Breach-Report_daiNA_cta72382.pdf. For instance, copiers, printers and fax machines contain memory from which the content of documents can be recovered. Accordingly, before disposing of any equipment that contains memory, the equipment should be properly sanitized by having its memory erased in a secure fashion. This is the same as ensuring that paper records containing client information are shredded.

There is no "one size fits all" approach to how law firms protect client data. Variables such as a law firm's size, its geographic footprint, office structure, practice areas, technological sophistication and available resources are factors that influence a law firm's approach to protecting its data. For instance, options to protect confidential information stored on a laptop computer could include:

- Protecting it with a strong password.
- Encrypting its hard drive.
- Drafting a policy governing its use outside the office.
- Having lawyers and staff sign a terms of use agreement.
- Training lawyers and staff on risks and best practices for its use.
- Employing a combination of some or all of the above steps.

Clients, especially those in regulated industries, are increasingly inquiring about the security measures a law firm takes to protect its data, and as part of its compliance program are requiring that various data security measures be employed by their law firms. Lawyers and law firms that cannot meet or at least commit to satisfying a client's data protection requirements will lose future engagements to those that can meet those requirements. While there are important strategic business reasons why lawyers should take data and cyber security seriously, the focus of this article is on the ethical reasons for doing so.

Lawyer's Duty of Competence Requires Knowledge of the Risks and Benefits of Technology

A fundamental ethical duty imposed upon lawyers is the obligation to provide competent representation to a client. This "requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." Model Rule of Prof'l Conduct R. 1.1.

The Model Rules of Professional Conduct were modified in 2012 to explicitly require that lawyers keep abreast of changes in the practice of law, "including the risks and benefits of technology," used in the delivery of legal services. Model Rule of Prof'l Conduct R. 1.1 cmt. [8]. A lawyer's duty of competence can be met through continuing study and education or through association with others who are competent in the field in question. Model Rule of Prof'l Conduct R. 1.1 cmts. [2],[8].

The root of a lawyer's ethical duties involving data security is found in Rule 1.1's requirement of knowing the risks and benefits of technology. This means that a lawyer's ethical duty to provide competent representation now encompasses competence in those technologies used to provide legal services. If a lawyer is unfamiliar with a particular technology or technological tool and whether or how to use it, then Rule 1.1 requires the lawyer seek assistance:

> In addition, an attorney or law firm is obligated to take reasonable and competent steps to assure the client's electronic information is not destroyed. In order to do that, an attorney must either have the competence to evaluate the nature of the potential threat to the client's electronic files and to evaluate and deploy appropriate computer hardware and software to accomplish that and/or if the attorney lacks or cannot reasonably obtain that competence to retain an expert consultant who does have that experience.

Arizona Ethics Opinion No. 05-04 (2005). See also Arizona Ethics Opinion No. 09-04 (2009)(explaining "it is also important that lawyers recognize their own competence limitations regarding computer security measures and take the necessary time and energy to become competent or alternatively to consult available experts in the field"); Pennsylvania Ethics Opinion No. 2011-200 (noting the duty of competence mandates "suitable measures to protect confidential electronic communications and information").

Moreover, lawyer must not only understand the technology they use to provide legal services to clients, they must also keep aware of changes in that technology which impacts the security of client information in their possession. *See, e.g.*, New Hampshire Ethics Opinion No. 2012-13/4 (observing "[c]ompetent lawyers must have a basic understanding of the technologies they use" and "keep abreast of . . . changes"). Oregon Ethics Opinion No. 2011-188 (explaining "[a]s technology advances, the third party vendor's protective measures may become less secure").

The difficulty lawyers face on this issue is the speed at which technology is advancing. The mobile phones now carried by many lawyers today have more computing power and storage capacity then many desktop computers used a decade ago. Today, mobile devices, file-sharing technologies and cloud storage allow lawyers to work remotely, but create new security issues for lawyers and law firms in safeguarding firm and client information. When it comes to understanding the risks and benefits of technology, the lawyer's duty of competence must evolve as the technologies we use to provide legal services evolve in the future.

Duty to Safeguard Against the Unauthorized or Inadvertent Disclosure of Client Information

If the root of a lawyer's ethical duty involving data security is found in Rule 1.1, then its trunk is outlined by Rule 1.6. As it pertains to data security, Rule 1.6 of the Model Rules states that a lawyer "shall not reveal" any information "relating to the representation of a client unless the client gives informed consent, [or] the disclosure is impliedly authorized . . . to carry out the representation." Model Rule of Prof'l Conduct R. 1.6(a). Rule 1.6 is not limited to information protected by the attorney-client privilege but "to all information relating to the representation, whatever its source." Model Rule of Prof'l Conduct R. 1.6 cmt. [3].

An inadvertent or unauthorized disclosure of client information resulting from a data breach falls within the ambit of Rule 1.6(c). Rule 1.6(c) requires a lawyer to "make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client."

The Comments to Rule 1.6 explain that an inadvertent or unauthorized disclosure or the unauthorized access to information relating to the representation of a client does not constitute a violation of paragraph (c) "if the lawyer has made reasonable efforts to prevent the access or disclosure." Model Rule of Prof'l Conduct R. 1.6 cmt. [18]. Comment 18 lists a series of factors to consider in assessing whether "reasonable efforts" were taken to protect against an inadvertent or unauthorized disclosure or access of information including:

- The sensitivity of the information.
- The likelihood of disclosure if additional safeguards are not taken.
- The cost of employing additional safeguards.
- The difficulty of implementing the safeguards.
- The extent to which the safeguards adversely affect a lawyer's ability to represent a client.
- Whether the client required special security measures be taken or provided informed consent to forego security measures that might be required under this rule.

Rule 1.6 takes a balancing approach when evaluating the security measures that can or should be taken when protecting client information. It recognizes that additional safeguards may be required with highly sensitive information, while also noting the cost and difficulty of implementing or using certain types of safeguards are relevant considerations when evaluating whether to apply additional safeguards. And remember, the additional safeguards do not have to be technology based. They can involve training, the development of firm policies, and the application of best practices involving the use of technology by the firm's lawyers.

Various ethics opinions have referenced a number of technological options available to protect client information. *See, e.g.*, Arizona Ethics Opinion 09-04 (2005) ("In satisfying the duty to take reasonable security precautions, lawyers should consider firewalls, password protection schemes, encryption, antivirus measures, etc."). However, State ethics opinions generally leave it to the "sound professional judgment" of the attorney to determine what security measures should be taken. *See, e.g.*, Arizona Ethics Opinion 05-04 ("[p]recisely which of these software and hardware systems should be chosen — and the extent to which they must be employed is beyond the scope and compliance of the Committee. This is the only kind of thing each attorney must assess."); New Jersey Ethics Opinions 5 (2008) (explaining a lawyer "is required to exercise sound professional judgment on the steps necessary to secure client confidences against foreseeable attempts at unauthorized access").

Law firms should not overlook training on data security and the development of policies as important data security measures under Rule 1.6. If there is one truism when it comes to data security, no technological safeguard is foolproof, or can entirely eliminate the risk of unauthorized access to client data. Law firms can have advanced technological safeguards built into their email and information systems, but if lawyers do not know how to use the firm's technology, then those safeguards are rendered worthless. As a result, technology and data security training is an important component to any risk management program for law firms.

Some lawyers will value convenience over security and deliberately work around a firm's security measures because they either fail to appreciate the risk of their conduct or simply do not care. A law firm's most tech-savvy lawyers, its Millennials, are the ones most likely to try to circumvent its security rules. Sarah Greene, "Do Millennials Believe in Data Security," Harvard Business Review, Feb. 18, 2014, available at http://blogs.hbr.org/2014/02/do-millennials-believe-in-data-security/?utm_source=Socialflow&utm_medium=Tweet&utm_campaign=Socialflow. While training can help explain the risk to client data, a law firm should consider data security policies that prohibit this type of conduct. If a law firm adopts one or more policies on data security, it must consistently enforce those policies in order for them to be effective.

Comment 18 to Rule 1.6 further notes that whether additional steps are required to comply with other laws such as state and federal laws governing data privacy is beyond the scope of the Rule. Id. However, the preamble to the Model Rules reminds us that "[a] lawyer's conduct should conform to the requirements of the law."

Rule 1.6's duty of confidentiality does not end upon the termination of the attorney-client relationship. See Model Rule of Prof'l Conduct R. 1.6, cmt. [20]. Rule 1.9(c) extends the duty of confidentiality to "former clients" and provides: "A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client . . . shall not thereafter . . . (2) reveal information relating to the representation except as these Rules would permit or require with respect to a client." Model Rule of Prof'l Conduct R. 1.9(c).

Social Media

Over the past decade, social media networks such as MySpace, Facebook, LinkedIn, Twitter Instagram or Snapchat have become wildly popular. Facebook, for instance, recently announced that it had over 1.23 billion monthly active users. Social media users frequently discuss various aspects of their personal and professional lives with their friends and followers on these networks.

The use of social media by lawyers and employees of law firms triggers a risk that confidential client information may be disclosed in violation of Rule 1.6. Many may not realize that Rule 1.6 not only encompasses any information relating to the representation of a client, but extends to disclosures "that do not themselves reveal protected information but could reasonably lead to the discovery of such information by a third person." Model Rule of Prof'l Conduct, R. 16, cmt. [4]. Accordingly, law firms should consider requiring its lawyers and staff sign confidentiality agreements. Firms should also consider developing social media policies that prohibit the disclosure of any information relating to a firm matter, or relating to the legal services provided to current or former clients of the firm or relating to information provided by a client.

Duty to Protect Client Information in Electronic Communications

Rule 1.6 takes a similar approach to the transmission of information relating to the representation of a client. Comment 19 to the Rule explains that "reasonable precautions" must be taken "to prevent the information from coming into the hands of unintended recipients." Special security measures (e.g. encryption) are not required "if the method of communication affords a reasonable expectation of privacy." Id.

Comment 19 explains that factors to consider in evaluating the "reasonableness of the lawyer's expectation of confidentiality" include:

- The sensitivity of the information.
- The extent to which the privacy of the communication is protected by law.
- The extent to which the communication is protected by a confidentiality agreement.

Generally, most bar associations that have considered the issue do not require lawyers to encrypt email communications containing confidential client information under ordinary circumstances because the risk of unauthorized disclosure with email is no greater than with other communication technologies. *See, e.g.*, California Formal Ethics Opinion No. 2010-179 (collecting ethics opinions). The ABA, in Formal Opinion 99-413, observed:

> The Committee believes that email communications, including those sent unencrypted over the Internet, pose no greater risk of interruption or disclosure than other modes of communication commonly relied upon as having a reasonable expectation of privacy. . . . The risk of unauthorized intercryption and disclosure exists in every medium of communication, including email. It is not, however, reasonable to require that a mode of communicating information must be avoided simply because interception is technologically possible, especially when unauthorized intercryption or dissemination of the information is a violation of the law.

However, Rule 1.6 also recognizes that "special circumstances" can require additional precautions (*e.g.*, encryption) be taken. *Id*. Rule 1.6 further explains that a client can either require the implementation of special security measures not otherwise required under the Rule or, with informed consent, can forego security measures the Rule would otherwise require. *Id*. Harkening back to the ABA Formal Opinion No. 99-413, that Opinion further observes:

> The conclusions reached in this opinion do not, however, diminish a lawyer's obligation to consider with [his/her] client the sensitivity of the communication, the costs of its disclosure, and the relative security of the contemplated medium of communication. Particularly strong protective measures are warranted to guard against the disclosures of highly sensitive matters. These measures might include the avoidance of email, just as they would warrant the avoidance of telephone, fax, and mail.

While encryption of email may not be ordinarily required, ethics opinions recognize that when highly sensitive information is involved, it may be appropriate to only transmit that information electronically if it is encrypted. Accordingly, lawyers should consider at the file opening stage discussing with the client whether any special security measures are required when transmitting information electronically, and then confirm in an engagement letter the client's position as to whether any special security measures are required for that particular engagement.

Duty to Ensure that a Law Firm and its Lawyers are Conforming to the Rules of Professional Conduct and Conduct of Non-Lawyer Assistants Is Compatible with those Professional Obligations

Most lawyers do not have an IT background or training in computer or network security. That means we must rely on the assistance of IT professionals to create a network infrastructure that will allow us to work remotely and communicate electronically. This reality triggers the application of Rules 5.1 and 5.3 of the Model Rules of Professional Conduct.

Rule 5.1 imposes supervisory obligations on partners or lawyers with "comparable managerial authority" to ensure the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct. Model Rule of Prof'l Conduct 5.1(a). This requires "reasonable efforts to establish internal policies and procedures designed to provide reasonable assurance" that the firm's lawyers will conform to the Rules of Professional Conduct including the duty of competence in Rule 1.1 and the duty of confidentiality in Rule 1.6. Model Rule of Professional Conduct Rule 5.1., cmt. [2].

The development of policies and practices addressing data security, the appropriate use of firm equipment, maintaining the confidentiality of client information, safe internet practices, and associated training on these topics are examples of efforts that can provide "reasonable assurance" that the firm's lawyers are complying with their ethical duties involving data security. Whether additional measures beyond "internal policies and procedures" are required will depend on the firm's size and structure, the experience of its lawyers, the nature of its practice and the frequency with which difficult ethical issues arise. See Model Rule of Professional Conduct 5.1, cmt. [3].

Rule 5.3 takes an identical approach with non-lawyers who are employed, retained or associated with a lawyer or firm. It requires partners and any lawyer or group of lawyers with "comparable managerial authority" to ensure that the firm has in effect measures giving reasonable assurance that the conduct of non-lawyer assistance "is compatible with the professional obligations of the lawyer." Model Rule of Professional Conduct R. 5.3(a). This means that non-lawyers who work within the firm (e.g., secretaries, IT specialists, docket clerks, paralegals) and those who work outside firm (e.g., court reporters, IT consultants, expert witnesses, ediscovery vendors), should understand the need to preserve the confidentiality of client and firm information to which they access.

The comments to Rule 5.3 explain that,"[a] lawyer must give such assistants appropriate instruction and supervision concerning the ethical aspects of their employment, particularly regarding the obligation not to disclose information relating to the representation of the client, and should be responsible for their work product."

Outsourcing Legal and Non-Legal Support Services

The ABA, in Formal Opinion 08-451, addressed a lawyer's ethical obligations when outsourcing legal and non-legal support services. That opinion takes the position that:

> Where the relationship between the firm and individuals performing the services is attenuated, as in a typical outsourcing relationship, no information protected by Rule 1.6 may be revealed without the client's informed consent. The implied authorization of Rule 1.6(a) and its Comment [5] thereto to share confidential information within a firm does not extend to outside entities or to individuals over whom the firm lacks effective supervision and control.

The Opinion further recommends that when outsourcing client services, the lawyer should consider:

- Conducting reference checks and investigating the background of the lawyers or non-lawyers and any placement agencies or service providers that may be involved.
- Interviewing the principal lawyers involved and assessing their educational background.
- Investigating the security of the provider's premises, computer network, and disposal procedures.
- Inquiring into the hiring practices of any intermediary involved to evaluate the quality and character of those likely to have access to the client information.
- Using written confidentiality agreements and performing conflicts checks for any service providers involved.
- When lawyers in a foreign country are involved, assessing whether the professional regulatory system require core ethical principles similar to those in the United States be followed and is effective in policing those principles, and whether the system of legal education through which the lawyers are trained in that country is comparable to the United States.

Additionally, the 2012 amendments to the Model Rules addressed one aspect of this outsourcing issue by adding a new Comment [6] to Rule 1.1 which explains that a lawyer "should ordinarily obtain informed consent from the client before retaining or contracting other lawyers outside his or her own firm" to provide or assist in the provision of legal services to a client. Model Rule of Prof'l Conduct, R. 1.1, cmt. [6]. Additionally, the lawyer must also reasonably believe "that the other lawyers' services will contribute to the competent and ethical representation of the client." *Id*.

Cloud-Computing and Cloud Storage Ethical Issues

Cloud computing refers to applications or computing services available for use over the internet as opposed to software installed directly onto the user's computer. The National Institute of Standards and Technology ("NIST") defines cloud computing as:

> [A] model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (*e.g.*, networks, servers, storage, applications, and servers) that can be rapidly provisioned and released with minimal management effort or service provider interaction.

Peter Mell and Tim Grance, The NIST Definition of Cloud Computing, September 2011, at 2, available at: www.csrc.nist.gov/publications/nistpubs/800-145/SP800-145.pdf. Examples of Cloud computing applications include Google Docs, Dropbox and Microsoft Office 365.

Documents generated through web-based applications are generally stored in the "cloud." Cloud storage in turn refers to an internet-based model of data storage involving multiple servers owned by third parties that "host" the data in remote locations. Clouds can be: 1) public, which are available for use by anyone; 2) private, which are available for use solely by the employees of a single organization, or 3) hybrid, which are available to multiple organizations, and combine features of both public and private clouds.

Cloud computing and cloud-based storage permit lawyers greater flexibility in how they can access documents or information, work, and share information. Documents or emails can be accessed wherever, whenever and however network or wifi access can be obtained. It can provide significant cost savings to lawyers and law firms that use the cloud. The use of cloud computing, however, implicates the lawyer's duty of competence under Rule 1.1. It also means that data is not stored on a lawyer or law firm's servers, which can pose new data security and cyber risks, and allows third parties to have some form of access to client information, which triggers the application of Rules 1.6 and 5.3.

At present, twenty (20) states have issued ethics opinions addressing the use of cloud-computing or cloud storage. The ABA maintains a list of these state ethics opinions, which is available at www.americanbar.org/groups/departments_offices/legal_technology_resources/charts_fyis/cloud-ethics-chart.html. While there are variations in these ethics opinions, they generally permit the use of cloud computing and cloud storage, but require the lawyer to exercise reasonable care in the selection of a cloud vendor and in assessing the vendor's procedures for safeguarding the confidentiality of client information. *See, e.g.* New York State Bar Assn. Op. 842 (2010) (concluding that lawyers may ethically use cloud storage so long as they take "reasonable care to ensure that the system is secure and that client confidentiality is maintained"). That opinion explains that exercising "reasonable care" to protect a client's information against unauthorized disclosure "may" include:

- Verifying the cloud storage provider has an enforceable obligation to preserve confidentiality, and will notify the lawyer if served with process requiring the production of client information.
- Investigating the adequacy of the cloud provider's security, policies, recoverability methods, and other procedures.
- Employing available technology to guard against reasonably foreseeable attempts to infiltrate the data that is stored.

- Investigating the cloud provider's ability to purge any copies of the data, and to move the data to a different host for any reason.

Other factors that Pennsylvania Formal Opinion 2011-200 suggests should be considered include whether the cloud provider:

- Explicitly agrees that it has no ownership or security interest in the data.
- Includes in its terms of service or service level agreement an explanation how confidential client information will be handled.
- Provides a method for retrieving data if the provider goes out of business, the service has a break in continuity or the agreement is terminated.
- Employs technology built to withstand a reasonably foreseeable attempt to infiltrate data, including penetration testing.
- Provides the law firm with the right to audit the provider's security procedures and to obtain copies of any security audits performed.
- Agrees to host the data only within a specified geographic area.

That opinion explains that should the data be hosted outside of the United States then the law firm should review whether "the hosting jurisdiction has privacy laws, data security laws, and protections against unlawful search and seizure that are as rigorous as those of the United States." It further suggests that a lawyer investigate the cloud provider's:

- Security measures, policies and recovery methods.
- System for backing up data.
- Security of its data centers and if storage is provided in multiple centers.
- Safeguards against disasters, including multiple server locations.
- History, including the length of time it has been in business, funding and stability.
- Process used to comply with data subject to a litigation hold.

Another relevant inquiry is whether the cloud provider has ever suffered one or more security breaches, and if so how the breach or breaches occurred and what steps have been taken to prevent a reoccurrence. However, it should be remembered that the duty of confidentiality "does not require that a lawyer use only infallibly secure methods" to store and transmit information. North Carolina Formal Ethics Opinion 6 (2012).

Whether a client's consent is required to the use of cloud computing appears to be an open question. Several ethics opinions suggest that its use may be "impliedly authorized" so long as reasonable efforts are used to ensure the data is adequately safeguarded. *See, e.g.*, New Hampshire Ethics Op. 2012-13/4; Pennsylvania Formal Opinion 2011-200; Massachusetts Ethics Opinion 05-04. The use of the Cloud, however, is just another form of outsourcing. Thus, ABA Formal Opinion 08-451, which takes the position that when an outsourcing relationship is attenuated, client consent is required before information covered by Rule 1.6 is disclosed, simply cannot be ignored. And the New Hampshire and Pennsylvania ethics opinions noted above recognize that client consent may be required depending on the sensitivity of the data involved. So lawyers should carefully evaluate this issue and consider whether to seek the consent of the client at least where highly sensitive information is involved.

Ethics after a Breach

The Rules of Professional Conduct have a temporal dimension in the context of a data breach. The prior sections of these materials addressed a lawyer's ethical duties to safeguard information before a breach occurs. When a breach does occur, several other ethical rules and considerations are triggered. Forty-seven (47) states, the District of Columbia, the Virgin Islands and Guam have adopted data breach notification laws that potentially apply to data breaches involving lawyers and law firms. See National Conference of State Legislatures, State Security Breach Notification Laws, available at www.ncsl.org/research/telecommunications-and-informationtechnology/security-breach-notification-laws.aspx. Most, but not all, of the state data breach notification laws address the unauthorized acquisition of or in some instances the unauthorized access to unencrypted computerized data containing various types of personal information. Accordingly, one way to limit the risk of having to comply with most state data breach laws is to encrypt portable laptops and mobile devices which either contain or provide access to personally identifiable information.

The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") through the Health Information Technology for Economic and Clinical Health Act ("HITECH"), also imposes reporting obligations on law firms that qualify as "business associates" under HIPAA when they suffer a breach of protected health information ("PHI") that compromises the security or privacy of the PHI. See 45 C.F.R. §§ 164.400-414.

When state or federal law requires a data breach to be reported, the rules of ethics require it to be reported as well. Some states' data breach laws contain specific requirements of what to include in the notifications. Additionally, these laws require that notice be provided to those individuals whose personal information was accessed and several also require notice to be provided to other third parties. Thus, Model Rules 4.1 and 4.3's requirements will likely be triggered when notices are required to be sent under these data breach notification laws.

The first rule of good risk management is to never make the problem worse. Thus, keep in mind that whatever communication you have with the client about the data breach could end up as the first charge in a disciplinary proceeding or civil action. Candor is a must; a lawyer should endeavor to avoid a claim that the information provided in a breach notification was only partially true or misleading. Also remember that how a lawyer informs the client of a mistake can be as important as what is said.

Rule 1.4 addresses a lawyer's duty to communicate with a client, and among other things, requires a lawyer to keep the client reasonably informed about the status of a matter, promptly comply with reasonable requests for information and promptly inform the client of any circumstance to which informed consent may be required. Model Rule of Professional Conduct R. 1.4(a). When a data breach occurs that involves a client's information, Rule 1.4 triggers an obligation to notify the client about the breach.

A lawyer's duty is to act in the client's best interests in fulfilling a client's expectations for information. Model Rule of Professional Conduct, Rule 1.4, cmt. [5]. While a lawyer may be justified in delaying the notification to a client in order to investigate the breach and determine how it occurred, or to identify the specific information involved, or at the request of law enforcement, a lawyer "may not withhold information to serve the lawyer's own interest or convenience." Model Rule Professional Conduct, Rule 1.4, cmt. [7].

Moreover, a lawyer must evaluate whether the data breach triggers the potential for a personal interest conflict under Rule 1.7 of the Model Rules. Rule 1.7(a) states that a conflict of interest exists whenever circumstances present "a significant risk that the representation of one or more clients will be materially

limited . . . by a personal interest of the lawyer." Model Rule of Prof'l Conduct, R.1.7(a). The Comments explain that "if the probity of a lawyer's own conduct is in serious question, it may be difficult for the lawyer to give detailed advice." Model Rule of Prof'l Conduct, R. 1.7, cmt. [10].

In light of Rule 1.7's requirement that there be a "significant risk" and a "material limitation" in the lawyer's ability to represent the client, a case-by-case analysis should be made as to whether a personal interest conflict has been triggered by the data breach. Factors that should be considered include the type and sensitivity of the information at issue, the person(s) who gained access or potentially could gain access to the information, whether the person or persons are required to maintain the confidentiality of the information, and the extent to which the information has been returned, recovered from or destroyed by the party who gained access to the information.

On this issue, it would be wise for lawyers to err on the side of caution and communicate to the client that a data breach involving the client's information has occurred. Such a letter should explain how the breach occurred, what information was involved, and any other relevant information, including whether any investigation by law enforcement is or was involved. The letter should also include the lawyer's analysis as to whether the data breach triggers a personal interest conflict and whether it affects the lawyer's ability to continue to diligently and competently represent the client.

A lawyer should also evaluate whether under his or her state ethics rules, the client should be advised of the significance of the mistake or the potential for a claim against the lawyer as a result of the data breach. This should not be confused with an admission of liability. Be sure to comply with the requirements of any applicable state or federal data breach notification law. Remember that you may have a reporting obligation under a client's engagement guidelines. And even when an incident does not qualify as a data breach, you still may be an obligation to report it under federal administrative regulations. Under HIPAA for instance, protected health information may have been "accessed" by a hacker but not acquired or exfiltrated from your firm, and thus would not qualify as a data breach under HIPAA's breach notification safeguard. Nonetheless, that could qualify as a "security incident" under HIPAA which would have to be reported to a Covered Entity under the terms of a Business Associate Agreement.

Finally, under the Model Rules, when a lawyer determines that the potential for a personal interest conflict exists, the lawyer can only continue to represent the client if the conflict is disclosed and the client's informed consent is confirmed in writing. Model Rule of Prof'l Conduct, R. 1.7(b)(4). Whenever a lawyer discloses to the client the existence of a conflict of interest or the potential of a claim against the lawyer, the client should be reminded of the right to obtain separate and independent counsel to evaluate whether the conflict should be waived or the potential for asserting such a claim.

***About the author**: Steven M. Puiszis is a Partner with Hinshaw & Culbertson LLP. He serves as Hinshaw's Deputy General Counsel, counseling the firm's lawyers on ethics, professional responsibility and risk management issues. He is a member of Hinshaw's Lawyers for the Profession Practice Group which represents lawyers and law firms in liability and professional responsibility matters. Steve also heads the firm's ediscovery response team and serves as its privacy and security officer. He received his J.D. from Loyola University Chicago, and is a Past President of the Illinois Association of Defense Trial Counsel. Steve formerly served on the Board of Directors of DRI and as its Secretary Treasurer. He is a Fellow of the American Bar Foundation, a member of the International Association of Defense Counsel (IADC), and the Association of Defense Trial Attorneys (ADTA). His publications include Data Protection and Privacy in the United States, and Mitigating Law Firm's Cyber Risk; separate book chapters*

published in Risk Management In Law Firms, Globe Law and Business Publishing Ltd., London, England, sponsored by the International Bar Association; The Role of General Counsel in Law Firm Risk Management, Law Firm Practice Management, the DRI Defense Library Series, DRI, Chicago, Illinois.

LOS ANGELES COUNTY BAR ASSOCIATION LACBA HOME >>

county bar update

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Ethical Rules Require Reasonable Care When Using Technology in the Practice of Law

By Wendy Wen Yun Chang, partner, Hinshaw & Culbertson, LLP, and member, LACBA Professional Responsibility and Ethics Committee. She can be reached at wchang@hinshawlaw.com. The opinions expressed are her own.

The use of technology in the practice of law can be both a blessing and a burden. New tools constantly provide attorneys with the ability to access and transmit larger amounts of information with ever growing ease. With the advent of smartphones, tablets, touchpads, temporary storage devices, portable hard drives, and e-mails that follow us wherever we are, clients require increased speed, efficiency, and immediacy in the provision of legal services, which oftentimes demands the use of significant amounts of new technologies. The pace of their development creates ethical risks that outpace specific legal authorities guiding our usage of them. How can a lawyer navigate this ethical minefield? The answer is, as with much of the law, to know the rules, and use your common sense.

At its core, the ethical requirements relating to the use of technology are analytically no different than in a nontechnological setting, and the law imposes no greater requirements. The foundation of every attorney's duty is the duty of the attorney to "maintain inviolate the confidence, and at every peril to himself or herself to protect the secrets, of his or her client."[1] "Secrets" extends to anything that would be embarrassing or detrimental to a client[2] and even extends to information that is publicly available.[3] This duty is not a bar to the use of technologies, so long as the attorney acts in a reasonable manner to protect the client's confidential information.[4] The reasonableness of an attorney's actions to ensure both that secrets and privileged information of a client remains confidential and that the attorney's handling of the information does not result in a waiver of any privileges or protections is considered to be a fundamental part of an attorney's duty of competence.[5]

The obvious question, then, is what does an attorney need to do to meet the "reasonableness" standard? First and foremost, while the rules do not require that attorneys be technology experts when assessing the technology being used, attorneys need to have a basic understanding of the electronic protections afforded by the technology used in their practice.[6] If they lack the expertise to assess that technology, they must seek additional information or consult with someone who possesses the necessary knowledge, such as an information technology consultant.[7]

At a minimum, an attorney should employ the standard security protections that are readily available and/or are oftentimes preloaded onto many mobile devices—such as firewalls, virus protection, malware protections, unique passwords[8]—and use common sense before downloading attachments or clicking on phishing links from unknown sources, which may contain malware or viruses that could infect all types of mobile devices.[9] The attorney should also consider the availability of and then use backup systems for the recovery of lost data and remote data locking and/or wiping capabilities in the event of the loss or destruction of the device.[10]

An attorney should also consider how the particular technology differs from other media use.[11] For example, while California does not generally require the use of encryption when sending or receiving standard attorney-client e-mails,[12] whether encryption should be used to safeguard confidential information being transmitted may depend on the nature of the information involved or the ease by which security measures may be invoked. In a world where no information is 100 percent safe,[13] the higher the information's degree of sensitivity, the more an attorney may be required to do to protect that information to meet the "reasonableness" standard—which can include using specialized security measures and ultimately may require the attorney to refrain from using the technology at all without informed client consent.[14] This may involve not only the transmission of information

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over the Internet via e-mail but can also include the consideration of what type of information can or should be uploaded into any cloud-based data storage system and/or downloaded onto an easily transportable (and easily lost or stolen) device, ranging from a laptop to standard small thumb drive or memory card, which oftentimes can come without password or encryption capabilities.

The attorney should also consider the impact of potential waiver issues relating to inadvertent disclosure through the improper handling of confidential information. A communication does not lose its privileged character only because it is communicated by electronic means or because persons involved in the delivery, facilitation, or storage of electronic communications may have access to the content of the communication.[15] However, the attorney-client privilege will protect confidential communications between the attorney and client in cases of inadvertent disclosure only if the parties act reasonably to protect that privilege.[16] In this regard, attorneys should consider not only their own actions and that of their agents and employees[17] but also educate their clients on the risks of waiver and steps to avoid it. For example, from the transmission of documents with unscrubbed metadata containing confidential information[18] to the use of insecure pathways and networks to transmit information such as public WiFi[19] to a client communicating with the attorney on a company computer resulting in the waiver of the privilege[20] to the public discussion of client matters on the Internet or social media (by the attorney and/or the client), the risks of inadvertent waiver are significant and must be carefully considered by both sides to the attorney-client relationship. Relatedly, the attorney should also consider and educate the client about the potential consequence of disqualification in the event of misuse of another party's confidential information, even if such information is not inadvertently obtained.[21]

Finally, if a device is going to be retired, replaced, discarded, and/or returned (if leased), the attorney should take all necessary steps to wipe and remove all confidential data from the device before it leaves the attorney's custody.[22]

Think before you use that technology, and take reasonable steps to protect your client's information.

[1] Cal. Bus. & Prof. Code §6068(e)(1).

[2] State Bar of Cal., Comm. on Prof'l. Responsibility and Conduct, Formal Op. No. 1981-58.

[3] *See* Mitchell v. Superior Court, 37 Cal. 3d 591, 599 (1984); In re Johnson, 4 Cal. State Bar Ct. Rptr. 179, 189 (Rev. Dept. 2000).

[4] State Bar of Cal., Comm. on Prof'l. Responsibility and Conduct, Formal Op. No. 2010-179; *see also* Los Angeles County Bar Assn., Prof'l Responsibility & Ethics Comm., Formal Op. No. 374 (1978) (under conditions where certain safeguards are observed, disclosure of client secrets and confidences to a central data processor does not violate Section 6068(e), equating such disclosure to that of disclosures to nonlawyer office employees).

[5] State Bar of Cal., Comm. on Prof'l. Responsibility and Conduct, Formal Op. No. 2010-179.

[6] *Id*.

[7] *Id*.

[8] *Id*.

[9] David G. Ries, *Safeguarding Confidential Data: Your Ethical and Legal Obligations*, ABA Law Practice (July/August 2010, Vol. 36, No. 4, at 49).

[10] *See, e.g*., Jamie Lendino, *Kill Your Phone Remotely*, PCmag.com (September 11, 2009).

[11] State Bar of Cal., Comm. on Prof'l. Responsibility and Conduct, Formal Op. No. 2010-179.

[12] Los Angeles County Bar Assn., Prof'l Responsibility & Ethics Comm., Formal Op. No. 514 (2005) (*cited in* State Bar of Cal., Comm. on Prof'l. Responsibility and Conduct, Formal Op. No. 2010-179).

[13] "[I]f somebody wants to get into your system, they have a very, very good chance of doing it. So if you don't want your system compromised, disconnect it from the Internet. Turn it off and don't allow people to touch it, and then open up the box and take a hammer to the hard drive. At that point, you're relatively secure." Philip Reitinger, Director of National Cybersecurity Center, Department of Homeland Security, at the 2009 Annual Review of the Field of National Security Law, a conference cosponsored by the ABA Standing Committee on Law and National Security, *in* Ed Finkel, *Cyberspace Under Siege*, ABA Journal (11/1/10).

[14] State Bar of Cal., Comm. on Prof'l. Responsibility and Conduct, Formal Op. No. 2010-179.

[15] Evid. Code §917 (*cited in* Cal. State Bar Formal Op. No. 2010-179).

[16] Regents of University of California v. Superior Court (Aquila Merchant Services, Inc.), 165 Cal. App. 4th 672, 683 (2008).

[17] *See* Cal. R. of Prof'l. Conduct R. 3-110, *discussion and citations contained therein* (duty to supervise staff and attorneys).

[18] N.Y. Bar Assn. Ethics Op. 782 (modified 2004) (2004 WL 3021157).

[19] State Bar of Cal., Comm. on Prof'l. Responsibility and Conduct, Formal Op. No. 2010-179.

[20] Holmes v. Petrovich Development Co., 119 Cal. App. 4th 1047 (2011).

[21] Clark v. Superior Court (Verisign), 196 Cal. App. 4th 37 (2011); Rico v. Mitsubushi Motors Corp., 42 Cal. 4th 807 (2007); State Comp. Ins. Fund v. WPS, Inc., 70 Cal. App. 4th 644 (1999).

[22] If the equipment is leased, the lease should preserve the right of the attorney to do so.

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TAB 2

Déjà Vu All Over Again: Brainstorming the New California Rules Project

DÉJÀ VU ALL OVER AGAIN: BRAINSTORMING THE NEW CALIFORNIA RULES PROJECT

Merri A. Baldwin, Panel Moderator **San Francisco, CA**

Merri Baldwin is a shareholder in the San Francisco office of Rogers Joseph O'Donnell, P.C. Ms. Baldwin's practice focuses on business litigation and attorney liability and conduct. She is vice-chair of the State Bar's Standing Committee on Professional Responsibility and Conduct and is a certified legal specialist in Legal Malpractice Law, California Board of Legal Specialization. Ms. Baldwin is a member of the executive committee of the Bar Association of San Francisco's Legal Malpractice section and is a vice-chair of the American Bar Association Litigation Section's Professional Services Litigation Committee. She is an adjunct professor at Golden Gate University School of Law, and speaks and writes frequently on legal ethics and professional responsibility matters. She co-edited The Law of Lawyers' Liability (2012, First Chair Press.) Ms. Baldwin received her law degree from the UC Berkeley School of Law, where she was co-editor-in-chief of the Berkeley Women's Law Journal. She graduated magna cum laude from Smith College, and was a Fulbright Scholar at the London School of Economics. Ms. Baldwin is the Treasurer of the Bar Association of San Francisco for 2015.

Carole J. Buckner **Irvine, CA**

Carole Buckner practices law through Buckner Law Corp. in Irvine, California. She is AV rated in Martindale Hubbell for over 15 years. Ms. Buckner consults and advises clients on matters involving legal and ethical issues, and also serves as an expert witness. Ms. Buckner is the Dean of St. Francis School of Law. As a law school professor since 2001, Carole has taught Professional Responsibility, Legal Ethics in Business Representation, and Contemporary Ethical Issues, as well as Evidence, Civil Procedure, Legal Writing, Torts, Contracts, UCC, California Civil Procedure, Real Property, and Remedies. Carole is a former member of the State Bar's Committee on Professional Responsibility and Conduct (COPRAC) from 2006 through 2011, and served as Chair, Vice Chair and Special Advisor to COPRAC. She also served as COPRAC's liaison to the California State Bar's Commission for the Revision of the Rules of Professional Conduct. A 1980 graduate of the University of California, Berkeley, she holds her J. D. from Hastings College of the Law (1984). She has extensive experience conducting business, commercial, and employment related civil litigation in private practice, beginning in 1984, including a position as corporate counsel to Amplicon, Inc. and California First National Bancorp. Carole also served as a Special Assistant United States Attorney, prosecuting white collar criminal matters in the Central District of California between 2006 and 2010. Carole is the co-chair of the Professionalism and Ethics Committee of the Orange County Bar Association (OCBA), and is a contributing editor of the Ethically Speaking column in the Orange County Lawyer Magazine. She is also a former chair of the Los Angeles County Bar Association's Professionalism and Ethics Committee and a member of the Association of Professional Responsibility Lawyers (APRL). Carole speaks and writes frequently on ethics-related issues.

Kevin E. Mohr **Fullerton, CA**

Kevin Mohr has been a law professor at Western State College of Law since 1991. He teaches Contracts, Intellectual Property, Law Practice Management, and Professional Responsibility. Professor Mohr is a former Chair and Special Advisor of the State Bar's Committee on Professional Responsibility and Conduct, and is currently the Consultant to the State Bar of California's Special Commission for the Revision of the California Rules of Professional Conduct. He is a Master and Past President of the Peter M. Elliott Inn of Court. He is currently the Vice-Chair of the Los Angeles County Bar Association Professional Responsibility and Ethics Committee. Professor Mohr is also Chair of the Website and Technology Committee of the Association of Professional Responsibility Lawyers and a contributor to the ABA Annotated Model Rules of Professional Conduct. Professor Mohr is coauthor of Legal Ethics: Rules, Statutes, and Comparisons (LexisNexis 2014). He frequently lectures and writes about ethical and conflict of interest issues in the practice of law and is a standing contributor to the State Bar of California and various local bar associations. He received his B.A. from Harpur College, his M.S. from the University of Wisconsin, and his J.D. from Yale Law School.

Richard A. Zitrin **San Francisco, CA**

Richard Zitrin is principal of the Zitrin Law Office of San Francisco and a Lecturer in Law at the University of California, Hastings College of the Law. He has spent his career as a trial lawyer, has taught legal ethics at Hastings since 1994, and also taught at the University of San Francisco School of Law from 1977 to 2005, where he was the founder and first Director of the Center for Applied Legal Ethics. He is a certified specialist in Legal Malpractice. Mr. Zitrin is lead author of a general-audience book on lawyers and the American legal system, The Moral Compass of the American Lawyer (Ballantine, 1999), a textbook that emphasizes a practical approach to teaching ethics, Legal Ethics in the Practice of Law (LEXISNEXIS, 4th edition 2013), and an annually-updated book comparing the rules of ethics, Legal Ethics Rules, Statutes and Comparisons (LEXISNEXIS). The Moral Compass has been translated into Japanese, Traditional Chinese, and Modern Chinese. He currently writes a column for the San Francisco Recorder and law.com entitled "The Moral Compass." In 2006 Mr. Zitrin received the American Bar Association's annual Pro Bono Publico Award. From 2002 to 2010, he coordinated a pro bono program sponsored by the Bar Association of San Francisco and Glide Memorial Church. He serves as pro bono consultant to numerous legal services agencies and to several members of the California legislature and the United States Congress. He was Chair of the State Bar of California's Committee on Professional Responsibility and Conduct from in 1994-5, the year the first COPRAC ethics conference occurred. He is a graduate of Oberlin College and New York University School of Law. He is admitted to practice in California and New York.

DÉJÀ VU ALL OVER AGAIN: BRAINSTORMING THE NEW CALIFORNIA RULES PROJECT

LIST OF WRITTEN MATERIALS

1. Board of Trustees Agenda Memorandum dated November 3, 2014 re: Establishment and Appointments to Second Commission for the Revision of the Rules of Professional Conduct
2. Summary – "Ethics Professors' Letter" Issues, posted on legalethicsforum.com
3. Letter to Chief Justice Cantil-Sakauye from Law Professors re: Comment on Proposed Rules of Professional Conduct
4. *Viewpoint: State Bar Initiates Ethics Rewrite 2.0*, Richard Zitrin, The Recorder, February 2015
5. Second Commission for the Revision of the Rules of Professional Conduct Schedule of Meetings by Rule and Rule Assignment Templates
6. Selected ABA Model Rules
   - Comparison of ABA Model Rule 1.7, Comment [22] to First Commission's Proposed Rule 1.7, Comment [22]
   - Comparison of ABA Model Rule 3.8 to First Commission's Proposed Rule 3.8
   - ABA Model Rule 1.10 (black letter rule only)
   - California Rule of Professional Conduct 3-110
   - ABA Model Rule 1.3 (black letter rule only)
   - ABA Model Rule 6.1 (black letter rule only)
   - Pro Bono Resolution
   - ABA Model Rule 1.14 (black letter rule only)

Written materials can be downloaded at:
http://www.calbar.org/ethics-symposium/2015_materials.html

AGENDA ITEM

123 November 7 2014

DATE: **November 3, 2014**

TO: **Members, Board of Trustees**
Members, Board Committee on Regulation and Discipline

FROM: **Thomas Miller, General Counsel**
Dina E. Goldman, Supervising Sr. Asst. General Counsel
Miriam Krinsky, Vice Chair, Committee on Regulation and Discipline

SUBJECT: **Establishment and Appointments to Second Commission for the Revision of the Rules of Professional Conduct**

EXECUTIVE SUMMARY

At the State Bar's request, the Supreme Court returned to the Bar for further consideration and revision proposed amendments and additions to the California Rules of Professional Conduct drafted by the Commission for the Revision of the Rules of Professional Conduct and submitted to the Court in 2012. With its order, the Clerk of the Court included recommendations to assist the Bar in its task of revising the Rules of Professional Conduct, including a request that the Bar establish a second Commission and appoint its members no later than November 26, 2014. This item requests Board approval to establish the commission, approve its charter, and delegate authority to the President to appoint members of the commission.

BACKGROUND

The Commission for the Revision of the Rules of Professional Conduct conducted a thorough study of the California Rules of Professional Conduct ("CRPC") and in 2010 submitted to the State Bar's Board of Trustees for approval a comprehensive set of amendments and additions to the Rules and Comments. State Bar and Supreme Court staff have worked together since 2012 to develop a useful format for presentation of the proposed CRPC amendments to the Court. This has included significant investments of Bar staff time in providing memoranda and support for the revised rules and comments and substantial investment of Court and Court staff time in reviewing the proposed new and amended provisions. After reviewing some of the proposed amended rules and comments, the Supreme Court, at the Bar's request,[1] returned the proposed CRPC to

[1] Feedback from Supreme Court staff to State Bar staff during the years of briefing rule change submissions identified numerous issues affecting multiple rules that could not be resolved with the

the Bar to create a new revision of the rules through a new and refocused process. Both the Bar and the Court agreed that the rule revision process could be improved and the ultimate product could be enhanced if the State Bar were to undertake a renewed consideration of amendments and revisions to the CRPC within a set time frame.

With the return of the proposed CRPC, the Supreme Court communicated a set of recommendations to guide the Bar in its task of revising the CRPC. Specifically, in a letter dated September 19, 2014 from the Clerk of the Court ("the Court's letter" which is attached as Attachment 1)[2], it was recommended that the Bar establish a second Commission for Revision of the Rules of Professional Conduct ("second Commission") and appoint its members no later than November 26, 2014. The Court's letter requested that the Bar consult with Court staff regarding the recommended size and composition of the second Commission, and indicated that the Court plans to appoint a non-voting member from Court staff to assist the Commission. The Court's letter also recommended parameters for a new charter for the second Commission. Finally, the Court's letter stated that the second Commission should complete its work and submit the revised CRPC to the Court for final consideration no later than March 31, 2017.

DISCUSSION

Charter of Second Commission

The Court's letter suggested that, in developing the charge for the second Commission, the Bar should be guided by its mission of public protection and the four policy considerations that appeared in the first Commission's Charter. These policy considerations are as follows:

"1) Facilitate compliance with and enforcement of the rules by eliminating ambiguities and uncertainties in the rules;

2) Assure adequate protection to the public in light of developments that have occurred since the rules were last reviewed and amended in 1989 and 1992;

3) Promote confidence in the legal profession and the administration of justice; and

4) Eliminate and avoid unnecessary difference between California and other states, fostering the evolution of a national standard with respect to professional responsibility issues."

The Court's letter "strongly urge[d] that the second Commission begin with the current CRPC and focus on revisions that are necessary to address developments in the law, and that eliminate, where possible, any unnecessary differences between California's

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available information. The State Bar was encouraged to revisit the project before filing further rule changes for consideration, and President Luis Rodriguez agreed.

[2] The letter documenting the Bar's request and the Supreme Court's order are also attached as part of Attachment 1.

rules and those used by a preponderance of the states." The letter also stressed that the proposed rules should adhere to the historical purpose of the CRPC to regulate the professional conduct of members of the Bar and thus should remain a set of minimum discipline standards. The letter also stated that while the second Commission may be "guided by" the ABA's Model Rules of Professional Conduct where appropriate, it should "avoid incorporating the purely aspirational or ethical considerations that are present in the Model Rules and Comments." Lastly, the letter stated that the CRPC should stand on their own and "[c]omments to the proposed rules should be used sparingly and only to elucidate and not to expand upon the rules themselves."

A proposed charter for the second Commission is attached as Attachment 2.

Appointments to the Second Commission

The Supreme Court has requested that the second Commission be created and appointments to it made by November 26, 2014. In order to meet this deadline, the President has requested that the Board delegate appointment authority to him within specified parameters set by the Board.

Appointment authority to special committees and commissions of the State Bar lies with the Board of Trustees. The State Bar Act gives the Board of Trustees authority to "appoint such committees … as it deems necessary or proper" to carry out its work. (Cal. Bus. & Prof. Code § 6029.) All State Bar officers, agents, committees, commissions, and other entities have only the powers, duties, and authority delegated by the Board and are subject to its supervision and control. (Cal. Bus. & Prof. Code § 6024; State Bar Rule 6.20.) For committees of the Board other than the standing committees, the Board in May 2010 delegated authority to the President to appoint any ad hoc committee, special committee, task force or other working group of the board, subject to approval by the Board. (Board Agenda Item and Minutes, 144 May 15 2010; Board Book tab 9, art. 1 sec. 3(b).) The policy specifies that such ad hoc committees, task forces, or working groups have a short term, not to exceed one board year (i.e., the period between creation and the next annual meeting of the State Bar). The second Commission is not subject to this Board policy since it is not a committee of the Board and will have a term that exceeds one Board year.

The Board generally makes appointments to State Bar committees and commissions, subject to criteria established under board resolutions. (See Board Book tab 15, arts. 1-4.) The Board's appointments are based on a review of appointment applications that are vetted through the Nomination and Appointments Committee. (See Board Book tab 15, art. 1, §§ 7-8.) Since by necessity the appointments to the second Commission will require an expedited process, the President has requested that the Board suspend and waive its general procedure and delegate authority to the President to appoint members of the second Commission, subject to parameters set forth by the Board, e.g., that the appointments be made generally subject to the criteria that appear in the Board's appointment policies (See Board Book tab 15, art. 2.), and that the President discuss the list of potential candidates with Court staff before making appointments.

It is recommended that the second Commission have a membership not to exceed 12 and be comprised of members with diverse and also useful applicable professional expertise; the President may wish to consider, for example, practitioners, current or former judicial officers, academicians, former COPRAC members, and public members.

ISSUE

Should the Board establish a second Commission for Revision of the Rules of Professional Conduct, adopt a charter for the Commission, and delegate appointment authority to the President to appoint the membership of the Commission?

FISCAL / PERSONNEL IMPACT:

Staff time, administrative costs and expense reimbursements related to meetings will result in some fiscal impact, the exact amount of which is unknown at this time.

RULE AMENDMENTS:

N/A

BOARD BOOK IMPACT:

N/A

RECOMMENDATION

It is recommended that the Regulation and Discipline Committee recommend that the Board establish a second Commission for Revision of the Rules of Professional Conduct and adopt a charter for the Commission. In addition, the President has requested that the Board delegate appointment authority to the President to appoint the membership of the Commission within specified parameters established by the Board.

PROPOSED REGULATION AND DISCIPLINE COMMITTEE RESOLUTION:

Should the Regulation and Discipline Committee agree with the recommendation, the following resolutions would be in order:

> **RESOLVED,** that the Regulation and Discipline Committee hereby recommends that the Board of Trustees establish a second Commission for Revision of the Rules of Professional Conduct; and it is
>
> **FURTHER RESOLVED,** that the Regulation and Discipline Committee hereby recommends that the Board of Trustees adopt a charter for the Commission in the form attached hereto as Attachment 2; and it is

FURTHER RESOLVED, that the Regulation and Discipline Committee hereby recommends that the Board of Trustees suspend and waive the procedures for appointment of State Bar committees and commissions and delegate authority to the President to appoint the membership of the Committee, not to exceed 12 members; and it is

FURTHER RESOLVED, that the Regulation and Discipline Committee hereby recommends that the Board of Trustees set the following parameters for the President's appointments: that the appointments be made generally subject to the criteria that appear in the Board's appointment policies; that the President appoint members with diverse but applicable professional expertise and consider, for example, practitioners, current or former judicial officers, academicians, former COPRAC members, and public members; and that the President discuss the list of potential candidates with Court staff prior to finalizing the appointments.

PROPOSED BOARD OF TRUSTEES RESOLUTION:

Should the Board concur with the recommendations of the Committee on Regulation and Discipline, the following resolutions would be in order:

RESOLVED, that upon recommendation of the Committee on Regulation and Discipline, the Board of Trustees hereby establishes a second Commission for Revision of the Rules of Professional Conduct; and it is

FURTHER RESOLVED, that upon recommendation of the Committee on Regulation and Discipline, the Board of Trustees hereby adopts a charter for the Commission in the form attached hereto as Attachment 2; and it is

FURTHER RESOLVED, that upon recommendation of the Committee on Regulation and Discipline, the Board of Trustees hereby suspends and waives the procedures for appointment of State Bar committees and commissions and delegates authority to the President to appoint the membership of the Committee, not to exceed 12 members; and it is

FURTHER RESOLVED, that upon recommendation of the Committee on Regulation and Discipline, the Board of Trustees hereby sets the following parameters for the President's appointments: that the appointments be made generally subject to the criteria that appear in the Board's appointment policies; that the President appoint members with diverse but applicable professional expertise, and consider, for example, practitioners, current or former judicial officers, academicians, former COPRAC members, and public members; and that the President discuss the list of potential candidates with Court staff prior to finalizing the appointments.

THE STATE BAR
OF CALIFORNIA

SENATOR JOSEPH L. DUNN (RET.)
Executive Director/CEO

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ATTACHMENT - 1

August 11, 2014

Honorable Tani G. Cantil-Sakauye
Chief Justice
California Supreme Court
350 McAllister, 5th Floor
San Francisco, CA 94105

Dear Chief Justice:

As you know, since 2012 staff from the Supreme Court and the State Bar have worked together to develop a useful format for presentation of the proposed Rules of Professional Conduct submitted to the Supreme Court in 2011. Since 2013, bar staff have invested significant time and hard work in providing memoranda and support for the revised rules to the court. We also understand that court staff, and ultimately the court itself, have expended substantial time in reviewing the seventeen Rule analyses forwarded to the court thus far. The bar has an additional 50 rule presentations to submit to the court.

Continuing discussions among the court's representatives and bar staff over the past several years have made it apparent that under the current approach we cannot avoid a lengthy and unwieldy process going forward. Among the fundamental problems is the lack of information bar staff has at its disposal that would allow it to fully advise the court of the reasoning underlying the State Bar Board's approval of the rules, prepared by a special committee appointed more than 10 years ago, and of the rules themselves. Bar and court staff believe that the process could be expedited, the burden on the court and on court and bar staff lessened, and the ultimate product enhanced if the State Bar were to undertake a comprehensive reconsideration of the draft rules to be completed within a set time frame. Therefore, on behalf of the State Bar and with approval of our President, Luis J. Rodriguez, we request that the draft of the Rules of Professional Conduct pending at the Supreme Court be returned to the State Bar for further action. We believe that a renewed and targeted process would benefit from an early meeting of our respective staff representatives to discuss lessons learned to date and to determine how the rule revision process can best be restructured.

The State Bar is grateful to the Supreme Court for its guidance and cooperation in this important project and looks forward to working with the Court to create a new revision of the rules as needed, complete with adequate justification and information for the Board's consideration and to assist the court in its review.

Yours truly,

Joseph L. Dunn

Senator Joseph L. Dunn, Ret.
CEO

COPY

SUPREME COURT
FILED

SEP 19 2014

Frank A. McGuire Clerk

S206125
No. ADMIN. 2014-8-20-2

IN THE SUPREME COURT OF CALIFORNIA

EN BANC

ORDER GRANTING THE STATE BAR OF CALIFORNIA'S REQUEST TO RETURN PROPOSED AMENDMENTS AND ADDITIONS TO THE CALIFORNIA RULES OF PROFESSIONAL CONDUCT PREVIOUSLY SUBMITTED BY THE STATE BAR

From October 2012 to July 2014, the State Bar of California filed 17 petitions before this court seeking approval of various amendments or additions to the California Rules of Professional Conduct. Each petition pertains to a single rule and remains pending before this court pursuant to the court's intention to review all the proposed rules before acting on them. On August 11, 2014, the State Bar requested that all 17 of the submitted rules be returned to the State Bar for further consideration and revision.[1] The State Bar's request is approved.

CANTIL-SAKAUYE

Chief Justice

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[1] The State Bar filed all of these petitions under Supreme Court case number S206125. The following is a complete list of each proposed rule submitted and the filing date of each corresponding petition: (1) proposed rule 1.1 (Competence), filed October 22, 2012; (2) proposed rule 1.8.10 (Sexual Relations with Clients), filed October 22, 2012; (3) proposed rule 1.0 (Purpose and Scope of the Rules of Professional Conduct), filed August 13, 2013; (4) proposed rule 1.0.1 (Terminology), filed August 1, 2013; (5) proposed rule 1.4 (Communication), filed August 27, 2013; (6) proposed rule 1.4.1 (Disclosure of Professional Liability Insurance), filed September 5, 2013; (7) proposed rule 2.1 (Advisor), filed September 11, 2013; (8) proposed rule 6.1 (Voluntary Pro Bono Publico Service), filed September 18, 2013; (9) proposed rule 3.1 (Meritorious Claims and Contentions), filed October 3, 2013; (10) proposed rule 1.5.1 (Fee Divisions Among Lawyers), filed October 18, 2013; (11) proposed rule 8.1.1 (Compliance with Conditions of Discipline and Agreements in Lieu of Discipline), filed October 30, 2013; (12) proposed rule 6.2 (Accepting Appointments), filed November 21, 2013; (13) proposed rule 1.17 (Purchase and Sale of a Law Practice), filed November 26, 2013; (14) proposed rule 1.8.1 (Business Transactions with a Client and Acquiring Interests Adverse to the Client), filed December 27, 2013; (15) proposed rule 5.1 (Responsibilities of Partners, Managers, and Supervisory Lawyers), filed June 16, 2014; (16) proposed rule 5.2 (Responsibilities of a Subordinate Lawyer), filed July 11, 2014; (17) proposed rule 5.3 (Responsibilities Regarding Nonlawyer Assistants), filed July 25, 2014.

Supreme Court of California
350 McALLISTER STREET
SAN FRANCISCO, CA 94102-4797

FRANK A. McGUIRE
COURT ADMINISTRATOR AND
CLERK OF THE SUPREME COURT

RECEIVED
SEP 23 2014
Executive Office
The State Bar of California

(415) 865-7015
frank.mcguire@jud.ca.gov

September 19, 2014

Senator Joseph L. Dunn (Ret.)
Executive Director and Chief Executive Officer
State Bar of California
180 Howard Street
San Francisco, California 94105

Dear Senator Dunn:

I have been asked to respond to your August 11, 2014, letter sent on behalf of the State Bar of California requesting that the Supreme Court return the 17 proposed amendments or additions to the California Rules of Professional Conduct previously filed with the court. You stated that the bar wishes to engage in a comprehensive reconsideration of all of the proposed rules drafted by the Commission for the Revision of the Rules of Professional Conduct (first Commission) from 2001 to 2009 and approved by the State Bar Board of Trustees in 2010. The court has granted the State Bar's request and has issued an order returning the proposed rules for further consideration. The court anticipates that no further rule petitions will be filed until additional action has been taken by the bar.

The court also internally approved a set of recommendations from court staff intended to guide the State Bar in its task of revising the California Rules of Professional Conduct (CRPC). Specifically, the court requests that the State Bar establish a second Commission for Revision of the Rules of Professional Conduct (second Commission). Members of the second Commission should be appointed no later than November 26, 2014. The court asks that bar staff consult with court staff to establish the size and composition of the second Commission, and to discuss some of the issues that have arisen in the review process to help focus the second Commission's work. The court would like to review recommendations and a proposed charge for the second Commission at an upcoming administrative conference. To assist in the ongoing work of the second Commission, the court will appoint a non-voting member from court staff familiar with the review to date to sit on the second Commission, in order to consult with the court, as necessary.

The second Commission should be directed to complete its work and submit all proposed rules for final consideration by the court no later than March 31, 2017. In developing the charge for the second Commission, the drafters should be guided by the four policy considerations provided in the first Commission's Charter.[1] The court strongly urges that the second

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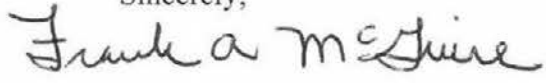
[1] Its Charter stated "[t]he Commission is to develop proposed amendments . . . that:

Commission begin with the current CRPC and focus on revisions that are necessary to address developments in the law, and that eliminate, where possible, any unnecessary differences between California's rules and those used by a preponderance of the states. The second Commission should also be guided in its task by the principle that the CRPC's historical purpose is to regulate the professional conduct of members of the bar, and that as such, the proposed rules should remain a set of minimum disciplinary standards. While the second Commission may be guided by and refer to the American Bar Association's Model Rules of Professional Conduct when appropriate, it should avoid incorporating the purely aspirational or ethical considerations that are present in the Model Rules and Comments. Comments to the proposed rules should be used sparingly and only to elucidate and not to expand upon the rules themselves. California's Code of Judicial Ethics provides one model for the use of commentary in the adoption of a set of rules.

Finally, the court wishes to express its deep appreciation and gratitude to the State Bar Board of Trustees, staff, and members of the first Commission for the years of hard work they dedicated to this difficult project. The second Commission is expected to build upon the strong foundation they have laid.

Sincerely,



FRANK A. McGUIRE
Court Administrator
and Clerk of the Supreme Court

cc: Beth Jay
Emily Graham
Greg Fortescue

"1) Facilitate compliance with and enforcement of the rules by eliminating ambiguities and uncertainties in the rules;

"2) Assure adequate protection to the public in light of developments [that] have occurred since the rules were last reviewed and amended in 1989 and 1992;

"3) Promote confidence in the legal profession and the administration of justice; and

"4) Eliminate and avoid unnecessary difference between California and other states, fostering the evolution of a national standard with respect to professional responsibility issues." (See Petition Request that the Supreme Court of California Approve New and Revised Rules of Professional Conduct to Replace the Existing Rules Of Professional Conduct (Oct. 2012) ["2012 Req."], pp. 3-4.)

Attachment 2

The Commission is charged with conducting a comprehensive review of the existing California Rules of Professional Conduct and preparing a new set of proposed rules and comments for approval by the Board of Trustees and submission to the Supreme Court no later than March 31, 2017.

In conducting its review of the existing Rules and developing proposed amendments to the Rules, the Commission should be guided by the following principles:

1. The Commission's work should promote confidence in the legal profession and the administration of justice, and ensure adequate protection to the public.

2. The Commission should consider the historical purpose of the Rules of Professional Conduct in California, and ensure that the proposed rules set forth a clear and enforceable articulation of disciplinary standards, as opposed to purely aspirational objectives.

3. The Commission should begin with the current Rules and focus on revisions that (a) are necessary to address changes in law and (b) eliminate, when and if appropriate, unnecessary differences between California's rules and the rules used by a preponderance of the states (in some cases in reliance on the American Bar Association's Model Rules) in order to help promote a national standard with respect to professional responsibility issues whenever possible.

4. The Commission's work should facilitate compliance with and enforcement of the Rules by eliminating ambiguities and uncertainties

5. Substantive information about the conduct governed by the rule should be included in the rule itself. Official commentary to the proposed rules should not conflict with the language of the rules, and should be used sparingly to elucidate, and not to expand upon, the rules themselves.

The proposed amendments developed by the Commission should be accompanied by a report setting forth the Commission's rationale for retaining or changing any rule and related commentary language.

TO POST ON LEGALETHICSFORUM.COM

SUMMARY – "ETHICS PROFS' LETTER" ISSUES

1.0.1(e) Narrowing of definition of "informed consent"

1.0.1(m) The overly narrow definition of "tribunal"

1.1 Competence – elimination of the "single act is excusable" concept, which is inexcusable

1.3 Diligence – the absence of a diligence rule – also inexcusable

1.5 Use of the virtually-unfathomable term "unconscionable" to define fees test, rather than "unreasonable," despite the use of "reasonable" in the State Bar Act codification

1.7 The problem of its "extensive and complex" comments. (A previous letter, signed by 30 California professors teaching ethics, had helped convince a majority of the Commission to vote in favor of an ABA-style 1.7, rather than the extremely complex and virtually unintelligible 3-310.)

1.8.1 Doing business with a client should be strengthened, and no changes in fee agreements should be allowed without meeting all requirements

1.8.1(b) Inappropriate narrowing of "independent counsel," allowing for counsel not truly vetted on the "doing business" issue

1.15 Simplifying the highly complex 30-paragraph comment section of the trust account rule

1.17 Selling off particular geographical areas of practice to the denigration of client interests

1.17 No absolute bar to fee increase in the event of sale of practice – should be a bar

2.1 Narrowing the concept of "independent professional judgment"

3.3 Overly narrow rule on candor

3.7 Lawyer as witness – no distinction between jury trial and other tribunals

3.9 Failure of the "advocate in non-adjudicative proceeding" rule to follow rules 3.3, 3.4 and 3.5

4.1 Failure to include a rule requiring "truthfulness to others"

4.4(a) Failure to provide a rule preventing a lawyer acting to create "embarrassment, delay or burden"

5.7 Failure to enact rule stating that lawyers are still bound by ethics rules when doing non-law work

….

As a close observer of the Commission's work – and the primary author of the "ethics professors' letter" signed by 55 CA professors teaching legal ethics that criticized extensive portions of the proposed rules – I wrote an article for the SF Recorder and law.com two weeks ago that can be found at http://www.therecorder.com/id=1202673053087?

The “ethics professors’ letter” is linked in that story, at
http://pdfserver.amlaw.com/ca/EthicsprofslettertoSupremeCourtwithsignatures140303docx.pdf

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March 3, 2014

Chief Justice Tani Cantil-Sakauye
and the Associate Justices
Supreme Court of California
350 McAllister Street
San Francisco, CA 94102

cc: Beth Jay, Principal Attorney to the Chief Justice

Re: Comment on proposed rules of professional conduct

Dear Chief Justice Cantil-Sakauye and the Associate Justices of the Court:

Please consider this comment on behalf of each of the undersigned, each a teacher of Legal Ethics or Professional Responsibility at a law school in California. We are providing you with identification for each professor, including law school affiliation and other significant identifying information. The information is for identification purposes only.

Preliminarily, we note the following: First, we believe that the ethical rules that govern the conduct of lawyers in California are extraordinarily important to the daily practice of law. Second, we also believe that, taken as a whole, the proposed rules fall short in their charge, first and foremost, to *protect clients and the public*.[1] Any variation from this path that puts the profession's self-interest or self-protection ahead of the needs of clients or the public must fail. Not only would such a course be a disservice to the consumers of legal services, but it would likely result in damaging the integrity of, respect for, and confidence in the profession that the rules are expressly designed to foster.

Third, the black-letter rules must serve not only as rules of discipline for those lawyers accused of offenses, but as *guidance* for the overwhelming majority of responsible and ethical lawyers who look to the rules for benchmarks that govern their behavior. Most of California's lawyers do not have the level of sophistication that members of the Rules Commission or this Board of Governors have developed. Thus, the State Bar must make it clear that these rules shall serve as guideposts to the average practitioner.

Fourth, we note the charge from our state's Supreme Court to bring California rules into closer alignment with the ABA Model Rules. There are some instances in which the California rules are superior, but more instances – particularly in the Commission's *omission* of certain rules – in which California would be wise to adopt an ABA-style rule.

[1] The laudable language in current proposed rule 1.0(a) says the following: "The purposes of the following Rules are: (1) To protect the public; (2) To protect the interests of clients; (3) To protect the integrity of the legal system and to promote the administration of justice; and (4) To promote respect for, and confidence in, the legal profession."

A few additional preliminary notes:

1. We note that this letter is not all-inclusive. Rather, it is an attempt to articulate some of the most important and more global concerns that we share about the rules draft submitted to the Board. There are a number of issues left unaddressed. In particular, we have generally not commented on specific paragraphs of the Comment sections of the rules, though these sections can be extremely important.

2. Issues not addressed include some that have received a great deal of attention, such as flat fees under Rule 1.5 and lawyers, including prosecutors, contacting represented parties. These issues either have been amply deconstructed elsewhere or are matters on which we did not reach consensus. Still other issues would unduly lengthen and diffuse the points made here.

3. While the signatories have all concurred in the below recommendations, some would have expressed their agreement in somewhat different language than the drafters of this letter have used. Moreover, we refer to but – due to the desire to avoid adding to this letter's already considerable length – have not always cited to the Commission's written reasoning or certain minority reports with which we agree.

4. Lastly, this letter is in no respect intended as criticism of the Rules Commission. Commission members have done laudable work, including, for example, ultimately approving a conflicts of interest rule that more closely approximates the ABA Model Rules, provides more client protection, and gives more guidance for the average attorney.

We note the following specific issues within five general areas of comment:

I. Rules relating to conflicts of interest

1. *Rule 1.7 – Basic conflict of interest rule*

We commend the Commission for adopting the ABA version of Model Rule 1.7 after much back and forth debate. This revises an earlier decision of the Commission to continue with California Rule of Professional Conduct ("CRPC") 3-310. On June 6, 2008, thirteen California ethics professors signed a letter critical of CRPC 3-310 ("*June 2008 Ethics Profs. Letter*"). The position in this letter is consistent with the *June 2008 letter*, except that the Commission has heeded the concerns expressed in that letter and elsewhere and to its credit adopted MR 1.7 in ABA format and style.

A. Comment 22 on advanced waivers – no position taken in this letter

This letter does not address the issue of whether Comment 22 of Rule 1.7, on advanced waivers, is or is not appropriate. The *June 2008 Ethics Profs. Letter* did address this issue, and opposed the adoption of this Comment paragraph, then enumerated ¶ 33.[2] To the extent that the same dozen signatories objecting to this paragraph are signatories here, their previous positions have been noted. Other signatories take no position on this paragraph here.

[2] One professor of the 13, Fred Zacharias, did not oppose this paragraph. Unfortunately, Prof. Zacharias passed away in the last year and is not available at all as a signatory to this letter.

B. Other comments to Rule 1.7 – in need of careful consideration

This letter does not – and could not succinctly – address each and every paragraph of the Comment section to Rule 1.7, other than as follows: We note that the comments are extensive and complex. While the Commission's history shows that earlier comments came about as the product of much discussion and deliberation, the ultimate comments as revised were not as carefully vetted.

Accordingly, we encourage the Board to carefully review these comments and re-refer to the Commission those comments that are unclear, overly dense, puzzling, or otherwise lacking. We believe more study of the verbiage of these comments, including some simplification, would be helpful to guide the average practitioner, and would ensure clarity and harmony between the rule and the comments.

2. *Rule 1.8.1 – Doing business with a client*

This analysis tracks the comment in the *June 2008 Ethics Profs. Letter* joined by 13 California ethics professors. The current Rule 1.8.1 draft would improperly allow lawyers to bypass the current requirements of Rule 3-300 when they modify their fee agreements with clients, and also be at odds with California case law on fiduciary duty. Despite widespread criticism, the Commission has improvidently insisted on a clearly anti-client rule that serves only the interests of lawyers wishing to change their fee structure in the middle of a representation.

A. The current and proposed rules

Lawyers have long been able to enter into initial fee contracts with clients at arms' length. As in most states, California case law makes it clear that a lawyer's fiduciary duty to a client begins only *after* inception of the attorney-client relationship. This allows lawyers and clients to negotiate freely over the retention of lawyer by client.

Any *subsequent modification* of a fee agreement with a client, however, is done under circumstances where the lawyer has already taken on *ongoing fiduciary duties to the client*. Thus, a modification of a fee agreement is a business transaction with a client, and may involve acquiring a pecuniary interest adverse to the client as well. Current Rule 3-300 would therefore require that before such modification could be entered into, the lawyer must: (a) make the terms of the transaction fair and reasonable; (b) advise in writing that the client seek independent counsel to advise about the transaction; and (c) give the client a reasonable period of time to seek that advice.

B. Modification of fee contracts excluded

The current draft of Rule 1.8.1 simply eliminates these requirements, and excludes modifications of fee contracts from the rule, under proposed Comment 5. This proposed language adds the italicized language to the existing comment: "This Rule is not intended to apply to an agreement by which a lawyer is retained by a client *or to the modification of such an agreement*."

The only possible justification for this language is lawyers' own self-interest – to modify fee contracts in the middle of representation without the existing protections afforded those clients.

Indeed, Comment 5 acknowledges that lawyers do have "fiduciary principles [that] might apply" to fee agreements. Formerly, prior to the *June 2008 Ethics Profs. Letter*, the proposed comments also stated that "[o]nce a lawyer-client relationship has been established, the lawyer owes fiduciary duties to the client that apply to the modification of the agreement." While this language has been eliminated, the truth of this statement remains. In essence, then, the Commission's draft sets up a *conflict between common law principles of fiduciary duty and the ethics rules themselves*. In advising lawyers to "consult case law and ethics opinions" about their fiduciary duties, the Commission even begs the question of attempting to reconcile these duties with their proposed rule.

The phrase relating to modifications of fee contracts in Comment ¶ 5 must be stricken.

C. Inappropriate use of independent counsel

The current draft of Rule 1.8.1(b) eliminates the requirement that the lawyer wishing to engage in a business transaction or acquisition of pecuniary interest of a client must advise the client of the opportunity to seek the advice of independent counsel. The modified rule – with limiting language that is absent from the ABA rule, MR 1.8(a)(2) – states that if the client is already represented by independent counsel, there need be no notice. This, read together with Comments 13 and 14 of the proposed rule, substantially diminishes client protection.

Comments 13 and 14 define independent counsel in such a way as to include any corporate general counsel. Such counsel need not be California counsel and need not be schooled in the requirements of California rules or contracts. Thus, independent counsel not hired for the specific purpose of examining the transaction in question may well miss the very issues necessary to evaluate the transaction. Moreover, under the ABA's Comment, ¶ 4, written disclosure is still required from one of the involved lawyers. This is not true of the current California comments.

In short, having independent counsel is no substitute for adequate disclosure and advice by the lawyer wishing to engage in the transaction. The ABA rule language in MR 1.8(a)(2) and Comment ¶ 4 should replace the ill-advised Commission language.

3. Rule 1.0.1(e) – Definition of informed consent

While the definition of "informed consent" contained in Rule 1.0.1(e) conforms to the ABA Model Rule, it is something of a retrenchment of the broader – and more client-protective – existing California definition currently contained in the conflicts of interest rule. At least in this one case, the Commission has chosen ABA congruence over better California language more protective of clients' interests.

The existing definition of informed consent in the case of conflicts of interest is embodied in current CRPC 3-310(A), which combines disclosure and consent:

(1)"Disclosure" means informing the client or former client of the *relevant*

> *circumstances and of the actual and reasonably foreseeable adverse consequences* to the client or former client; (Emphasis added.)
>
> (2) "Informed written consent" means the client's or former client's written agreement to the representation following written disclosure....

The proposed Commission definition says nothing about "relevant circumstances" and thus narrows the information provided. This can be easily remedied. We suggest the following relatively simple changes to Rule 1.0.1(e), in the redlined language below:

> 'Informed consent' means a person's agreement to a proposed course of conduct after the lawyer has communicated and explained ~~adequate information and explanation about~~ the relevant circumstances and the reasonably foreseeable material risks of, and reasonably available alternatives to, the proposed course of conduct.

This will provide a more clearly informed consent to clients not only as to conflicts of interest, as the current rule now stands, but in all informed-consent situations.

4. Rule 3.7 – Lawyer as witness – conflicts of interest – jury trial vs. tribunal

We note that the proposed California rule remains broader than the ABA rule in that it allows clients to give informed written consent to allow a lawyer to testify as a witness. The ABA rule narrowly allows lawyers to testify on broadly substantive matters only when the lawyer's disqualification, essentially in order to enable testimony, "would work substantial hardship" on the client, even when the lawyer's testimony could be significantly helpful to the client's case.

We agree with the California construction. We note that the client *should* be able to get the full assistance of counsel, including testimony, *so long as* informed consent is given.

Nevertheless, conflicts of interest can and may occur despite informed consent. For example, the lawyer might be impeached based on collateral issues relating to credibility, a circumstance that would have been included the document obtaining the client's informed consent. However, *if* such conflict of interest exists or occurs between lawyer and client, the distinction between testimony at a *jury trial* vs. other adjudicative proceedings makes little if any sense. The issue is the conflict of interest by virtue of the lawyer's testimony, not the forum. The rule should be modified to strike the word "jury" and add the word "tribunal."[3]

II. Rules relating to able representation

1. Rule 1.1 – Competence

This comment is closely connected to the next comment, on MR 1.3, Diligence.

[3] We see no reason to limit application to "trial," as under the ABA Model Rule, as opposed to "tribunal." We note, however, that the definition of "tribunal," as it has been proposed by the Commission, is seriously flawed in its narrow construction. See *infra*.

The competence rule, as modified, gives an unfortunate and overly broad "free pass" to a lawyer committing any first act of negligence, or any first "mistake," *no matter how egregious* that mistake may be. Section (a) of the rule remains unchanged: "A lawyer shall not *intentionally*, *recklessly*, or *repeatedly* fail to perform legal services with competence." (Emphasis added.) However, Comment ¶ 6 has been added, explicitly stating that the rule is "not intended to apply to *a single act* of negligent conduct *or a single mistake*...." (Emphasis added.)

This comment is seriously misguided. The comment is supported by the Commission's rules introduction, which claims that "most jurisdictions" apply the competence rule only to intentional, reckless, or repeated acts." Evidence is to the contrary, however, as is the ABA rule. At best the Commission relies on an unsupported anecdotal statement.

Moreover, Comment ¶ 6 would forbid discipline even if the "single act" would meet a "gross negligence" standard. Use of the common non-legal word "mistake," muddies the scope of 1.1(a) and creates the possibility that *any* single mistake, however great, would fall outside the rule.

Fixing this rule is not difficult. First, we strongly recommend that this Board eliminate ¶ 6 of the Comment. At the very least, the Board should strike the words "or a single mistake" and add the word "simple" before "negligent conduct," so that the comment would only excuse a first act of simple negligence.

Second, we recommend that the Board add the words "gross negligence" to 1.1(a): "A lawyer shall not intentionally, recklessly, repeatedly, or with gross negligence...."

2. *Rule 1.3 – Diligence*

Most unfortunately, the Commission also determined not to approve Rule 1.3 on diligence. The Commission's explanation, in its document updated May 17, 2010 entitled "Rules and Concepts that Were Considered, But Are Not Recommended for Adoption" ("*May 2010 Non-Adoption Summary*") argues that "diligence is a professional responsibility standard that is subsumed within a lawyer's duty of competence." This is not so.

Although proposed Rule 1.1 pays lip service to the concept of diligence in subsection (b) and Comment ¶ 2, this is not close to adequately replacing the diligence rule. For instance, while proposed Comment ¶ 2 is similar to ABA Rule 1.3's Comment ¶ 1, other important components of diligence merit no mention in the proposed competence rule, and thus no mention at all in California: work overload (ABA Rule 1.3, Comment ¶ 2), procrastination and delay (ABA Comment ¶ 3), and following through on matters to completion (ABA Comment ¶ 4).

We strongly agree with the Commission's minority report with respect to this rule. Simply put, competence, in the eyes of most lawyers (and most people) relates to requisite skill, while diligence relates to a different and distinct concept: *paying adequate attention*. MR 1.3 and its comments need to be approved by the Board.

III. Rules omitted in whole or part by the Commission

1. *Rule 1.0.1(m) – Definition of Tribunal*

The excellent definition of "tribunal" under the ABA Model Rules "denotes a court, an arbitrator ... or a legislative body, administrative agency or other body acting in an adjudicative capacity," that is, where the body "will render a binding legal judgment directly affecting a party's interests...."

Unfortunately, that broad and appropriate definition was not followed by the Commission. The Commission's definition is limited to courts, arbitrators, administrative law judges and special masters referred by the court. The result is that adjudications may occur in other forums that are simply deemed by the Commission *not* to be tribunals.

The effect of this can be enormous. The limited definition of "tribunal" could have a significant effect on how Rules 3.7, 3.9 and, if passed, 4.1 (see *infra*) are interpreted. Most tellingly, however, is the substantial and material effect on the vitally important Model Rule 3.3, "Candor to a Tribunal." If the definition of tribunal is unduly limited, lawyers in California will not have any ethical requirement to be candid towards a number of adjudicative bodies that are making binding decisions.

Surely, we hope and expect that California's integrated State Bar would not want to convey to its lawyers or the public that members of the California bar may be less than candid before certain adjudicative bodies. Nevertheless, that is what the current proposal implies. This definition must be changed to conform to the broader ABA definition.

2. *Rule 4.1 – Truthfulness to others*

Similar issues about the integrity of California bar members are raised by the absence of Model Rule 4.1. This rule, admonishing lawyers that they may not make false material statements while representing a client, seems to be a simple and completely appropriate statement about proper lawyer behavior.

The Commission in its *May 2010 Non-Adoption Summary* argues, however, that use of the word "knowingly" raises the issue of what constitutes "knowledge," claims that "gross misconduct" is already disciplinable under the Business & Professions Code, and finally states that a rule is unnecessary because the concept is "as old as the legal profession itself." None of those reasons have any merit when a simple, straightforward rule of common usage and understanding can be adopted to clearly codify the prohibited conduct.

We strongly recommend implementation of this rule. We see no valid articulable reason not to have this important rule.

3. *Rule 3.3 – Duty of candor*

Similarly, proposed Rule 3.3 implies the same kind of limitation on attorney candor. In sharp contrast to the ABA rule, which requires candor until the matter is resolved, Section (c) of the proposed CRPC requires that the duty of candor continue until the conclusion of the proceeding "or the representation, whichever comes first." Paragraph 13 of the proposed rule is also modified.

Apparently, there was a concern among some Commission members in creating this narrower language that lawyers might have an affirmative obligation to reveal information discovered after they no longer represented a client. However, the effect of this modification is to permit lawyers to withdraw from representation while an adjudicative proceeding is pending and thereby absolve themselves from any ongoing duty of candor. Moreover, because a lawyer need not have made an appearance before the tribunal to implicate the obligation of candor, the CRPC version may also allow a lawyer to "withdraw" from the client – and thus the duty – without any imprimatur from the tribunal.

The limiting language in section (c) and Comment ¶ 13 must be removed, conforming to the ABA rule. If the Board is concerned about after-acquired information, it could consider inserting the words "When representing a client" to the very beginning of the rule.

Note our concern, *supra*, that the definition of "tribunal" *must* be broadened.

4. Rule 3.9 – Advocate in non-adjudicative proceeding

Rule 3.9 has been adopted in the Commission's proposal. Inexplicably, however, the CRPC version of the rule does not require compliance with other rules relating to candor and honesty, 3.3, 3.4, and 3.5. Such compliance *is* required by ABA MR 3.9.

We cannot explain the Commission's resistance to common statements about attorney honesty, such as this and those set forth above. Given the reputation of lawyers in today's marketplace, we believe that it is better for rules of conduct to make it abundantly clear that lawyers will act honestly and honorably. There is no excuse for not requiring compliance with other rules in situations not involving adjudicative proceedings. (Moreover, this is another further problematic example of why the definition of "tribunal" must be broadened, in order to narrow the scope of what is meant in Rule 3.9 about a "nonadjudicative proceeding.")

This rule should conform to the ABA language and apply 3.3, 3.4, and 3.5.

5. Rule 4.4(a) – Barring use of embarrassment, delay, or burden

Similarly, the Commission has not recommended implementation of Rule 4.4(a), because – according to the *May 2010 Non-Adoption Summary* – the terms "embarrass, delay, or burden a third party" are seen as vague and overbroad. The Commission is concerned that such a rule might have "a chilling effect on legitimate advocacy."

However, no such chilling effect has been shown to exist in the vast number of states that have approved Rule 4.4(a). Perhaps this is because the rule does not simply *prevent* actions that embarrass, delay and burden. Rather it *limits* a lawyer where s/he uses "means that have *no substantial purpose other than*" these impermissible goals. Emphasis added. Legitimate advocacy is, of course, a legitimate goal.

We strongly recommend implementation of this rule.

6. Rule 5.7 – Rule application to "law-related services"

Similarly, the Commission has determined not to adopt Model Rule 5.7. This rule simply makes it clear that when lawyers, increasingly doing multi-disciplinary work, are not acting as lawyers in "law-related" matters, they still must comply with the rules of attorney conduct.

The Commission argues that California case law provides "broader and more nuanced guidance," such as to make the rule unnecessary. However, adding this rule will in no way have a chilling effect on the ability of California courts to provide more specific and nuanced guidance. Perhaps some matters would not require "nuanced" court adjudication if this rule is adopted.

7. *Rule 2.1 – Lawyer as advisor*

A. Strengthening the comments

The Commission has chosen to adopt a weakened version of this rule. In particular, in order for this rule to be effective, the truncated comments must be expanded to include ¶ 3 and the first two sentences of ¶ 5 of the ABA rule. Also, the Commission eliminated the sentence in ¶ 2 of the Comment that states, "Purely technical legal advice, therefore, can sometimes be inadequate." Apparently, this occurred because some Commission members were concerned about creating a "gotcha" civil liability against lawyers. This could be easily remedied by replacing the word "inadequate" with "insufficient," and striking the word "therefore."

B. Independent professional judgment

We understand as this letter is being distributed for signature, some effort may be made by Commission members to add a definition of "independent professional judgment" to this rule. While we have no draft of that proposal, we *strongly caution* the Board about adopting a sudden definition of this complex and exceptionally important term without it being fully and completely vetted. This is particularly true of any effort to equate "independent professional judgment" with "loyalty" – two vital and important concepts that are nevertheless not the same.

IV. Rules related to confidentiality

1. *Rule 1.6 – Basic confidentiality*

We remind the Board that this rule is based on the statutory modification to Bus. & Profs. Code § 6068(e) of 2004.[4] The Board should be very careful to ensure that in any modifications to the comments to the rule, the Commission has not overstepped the narrow bounds created by the legislature in drafting the original exceptions to confidentiality.

2. *Rule 1.13 – Organization as client*

Similarly, it is not possible to expect the Commission to draft Model Rule 1.13 in a way that would enable the whistleblower to ever go outside the organization, as the ABA has allowed in narrow circumstances, due to legislative pre-emption.

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[4] The California Supreme Court declined to modify issues relating to confidentiality on at least three occasions prior to 2004, demonstrating its clear view that this issue was the province of the legislature.

V. Rules related to lawyers' financial interests

1. *Rule 1.5 – Use of the term "unconscionable"*

The California Commission has insisted, repeatedly and counter-intuitively, in retaining the word "unconscionable" to define the propriety of fees and – even more puzzlingly – some expenses. The ABA uses the far more intelligible word "unreasonable." Moreover, California's own Business & Professions Code, in evaluating fee recoveries without written contracts, *also* uses the "reasonable" standard. Finally, the term "unconscionable" appears to create a higher threshold than "unreasonable," thus being lawyer- rather than client-protective.

Thus, the California rule would perpetuate use of a difficult-to-define, rather archaic, and lawyer-protective term that is at odds with the ABA formulation *and* at the same time perpetuates two California standards – one under the ethics rules and one under the State Bar Act.

This simply makes no sense. We strongly urge the Board to remove the word unconscionable and replace it with "unreasonable."

2. *Rule 1.15 – Trust accounts*

The Commission has developed an extraordinarily detailed and complicated trust account rule. We commend the Commission for the time and energy involved in fashioning such a detailed series of requirements.

However, we remain quite concerned that details of this extraordinary nature read more like a handbook than a disciplinary rule. While we have stated that we believe the CRPC must provide guidance as well as simple rules of discipline, we are concerned as to whether the trust account rule may be so complicated as to pose traps for both unwary *and wary* practitioners.

We note that the proposed CRPC rule runs 30 paragraphs, while the ABA rule is five paragraphs long. We believe more work needs to be done on this rule in order to provide practitioners with clear guidance and sufficient simplicity to enable California lawyers to comply with reasonable requirements without getting lost in the interstices of complex linguistics.

The Board should return this rule to the Commission with appropriate instructions.

3. *Rule 1.17 – Sale of a law practice*

A. Geographical area

The Commission has conflated the reference to "geographic area of practice" in the ABA rule – allowing a selling lawyer to cease practice in a state or particular "geographic area" – into selling off different geographic areas themselves. This is clearly a misinterpretation of the current ABA rule, intended or otherwise.

Importantly, this also damages clients. Sale of an "area" would allow a large law firm to sell all its San Diego clients, or San Joaquin clients, to another firm even while it continues to

practice in the same field. Clients will then be shunted to another law firm not of their choosing in a wide variety of circumstances.

This rule was designed to allow lawyers or law firms that are retiring or moving or materially changing their practice to forward their practices to other qualified lawyers. The geographical area sale proposed by CRPC 1.17 is far too broad, allowing buying and selling of areas as if the practice of law were only a business and not also a profession, and clients were products to be bought and sold.

This breadth should be narrowed substantially.

B. No increase of fees

Section (e) of the current proposed rule says that the fee to the client shall not be increased "solely" by reason of the purchase of the practice. Section (d) of the ABA rule makes this fee increase absolute. We strongly believe that the California language should also be absolute, and that the word "solely" should be stricken.

Respectfully submitted,

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THERECORDER

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Viewpoint: State Bar Initiates Ethics Rewrite 2.0

Richard Zitrin, The Recorder

February 13, 2015

Optimistic is a word I don't often use when it comes to the machinations of the State Bar of California. But the recent appointment of the second rules revision commission has me feeling positively optimistic. Well, cautiously optimistic.

As I wrote in this space last October, after years of fits and starts, and with far more fits than starts, the State Bar Commission for the Revision of the Rules of Professional Conduct, the first commission whose task was a soup-to-nuts revision of California's ethics rules, was disbanded by order of the Supreme Court with essentially none of its work product being adopted despite over a decade of work. The court ordered a new rules commission be created by the bar with input from the court, and on Jan. 30 the members of that rules commission were announced.

I'm hopeful about the makeup of that group. For those unfamiliar with this column, let me make my bias clear: the desire to see that protection of clients and the public come before the self-protection of lawyers.

MEET THE PLAYERS

By naming an appellate justice, Lee Edmon, as chair, State Bar President Craig Holden, who was given the power of appointment by the bar board, helped ensure a measure of objectivity and, one would hope, a concern for the public interest. By naming Jeffrey Bleich as co-vice chair, Holden chose someone who, when State Bar president in 2007, was keenly aware of the importance of the ethics rule revisions, and the first commission's problems. In addition, Bleich, most recently the U.S. ambassador to Australia, has a long history of advocating for the public good.

By electing to rename the first commission's co-vice chair, Mark Tuft, Holden again chose wisely. Tuft was the first commission's strongest advocate for protecting clients and the public. Other appointments are also wise choices. Toby Rothschild, a lifelong legal services lawyer who recently retired, attended most of the first commission's meetings and is already familiar with the issues at hand, including those that pit lawyers against clients.

One of Holden's most intriguing choices is Aja Brown, a 32-year-old African American woman who worked as a city planner, most recently for the city of Compton, before a surprise landslide election installed her as mayor of Compton in 2013. I don't know Mayor Brown, but I'd hope that with her background, she will be a public member who is interested in public protection.

More good news: the bar retained Professor Kevin Mohr as its "consultant," or chief counsel. Between them, Mohr and internal ethics counsel Randall Difuntorum have unique institutional knowledge about what worked and didn't work the first time around. With a much shorter deadline to work with, it's my hope that Mohr will be more outspoken in leading the commission to some key public policy positions and necessary truths. He certainly has the requisite knowledge, skill and perspective.

Other choices made by Holden, who received input from the court along the way, reflect the practice diversity the court wanted: the Los Angeles chief public defender, a federal prosecutor from L.A., a Santa Clara deputy county counsel and two more judges, one from superior court, and California Public Utilities Commission Chief Judge Karen Clopton. One would hope these public citizens would bring a perspective favoring the public good.

Not all the news is so positive. Along with Tuft, the two other holdover commissioners, Bob Kehr and Raul Martinez, are both lawyers' lawyers, though Kehr, to his credit, has proven to be someone who listens to and accepts rational discourse. But they are joined by Jim Ham, whose practice is almost entirely representing lawyers before the State Bar Court. And two of the three "advisors" to the commission (whatever that means), while able and honorable counsel, also defend lawyers for a living (the third advisor is another appellate judge).

It's not clear whether Holden, acting Executive Director Bob Hawley or someone else named these advisors. But it is clear that five professional lawyer protectionists—three commissioners and two advisors—will be in the commission meeting room. Too many, in my view, particularly when not sufficiently balanced with a client-centric perspective. There are no commission members who routinely sue lawyers or otherwise attack them. There are, so far as I can tell, no "clients," or in-house counsel, a glaring omission. And it's tough for just one public member, Mayor Brown, to represent the entire public.

CHALLENGES AND EXPECTATIONS

Of course, only time will tell whether this commission will have any better success than its predecessor, but it sure has a lot less baggage. Still, it will confront the somewhat puzzling and self-contradictory charges the Supreme Court has given the new commission. The court reiterated its charge to the first commission to "eliminate ambiguities … in the rules," to "assure adequate protection to the public" and "avoid unnecessary difference between California and other states, fostering the evolution of a national standard." This implied California should move towards the model rules created by the American Bar Association, and in fact in the past the court had urged the first commission to adopt the ABA's numbering system and to justify any differences between its draft and the ABA rules.

But that perspective differs from the statements to the second commission in the court's Sept. 19 letter to the State Bar, in which the court suggested to begin with the existing

California rules, not the ABA's, and made it clear the commission should "avoid incorporating the purely aspirational" portions of the ABA rules. In fact, the court wrote, "Comments to the proposed rules should be used sparingly and only to elucidate and not to expand upon the rules themselves," and that the rules' "historical purpose is to regulate the professional conduct of members of the bar, and that as such, the proposed rules should remain a set of minimum disciplinary standards."

These last two statements may have been the result of the first commission's overwhelmingly dense series of comments, particularly on conflicts of interest and trust accounts, some of which seemed legislative rather than explanatory. Still, eliminating comments and doing "bare-bones" disciplinary rules concerns many, including the signatories of the ethics professors' letter, who encouraged the court to develop rules providing guidance to the overwhelming majority of lawyers who will never face disciplinary charges. Significantly, Mark Tuft, the most important holdover from the first commission, has long been an advocate of providing guidance to the average practitioner. He is right.

Still, the Supreme Court's two "charges" to the new commission are sufficiently ambiguous when read together, so the new commission may still have a considerable amount of leeway to do what the court wants while ensuring the work product is something that protects the public and guides lawyers at the same time.

It's hard to know at this early date whether this second commission can meet the challenge, but given its makeup, it has a chance, something the last commission never really had.

The Recorder *welcomes submissions to Viewpoint. Contact James Cronin at jcronin@alm.com.*

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SECOND COMMISSION FOR THE REVISION OF THE RULES OF PROFESSIONAL CONDUCT
(TENTATIVE)

2015 SCHEDULE OF MEETINGS

Friday, March 27, 2015 (San Francisco)	
Friday and Saturday, May 29 & 30, 2015 (Los Angeles)	
June 26, 2015 (San Francisco)	
August 14, 2015 (Los Angeles)	
Friday and Saturday, September 25 & 26, 2015 (Los Angeles)	
October 23, 2015 (San Francisco)	
November 13, 2015 (Los Angeles)	
<u>Board of Trustees Meeting Dates</u> May 7-8, 2015 (SF) July 23-24, 2015 (LA) October 8-11, 2015 (Anaheim - Annual Meeting) November 19-20, 2015 (SF)	<u>Ethics Symposium (San Diego)</u> April 25 <u>Solo & Small Firm Summit (Newport Beach, CA)</u> June 18-20 <u>State Bar Annual Meeting (Anaheim, CA)</u> October 8-11

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Orientation Meeting (SF – Friday, 3/27/15)

- Introductions
- Key Administrative Considerations
- Commission's Work-Plan

Meeting 1 (LA – Friday, 5/29/15) [Day 1 of 2 Day Meeting]

- **Rule 1-100 – Rules of Professional Conduct, in General (long text)**

  [Martinez (L), Kornberg, Chou, Stout]

  (1) Whether to update existing references to the use of rules in non-disciplinary settings (e.g., to address whether a violation of a rule may be considered as evidence of a breach of a civil standard of care).

  (2) Whether to revise the long-arm/choice of law language (stating the extraterritorial reach of rules to State Bar member conduct occurring outside of California) to be consistent with language used by other jurisdictions (compare ABA MR 8.5(a) [long arm] and (b) [choice of law]).

  (3) Whether to recommend a new separate Terminology Rule (similar to the CA Code of Judicial Ethics terminology section) and, if so, which words and phrases should be included and what should be the respective definitions for each of them.

- **Rule 1-110 – Disciplinary Authority of the State Bar (short text)**

  [Eaton (L), Ham, Tuft]

  (1) Whether to revise the reference to "conditions" of discipline to more broadly refer to "the terms and conditions" of discipline.

  (2) Whether the more specific phrase "any agreement made in lieu of discipline, disciplinary probation, and public or private reprovals" should be substituted for the existing language that refers to "public or private reprovals or other discipline administered by the State Bar."

- **Rule 1-200 – False Statement Regarding Admission to the State Bar (short text)**

  [Clinch (L), Kehr, Peters]

  (1) Whether the rule should clarify that there are two types of conduct prohibited by the rule: (i) a Bar applicant's false statements in connection with the applicant's own admission process; and (ii) a lawyer's false statements made in connection with another person's application for admission.

  (2) Whether the rule should clarify that "admission" includes reinstatement proceedings and applications for special admission (e.g., pro hac vice, registered in-house counsel, etc. . .).

Meeting 2 (LA – Saturday, 5/30/15) [Day 2 of 2 Day Meeting]

- **Rule 1-311 – Employment of Disbarred, Suspended, Resigned, or Involuntary Inactive Member (long text)**

  [Rothschild (L), Brown, Ham]

  (1) Whether the rule should clarify the confidential or public record status of the notices that are required to be submitted to the State Bar when associating, or terminating an association, with a disbarred, suspended, resigned, or involuntary inactive member.

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- **Rule 1-120 – Assisting, Soliciting, or Inducing Violations (short text)**

  [Cardona (L), Langford]

  (1) Whether a related new rule governing "attempts" to violate the rules should be recommended for adoption by the Board (compare ABA MR 8.4(a)).

  (2) Whether a related new rule governing a lawyer's permissive or mandatory duty to report known violations of the rules should be recommended for adoption by the Board (compare ABA MR 8.3).

- **Rule 1-300 – Unauthorized Practice of Law (short text)**

  [Tuft (L), Bleich, Clopton]

  (1) Whether the rule should be revised to add references to case law that addresses conduct constituting the unauthorized practice of law in California (see, *Birbrower Montalbano, Condon & Frank v. Superior Court* (1998) 17 Cal.4th 119 [70 Cal.Rptr.2d 304]).

- **Rule 1-310 – Forming a Partnership With a Non-Lawyer (short text)**

  [Harris (L), Kehr]

  (1) Whether the reference to the formation of a "partnership" should be changed to a broader reference to the formation of a "partnership or other organization."

Meeting 3 (SF – Friday, 6/26/15)

- **Rule 2-100 – Communications With a Represented Party (potential controversy; long text)**

  [Zipser (L), Cardona, Chou, Martinez, Peters, Tuft]

  (1) Whether the protection against ex parte contact provided by the rule should continue to extend to a "party" represented by counsel or be expanded to any "person" represented by counsel (put another way, if a witness in a criminal proceeding has retained counsel in connection with the witness' participation in the criminal proceeding, then must the prosecutor and public defender obtain the permission of the witness's counsel before engaging in any communications with the witness?). (See *In the Matter of Dale* (Rev. Dept. 2005) 4 Cal. State Bar Ct. Rptr. 798 and compare MR 4.2.)

  (2) Whether there should be any change to the current exception that permits a lawyer to contact a represented public officer, board, committee or body without first obtaining the permission of the lawyer representing the public officer or body.

  (3) Whether the rule should clarify which person(s) in a corporation or other organization setting are entitled to the protection afforded by the rule (e.g., how far does this extend beyond the control group? and what about former officers or employees?).

  (4) Whether a related new rule governing contact with a party/person who is not represented by counsel should be recommended for adoption by the Board (compare ABA MR 4.3).

- **Rule 3-500 – Communication (short text)**

  [Harris (L), Clinch, Kehr]

  (1) Whether the rule should clarify that the duties imposed by the rule are not intended to affect the work product doctrine.

  (2) Whether to revise the rule to allow a lawyer to give a client access to documents as a means of responding to a client's request for copies of documents.

(3) Whether to revise the rule to clarify that providing the client with electronic copies of documents complies with the rule.

- **Rule 3-510 – Communication of Settlement Offer (short text)**

  [Kornberg (L), Brown, Langford]

  (1) Whether to revise the rule to require that a lawyer's communication of a settlement offer be transmitted in writing and that the lawyer retain a copy of that writing to be made available to the State Bar in the event of a disciplinary investigation of the lawyer involving the issue of the lawyer's communication of the settlement offer.

Meeting 4 (LA – Friday, 8/14/15)

- **Rule 3-100 – Confidential Information of a Client (potential controversy; long text)**

  [Tuft (L), Brown, Harris, Stout, Zipser]

  (1) Whether to revise the rule to permit, but not require, a lawyer to disclose confidential information when necessary to protect the interests of a client laboring under a diminished capacity due to age, infirmity, or other cause.

  (2) Whether to revise the rule to state an exception to the duty of confidentiality that allows a lawyer to secure legal advice about the lawyer's compliance with professional obligations. (See *Fox Searchlight Pictures, Inc., v. Paladino* (2001) 89 Cal.App.4th 294 [106 Cal.Rptr.2d 906], and compare MR 1.6(b)(4).)

  (3) Whether to revise the rule to state an exception to the duty of confidentiality that allows a lawyer to establish a claim or defense in a controversy with a client arising from that client's representation. (Compare CA Evid. Code § 958.)

  (4) Whether to revise the rule to state an exception to the duty of confidentiality allowing a lawyer to comply with a lawful order of a court that would require the lawyer's revelation of confidential information. (Compare CA Bus. & Prof. Code § 6103.)

  (5) Whether a related new rule governing a lawyer's "use," as opposed to disclosure, of confidential information should be recommended for adoption by the Board. (Compare ABA MR 1.8(b).)

  (6) Whether a related new rule specifically addressing the confidentiality of information provided to a lawyer by a prospective client should be recommended for adoption by the Board. (Compare State Bar Formal Ethics Opn. 2003-161 and ABA MR 1.18.)

  (7) Whether to revise the rule to require that when a lawyer seeks a client's informed consent to reveal confidential information that the consent be in writing and that the lawyer retain a copy of that writing to be made available to the State Bar in the event of a disciplinary investigation of the lawyer involving the issue of that revelation of confidential information.

- **Rule 3-110 – Failing to Act Competently (potential controversy; short text)**

  [Kehr (L), Clopton, Kornberg, Peters, Rothschild]

  (1) Whether the rule should be revised to delete the longstanding California standard prohibiting intentional, reckless or repeated acts of incompetence and substitute a new standard which states affirmatively that a lawyer must provide competent representation to a client. (See *Lewis v. State Bar* (1981) 28 Cal.3d 683, 688 [170 Cal.Rptr. 634].) (Compare ABA MR 1.1.)

  (2) Whether the concept of diligence should be separated from the competence rule and set forth as a new standalone rule. (Compare ABA MR 1.3.)

(3) Whether to retain a lawyer's duty of supervise as a concept subsumed within competence or recommend adoption of new a standalone rule(s) on supervision. (Compare ABA MR 5.1, 5.2 and 5.3; see rule 3-110, Discussion.)

(4) Whether the rule should be revised to address to what extent, if any, the duty of competence includes a lawyer's knowledge and understanding of modern technology used in the practice of law, such as "cloud computing." (See State Bar Formal Op. No. 2010-179. See also ABA MR 1.1, Comment [8].)

Meeting 5 (LA – Friday, 9/25/15 + Saturday, 9/26/15 [Review Meetings 1-5])

- **Rule 4-200 – Fees for Legal Services (potential controversy; long text)**

  [Martinez (L), Brown, Clinch, Eaton]

  (1) Whether the rule should be revised to delete the longstanding California standard prohibiting unconscionable fees and substitute a new standard that prohibits unreasonable fees. (See *Herrscher v. State Bar* (1934) 4 Cal.2d 399, 402.) (Compare ABA MR 1.5.)

  (2) Whether the scope of the rule should be expanded to cover expenses as well as fees that are billed to a client. (Compare ABA MR 1.5.)

  (3) Whether the rule should be revised to impose special requirements for the charging of a fee paid in advance including, for example, arrangements for a flat fee paid in advance or a "true retainer fee."

  (4) Whether the rule should be revised to specifically prohibit: a contingent fee for representing a defendant in a criminal matter; and/or any fee in a family law matter where payment is contingent upon the securing of a dissolution/nullity of marriage or upon the amount of support payments.

  (5) Whether the rule should be revised to impose requirements on a lawyer's modification of a fee arrangement with an existing client.

- **Rule 1-320 – Financial Arrangements with Non-Lawyers (long text)**

  [Tuft (L), Chou, Rothschild]

  (1) Whether the reference to a person who is not a lawyer should be revised to include an organization that is not authorized to practice law.

  (2) Whether the rule should be revised to address a lawyer's payment of court-awarded fees to a nonprofit organization the employed the lawyer in the matter.

- **Rule 2-200 – Financial Arrangements Among Lawyers (short text)**

  [Ham (L), Eaton, Kehr]

  (1) Whether the existing requirement for obtaining written client consent should be revised to specify that the consent must be obtained at the time that the lawyers in different firms enter into their agreement to divide a fee. (See *Mink v. Maccabee* (2004) 121 Cal.App.4th 835, 838 [17 Cal.Rptr.3d 486].)

  (2) Whether the rule should be revised to require that any fee split agreement among lawyers in different firms must be an agreement in writing.

  (3) Whether an exemption for court awarded fees should be added to the rule.

  (4) Whether the rule should be revised to require that copies of the written fee split agreement and the written client consent be retained by the lawyers who are parties to the fee split and that the copies be made available to the State Bar in the event of a disciplinary investigation of the lawyer involving the fee split agreement.

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Meeting 6 (SF – Friday, 10/23/15)

- **Rule 1-400 – Advertising and Solicitation (long text)**

  [Langford (L), Brown, Kornberg, Tuft]

  (1) Whether the rule should retain the existing California definitional approach (e.g., defining a "communication" and a "solicitation" and imposing pertinent prohibitions and requirements for each of these categories of attorney commercial speech) or abandon it in favor of a new concept. (Compare the New York lawyer advertising rules [https://www.nycourts.gov/rules/jointappellate/NY-Rules-Prof-Conduct-1200.pdf].) (See also, ABA MR 7.1 through 7.5.)

  (2) Regardless of whether the existing approach is changed, should the rule be updated to clarify the rule's applicability to modern technology concepts by specifically addressing, as examples, the following: "a domain name," "Internet web page or web site," "e-mail, other material sent or posted by electronic transmission," or "real-time electronic communication."

  (3) Whether the rule should be revised to delete (or modify) the existing requirement to retain copies of lawyer advertisements for two years. (Compare CA Bus. & Prof. Code § 6159.1 that states a one year retention requirement.)

  (4) Whether the existing provisions governing/prohibiting compensation paid to lawyers and non-lawyers for client referrals should be included in the advertising rule. (See Rules 1-320(B) and 2-200(B).)

- **Rule 1-500 – Agreements Restricting a Member's Practice (short text)**

  [Harris (L), Bleich, Cardona, Ham]

  (1) Whether the rule should be amended to permit an agreement among partners imposing a reasonable cost on departing partners who compete with the law firm for a limited time in a limited geographical area, consistent with the California Supreme Court's decision in *Howard v. Babcock* (1993) 6 Cal.4th 409 [25 Cal.Rptr.2d 80].

  (2) Whether the rule should be amended to identify agreements that may have the effect of restricting practice but do not violate the rule (e.g., a typical confidential settlement agreement).

- **Rule 2-400 – Prohibited Discriminatory Conduct in a Law Practice (potential controversy; long text)**

  [Kehr (L), Chou, Rothschild]

  (1) Whether the rule should be amended to clarify that the prohibition on discriminatory conduct applies to all managerial or supervisory lawyers, whether or not they have any formal role in the management of the law firm in which they practice.

  (2) Whether a related new rule generally governing anti-bias speech/conduct by lawyers should be recommended for adoption by the Board. (See the former prohibition against "offensive personality" that was found to be unconstitutionally vague in *U.S. v. Wunsch* (9th Cir. 1996) 84 F.3d 1110.) (See also MR 8.4(d) prohibiting conduct prejudicial to the administration of justice.)

NOTE: The information provided here is tentative and subject to change. The subcommittee assigned to a particular rule, as well as the dates and meetings at which rules are to be considered are all subject to change.

Meeting 7 (LA – Friday, 11/13/15)

- **Rule 1-600 – Legal Service Programs (short text)**

  [Rothschild (L), Clinch, Zipser]

  (1) Whether the rule should be amended to clarify that the concept of a "lawyer *participating* in a nongovernmental program . . ." means that the lawyer "practices with, or in the form of, a nonprofit legal aid, mutual benefit or advocacy group."
  (2) Whether the rule should be amended to clarify that aiding, as well as allowing, the unlawful practice of law is prohibited.
  (3) Whether a related new rule governing a lawyer's service as a director, officer or member of legal services organization should be recommended for adoption by the Board. (See ABA MR 6.3.)
  (4) Whether a related new rule(s) governing a lawyer's service as a director, officer or member of legal services organization should be recommended for adoption by the Board. (See ABA MR 6.3 and 6.4.)

- **Rule 1-650 – Limited Legal Services Programs (long text)**

  [Martinez (L), Harris, Rothschild]

  (1) Whether the rule should be amended to state that when a conflict is identified arising from a lawyer's representation of a legal services client and a client represented by the lawyer's firm, the lawyer who participated in the legal service program should be screened from the firm's representation of the firm's client who has interests adverse to the legal services client.

- **Rule 1-700 – Member as Candidate for Judicial Office (short text)**

  [Stout (L), Clopton, Tuft]

  (1) Whether the rule should be amended to prohibit a lawyer's statement of fact that the lawyer knows to be false or with reckless disregard as to its truth or falsity concerning the qualifications or integrity of a judge, adjudicatory officer or public legal officer, or of a candidate for election or appointment to judicial or legal office.

  (2) Whether the rule should be amended to clarify that a lawyer commences to become an applicant seeking judicial office by appointment at the time of first submission of an application or personal data questionnaire to the appointing authority and that the duty to comply with the rule ends when the lawyer advises the appointing authority of the withdrawal of the lawyer's application.

- **Rule 1-710 – Member as Temporary Judge, Referee, or Court-Appointed Arbitrator (short text)**

  [Clopton (L), Eaton, Stout]

  (1) Whether the rule should be amended to clarify that a lawyer must comply with applicable portions of the Code of Judicial Ethics while acting in a "quasi-judicial" capacity pursuant to an order or appointment by a court.

Meeting 8 & 9 (Two-Day Meeting to be Scheduled for January 2016)

- **Rule 2-300 – Sale or Purchase of a Law Practice of a Member, Living or Deceased (long text)**

  [Kehr (L), Brown, Martinez]

  (1) Whether the rule should be amended to delete the requirement that a lawyer's entire practice must be sold and instead expressly permit a partial sale of a substantive area of a lawyer's

practice (for example, a sale in which a lawyer transfers the lawyer's estate planning practice to a buyer, but retains all civil litigation cases). (See ABA MR 1.17.)

(2) Whether the rule should be amended to delete the requirement that a lawyer's entire practice must be sold and instead expressly permit a partial sale of a geographic area of a lawyer's practice (for example, a sale in which a litigator transfers all of the cases pending or to be filed in a court in northern California but retains cases pending or to be filed in southern California). (See ABA MR 1.17.)

(3) Whether the rule should be amended to require that unless the scope of the work is narrowed or expanded with the clients' informed consent, the purchaser assumes the seller's obligations under existing client agreements regarding fees and the scope of work.

(4) Whether the rule should be amended to clarify that a selling "lawyer" includes the personal representative of the estate of a deceased lawyer, the trustee of a trust of which a law practice is an asset, an attorney in fact under a lawyer's durable power of attorney, a conservator of the estate of a lawyer, or a lawyer appointed to act for the seller pursuant to Business and Professions Code sections 6180, 6185 and 6190.4.

(5) Whether the rule should be amended to clarify that the requirement that the lawyer seller cease to engage in the private practice of law does not prohibit employment as a lawyer on the staff of a public agency or a legal services entity that provides legal services to the poor, or as in-house counsel to a business.

- **Rule 4-210 – Payment of Personal or Business Expenses Incurred by or for a Client (short text)**

  [Rothschild (L), Kornberg, Peters]

  (1) Whether the rule should be amended to expressly permit a lawyer to pay court costs and reasonable expenses of litigation on behalf of an indigent or pro bono client in a matter in which the lawyer represents the client.

  (2) Whether the rule should be amended to clarify that it is not a violation for a lawyer to offer or give a gift to a current client, provided that anything given is not offered in consideration of any promise, agreement, or understanding that the lawyer would make a gift to the client.

  (3) Whether the rule should be amended to clarify that while a lawyer is prohibited from lending money, or offering, promising or agreeing to lend money, to a prospective client, a lawyer is permitted to lend money to a client after the lawyer is retained, so long as there is compliance with other applicable rules, such as the rule governing business transactions with a client.

  (4) Whether the rule should be amended to clarify that as used in the rule the term "costs" is not limited to those that are taxable or recoverable under an applicable statute or rule of court.

- **Rule 4-300 – Purchasing Property at a Foreclosure of Sale Subject to Judicial Review (short text)**

  [Langford (L), Clinch, Martinez, Stout]

  (1) Whether the rule should be amended to state that it is not a violation for a lawyer to participate in transactions that are specifically authorized by and comply with Probate Code sections 9880 through 9885; but that such transactions remain subject to other applicable rules, such as the rules governing business transactions with a client and the representation of adverse interests.

NOTE: The information provided here is tentative and subject to change. The subcommittee assigned to a particular rule, as well as the dates and meetings at which rules are to be considered are all subject to change.

- **Rule 4-400 – Gifts From Client (short text)**

  [Ham (L), Cardona, Tuft]

  (1) Whether the rule should be amended to prohibit a lawyer from soliciting a gift as well as inducing a gift.

  (2) Whether the rule should be amended to conform to related Probate Code restrictions that prohibit a lawyer from preparing on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift, unless the lawyer or other recipient of the gift is related to the client. This change would include the Probate Code's "certificate of independent review" procedure which functions as an exception to the statutory prohibition. (See CA Probate Code sections 21350 et seq.)

NOTE: The information provided here is tentative and subject to change. The subcommittee assigned to a particular rule, as well as the dates and meetings at which rules are to be considered are all subject to change.

COMMISSION DRAFT ASSIGNMENT TEMPLATE

CURRENT CALIFORNIA RULE 1-110
"Disciplinary Authority of the State Bar"

I. Text of Current Rule:

Rule 1-110 Disciplinary Authority of the State Bar

A member shall comply with conditions attached to public or private reprovals or other discipline administered by the State Bar pursuant to Business and Professions Code sections 6077 and 6078 and rule 9.19, California Rules of Court.

(There is no Discussion section to this rule.)

II. Background/Purpose:

The predecessor to current rule 1-110 was approved as rule 9-101 in 1983 at the same time as the Supreme Court's approval of the predecessor to current rule 9.19 of the Rules of Court. Together, these rules provided the State Bar with the "authority to attach conditions to reprovals that would allow the bar to tailor the discipline more closely to the lawyer's misconduct and provide more protection to the public." (See State Bar Seeks Comments On New Rule Of Professional Conduct, The State Bar of California News Release (June 27, 1983).)

III. Rule Amendment Issues:

A. Identified Substantive Issues:

1. Expanding scope of rule. By its terms, rule 1-110 applies to conditions attached to "reprovals" or "other discipline administered by the State Bar." This language does not encompass all situations in which a lawyer might be bound by discipline-related conditions. Examples include situations where the State Bar enters into an agreement in lieu of discipline and where the conditions arise from a disciplinary order issued by the Supreme Court. In both instances, the purpose of rule 1-110 appears applicable but the nature of the conditions appear to fall outside of the scope of rule 1-110. The first RRC concluded that rule 1-110 should be modified to clarify that a lawyer must comply with all discipline-related conditions, even if the conditions are not specifically attached to reprovals or other discipline administered by the State Bar.

   Question: Should the Commission recommend this change?

   Promoting confidence and public protection: Requiring a lawyer to comply with all discipline-related conditions should promote confidence and public protection by helping to secure a disciplined lawyer's compliance. A lawyer who disregards a condition arising from an agreement in lieu of

discipline reflects poorly on the profession and would pose a risk of harm to the public. For example, if a term of a lawyer's agreement in lieu of discipline is to attend client trust accounting school to help the lawyer avoid future trust accounting errors, but the lawyer fails to comply with this condition, then the risk of harmful trust accounting errors would persist.

2. Conforming rule language to case law. Current rule 1-110 refers to "conditions" attached to discipline but does not refer to the "terms" of a disciplinary agreement. To be more precise, the first RRC concluded that the language of the rule should be amended to use the phrase "terms and conditions" rather than simply the word "conditions." Both the Supreme Court and the State Bar Court Review Department have used the phrase "terms and conditions" in describing a lawyer's obligations to comply with disciplinary orders. See, e.g., *In re Brown* (1995) 12 Cal.4th 205, 224 [48 Cal.Rptr.2d 29] (respondent lawyer ordered to "promptly review the ***terms and conditions*** of his probation with the monitor to establish a manner and schedule of compliance consistent with the ***terms of*** [respondent's probation]." (Emphasis added.)

   Question: Should the Commission recommend this change?

   Removing inconsistencies and ambiguities: Changing the rule to state that a lawyer must comply with both "terms" and "conditions" removes an inconsistency with case law and eliminates a possible ambiguity. Decisions of the State Bar Court and the Supreme Court refer to "terms" and "conditions," but the current rule only refers to "conditions."

3. Moving explanatory last clause of current rule to Discussion. The last clause of the current rule is a reference to other related law that similarly requires a lawyer's compliance with disciplinary conditions. It is not essential for this reference to appear in the rule proper. A new rule Discussion section could be used for these references and there are other related laws that are omitted that could be included (See Business and Professions Code sections 6068(k) and (l).) To make the language of the rule concise and to add the omitted references, the first RRC modified and moved the last clause of current rule 1-110 to a new rule Discussion. The addition of this new Discussion is minimal and does not conflict with the rule proper.

   Question: Should the Commission recommend this change?

4. The current rule title refers to the "Disciplinary Authority of the State Bar."

   Question: Should the rule title be changed to specifically address the purpose of the rule to require that lawyers abide by all discipline-related conditions?

B. Non-Substantive Issues:

1. Current Rule 9.19(b) of the Rules of Court includes an outdated reference to former Rule of Professional Conduct 9-101 (the predecessor to current rule 1 110). (See footnote no. 2 for the text of Rule of Court 9.19(b).) The Commission's final report should identify this discrepancy and include a recommendation that the State Bar suggest an appropriate conforming amendment to Rule 9.19(b). Even if no change is made to current rule 1 110, the outdated reference in the Rules of Court should be addressed in the Commission's final report.

C. Issues Related to the ABA Model Rules:

1. There is no corresponding ABA Model Rule of Professional Conduct. However, a comparable rule 10(B) in the ABA Model Rules of Disciplinary Enforcement[1] provides that: "Written conditions may be attached to an admonition or a reprimand. Failure to comply with such conditions shall be grounds for reconsideration of the matter and prosecution of formal charges against the respondent." Current rule 1-110 is similar in concept to the ABA disciplinary enforcement rule but it is tailored to California's lawyer disciplinary system. Arguably, the existence of these similar concepts achieves appropriate uniformity and promotes a national standard.

D. Changes to Rule Discussion:

1. See III.A.3., above. There is no discussion to current rule 1-110. The first RRC concluded that the final clause of current rule 1-110 should be modified and moved to become the rule's only commentary. This clause in the current rule cites to other related law. Because this information does not describe the conduct governed by the rule but instead explains its scope by providing relevant cross references, the first RRC determined that these references were better suited to the rule discussion rather than

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[1] The following states appear to have discipline enforcement rules based, in whole or in part, on the ABA Model Rules of Disciplinary Enforcement: Alabama, Alaska, Delaware, Florida, Idaho, Louisiana, Michigan, Mississippi, Montana, Nevada, North, Dakota, Oklahoma, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Vermont, and West Virginia. In addition, Maine recently proposed a similar rule.

being retained in the rule proper. The first RRC's modifications deleted references to Business and Professions Code sections 6077 and 6078 because those code sections are not authority for requiring a lawyer to comply with an agreement in lieu of discipline or the terms and conditions of a disciplinary probation or reproval. Instead, those sections state the general authority of the State Bar in a lawyer disciplinary proceeding to impose lower level disciplinary sanctions and to recommend higher sanctions for Supreme Court consideration. In the place of those sections, a reference to Business and Professions Code section 6068 (k) and (l) was added because those subdivisions specifically address the duty of an attorney to comply with disciplinary conditions and agreements in lieu of discipline. The existing reference to rule 9.19[2] of the Rules of Court was retained by the first Commission as a part of the recommended Discussion. If implemented, this addition would be minimal and would not conflict with the rule proper.

E. ***Significant Public Comment or Stakeholder Concerns Presented to the First Commission:***

1. No significant concerns were conveyed to the first Commission in connection with current rule 1-110. OCTC and the San Diego County Bar Association supported as drafted the first RRC's proposed amended rule.

F. ***Research Resources:***

1. Business and Professions Code §§ 6077 and 6078
2. Business and Professions Code 6068(k) and (l)
3. California Rules of Court, rule 9.19

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[2] Rule 9.19 follows: Rule 9.19. Conditions attached to reprovals

(a) Attachment of conditions to reprovals

The State Bar may attach conditions, effective for a reasonable time, to a public or private reproval administered upon a member of the State Bar. Conditions so attached must be based on a finding by the State Bar that protection of the public and the interests of the member will be served thereby. The State Bar when administering the reproval must give notice to the member that failure to comply with the conditions may be punishable.

(b) Sanctions for failure to comply

A member's failure to comply with conditions attached to a public or private reproval may be cause for a separate proceeding for willful breach of rule 9-101 of the Rules of Professional Conduct.

4. In the Matter of Meyer (Rev. Dept. 1997) 3 Cal. State Bar Ct. Rptr. 697 (violation of rule 1-110 found.)

IV. Discussion Draft:

The following draft in redline/strikeout style implements the amendments discussed above for discussion purposes and to assist the assigned Commission members in preparing a report and recommendation on proposed amendments, if any, to current rule 1-110.

Rule 1~~.~~-110 ~~Disciplinary Authority of the State Bar~~ Compliance with Terms and Conditions of Discipline and Agreements in Lieu of Discipline

A member shall comply with the terms and conditions attached to any agreement made in lieu of discipline, disciplinary probation, and public or private reprovals~~ discipline administered by the State Bar pursuant to Business and Professions Code sections 6077 and 6078 and rule 9.19, California Rules of Court~~.

Discussion

[1] Other provisions also require a lawyer to comply with conditions of discipline. See, e.g., Business and Professions Code sections 6068(k) and (l) and California Rules of Court, Rule 9.19.

NOTE: The information provided here is tentative and subject to change. The subcommittee assigned to a particular rule, as well as the dates and meetings at which rules are to be considered are all subject to change.

SUBCOMMITTEE REPORT AND RECOMMENDATION: RULE 1-110

Lead Drafter: Eaton
Co-Drafters: Ham, Tuft
Meeting Date: May 29 – 30, 2015

CURRENT CALIFORNIA RULE

CLEAN:

Rule 1-110 Disciplinary Authority of the State Bar

A member shall comply with conditions attached to public or private reprovals or other discipline administered by the State Bar pursuant to Business and Professions Code sections 6077 and 6078 and rule 9.19, California Rules of Court.

SUBCOMMITTEE VOTE

There was a consensus among the subcommittee members to recommend the proposed rule as amended.

CONCEPTS ACCEPTED/REJECTED; CHANGES IN DUTIES; NON-SUBSTANTIVE CHANGES; ALTERNATIVES CONSIDERED

Concepts Accepted (Pros and Cons)

- Implement changes to address each of the known issues.
  - Pros: Improves public protection by securing lawyers' compliance with the terms and conditions of various types of discipline, not being limited to reprovals or discipline administered by the State Bar as in the current rule.
  - Cons: There are no known cons to adopting the proposed rule.

Concepts Rejected (Pros and Cons)

- Reformulate the rule to follow Rule 10(B) of the ABA Model Rules of Disciplinary Enforcement.
  - Pros: Comports with CA's longstanding policy of having a specific duty codified in the Rules of Professional Conduct.
  - Cons: Arguably, would detract from achieving uniformity with states that follow the ABA approach. However, because only a minority of states have adopted the ABA Model Rules of Disciplinary Enforcement,[1] there is at present no uniform standard for

[1] The following states appear to have discipline enforcement rules based, in whole or in part, on the ABA Model Rules of Disciplinary Enforcement: Alabama, Alaska, Delaware, Florida, Idaho, Louisiana, Michigan, Mississippi, Montana, Nevada, North, Dakota, Oklahoma, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Vermont, and West Virginia. In addition, Maine recently proposed a similar rule.

SUBCOMMITTEE REPORT AND RECOMMENDATION: RULE 1-110

Lead Drafter: Eaton
Co-Drafters: Ham, Tuft
Meeting Date: May 29 – 30, 2015

addressing this issue. Further, ABA Rule of Disciplinary Enforcement 10(B) is narrower in scope than the proposed rule, being limited to an admonition or reprimand.[2]

Changes in Duties/Substantive Changes to the Current Rule

- The current rule applies to reprovals and State Bar administered discipline. The proposed rule would expand the scope to encompass the terms and conditions of other types of discipline and arrangements in lieu of discipline.

Non-Substantive Changes to the Current Rule

- The proposed rule would clarify that the existing word "conditions" includes both "terms" and "conditions." The proposed rule would add a new minimal Discussion section that includes references that are in the black letter of current rule 1-110 and new references to related laws. The rule title would be revised to conform to the broader scope of, and more accurately describe, the content of the proposed rule.

Alternatives Considered

- Keep current rule without any changes (rejected); Adopt ABA Rule 10(B) (rejected)

OPEN ISSUES/CONCEPTS FOR THE COMMISSION TO CONSIDER

(1) If a Terminology Rule (similar to the CA Code of Judicial Ethics terminology section) is recommended by the Commission, then whether any of the following terms in proposed rule 1-110 should be defined in the Terminology Rule: "agreement made in lieu of discipline;" "disciplinary probation;" "public reproval;" or "private reproval." If so, then whether the definition should simply cross reference other State Bar rules that may already provide a suitable definition.

[2] Rule 10(B) provides:

B. Conditions. Written conditions may be attached to an admonition or a reprimand. Failure to comply with such conditions shall be grounds for reconsideration of the matter and prosecution of formal charges against the respondent.

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SUBCOMMITTEE REPORT AND RECOMMENDATION: RULE 1-110

Lead Drafter: Eaton
Co-Drafters: Ham, Tuft
Meeting Date: May 29 – 30, 2015

COMMENTS FROM THE DRAFTING SUBCOMMITTEE

Eaton

- [Date]: Email Comment
- [Date]: Email Comment

Ham

- [Date]: Email Comment
- [Date]: Email Comment

Tuft

- [Date]: Email Comment
- [Date]: Email Comment

PROPOSED RULE

CLEAN:

Rule 1-110 Compliance with Terms and Conditions of Discipline and Agreements in Lieu of Discipline

A member shall comply with the terms and conditions attached to any agreement made in lieu of discipline, disciplinary probation, and public or private reprovals.

Discussion

[1] Other provisions also require a lawyer to comply with conditions of discipline. See, e.g., Business and Professions Code section 6068, subdivisions (k) & (l) and California Rules of Court, Rule 9.19.

REDLINE:

Rule 1-110 Compliance with Terms and Conditions of Discipline and Agreements in Lieu of Discipline ~~**Disciplinary Authority of the State Bar**~~

A member shall comply with the terms and conditions attached to any agreement made in lieu of discipline, disciplinary probation, and public or private reprovals~~ or other discipline administered by the State Bar pursuant to Business and Professions Code sections 6077 and 6078 and rule 9.19, California Rules of Court~~.

Discussion

[1] Other provisions also require a lawyer to comply with conditions of discipline. See, e.g., Business and Professions Code section 6068, subdivisions (k) & (l) and California Rules of Court, Rule 9.19.

NOTE: The information provided here is tentative and subject to change. The subcommittee assigned to a particular rule, as well as the dates and meetings at which rules are to be considered are all subject to change.

SUBCOMMITTEE REPORT AND RECOMMENDATION: RULE 1-110

Lead Drafter: Eaton
Co-Drafters: Ham, Tuft
Meeting Date: May 29 – 30, 2015

RECOMMENDATION AND PROPOSED COMMISSION RESOLUTION

Recommendation:

Adopt proposed amended rule 1-110.

Proposed Resolution:

RESOLVED: That the Commission adopts proposed amended rule 1-110 in the form attached to this action summary.

DISSENTING POSITION(S)

Eaton
- [None or Statement of Dissenting Position]

Ham
- [None or Statement of Dissenting Position]

Tuft
- [None or Statement of Dissenting Position]

FINAL COMMISSION VOTE/ACTION

[Date of Vote]

[Action: Proposed amended rule adopted or not adopted]

[Record of Roll Call Vote]

ABA Model Rule 1.7, Comment [22] – Advance Waivers	First Commission, Proposed Rule 1.7, Comment [22]
[22] Whether a lawyer may properly request a client to waive conflicts that might arise in the future is subject to the test of paragraph (b). The effectiveness of such waivers is generally determined by the extent to which the client reasonably understands the material risks that the waiver entails. The more comprehensive the explanation of the types of future representations that might arise and the actual and reasonably foreseeable adverse consequences of those representations, the greater the likelihood that the client will have the requisite understanding. Thus, if the client agrees to consent to a particular type of conflict with which the client is already familiar, then the consent ordinarily will be effective with regard to that type of conflict. If the consent is general and open-ended, then the consent ordinarily will be ineffective, because it is not reasonably likely that the client will have understood the material risks involved. On the other hand, if the client is an experienced user of the legal services involved and is reasonably informed regarding the risk that a conflict may arise, such consent is more likely to be effective, particularly if, e.g., the client is independently represented by other counsel in giving consent and the consent is limited to future conflicts unrelated to the subject of the representation. In any case, advance consent cannot be effective if the circumstances that materialize in the future are such as would make the conflict nonconsentable under paragraph (b).	[22] Lawyers may ask clients to give advance consent to conflicts that might arise in the future, but a client's consent must be "informed" to comply with this Rule. A lawyer would have a conflict of interest in accepting or continuing a representation under a consent that does not comply with this Rule. Determining whether a client's advance consent is "informed," and thus complies with this Rule, is a fact-specific inquiry that will depend first on the factors discussed in Comments [18]-[20] (informed written consent). However, an advance consent can comply with this Rule even where the lawyer cannot provide all the information and explanation Comments [18]-[20] ordinarily requires. A lawyer's disclosure to a client must include: (i) a disclosure to the extent known of facts and reasonably foreseeable consequences; and (ii) an explanation that the lawyer is requesting the client to consent to a possible future conflict that would involve future facts and circumstances that to a degree cannot be known when the consent is requested. The lawyer also must disclose to the client whether the consent permits the lawyer to be adverse to the client on any matter in the future, whether the consent permits the lawyer to be adverse to the client in the current or in future litigation, and whether there will be any limits on the scope of the consent. Whether an advance consent complies with this Rule ordinarily also can depend on factors such as the following: (1) the comprehensiveness of the lawyer's explanation of the types of future conflicts that might arise and of the actual and reasonably foreseeable adverse consequences to the client; (2) the client's degree of experience as a user of the legal services, including experience with the type of legal services involved in the current representation; (3) whether the client has consented to the use of an adequate ethics screen and whether the screen was timely and effectively instituted and fully maintained; (4) whether before giving consent the client either was represented by an independent lawyer of the client's choice, or was advised in writing by the lawyer to seek the advice of an independent lawyer of the client's choice and was given a reasonable opportunity to seek that advice; (5) whether the consent is limited to future conflicts unrelated to the subject of the representation; and (6) the client's ability to understand the nature and extent of the advance consent. A client's ability to understand the nature and extent of the advance consent might depend on factors such as the client's education, language skills, and the client's familiarity with the particular type of conflict that is the subject of the consent. An advance consent normally will not comply with this Rule if it is so general and open-ended that it would be unlikely that the client

ABA Model Rule 1.7, Comment [22] – Advance Waivers	First Commission, Proposed Rule 1.7, Comment [22]
	understood the potential adverse consequences of granting consent. However, depending upon the extent to which the other enumerated factors set forth above are present, even a general and open-ended advance consent can be in compliance when: the consent was given by an experienced user of the type of legal services involved; and the client was independently represented regarding the consent or was advised in writing by the lawyer to seek the advice of an independent lawyer of the client's choice and was given a reasonable opportunity to seek that advice. In any case, advance consent will not be in compliance in the circumstances described in Comments [14]-[17A] (prohibited representations). See Rule 1.0.1(e) (informed consent) and 1.0.1 (e-1) (informed written consent). A lawyer who obtains from a client an advance consent that complies with this Rule will have all the duties of a lawyer to that client except as expressly limited by the consent. A lawyer cannot obtain an advance consent to incompetent representation. See Rule 1.8.8.

ABA Model Rule **Rule 3.8 Special Responsibilities of a Prosecutor**	**Commission's Proposed Rule** **Rule 3.8 Special Responsibilities of a Prosecutor**
The prosecutor in a criminal case shall: (a) refrain from prosecuting a charge that the prosecutor knows is not supported by probable cause;	~~The~~A prosecutor in a criminal case shall: (a) refrain from commencing or prosecuting a charge that the prosecutor knows is not supported by probable cause;
(b) make reasonable efforts to assure that the accused has been advised of the right to, and the procedure for obtaining, counsel and has been given reasonable opportunity to obtain counsel;	(b) make reasonable efforts to assure that the accused has been advised of the right to, and the procedure for obtaining, counsel and has been given reasonable opportunity to obtain counsel;
(c) not seek to obtain from an unrepresented accused a waiver of important pretrial rights, such as the right to a preliminary hearing;	(c) not seek to obtain from an unrepresented accused a waiver of important pretrial rights~~, such as the right to a preliminary hearing~~ unless the tribunal has approved the appearance of the accused *in propria persona*;
(d) make timely disclosure to the defense of all evidence or information known to the prosecutor that tends to negate the guilt of the accused or mitigates the offense, and, in connection with sentencing, disclose to the defense and to the tribunal all unprivileged mitigating information known to the prosecutor, except when the prosecutor is relieved of this responsibility by a protective order of the tribunal;	(d) comply with all statutory and constitutional obligations, as interpreted by relevant case law, to make timely disclosure to the defense of all evidence or information known to the prosecutor that tends to negate the guilt of the accused or mitigates the offense, and, in connection with sentencing, disclose to the defense and to the tribunal all unprivileged mitigating information known to the prosecutor, except when the prosecutor is relieved of this responsibility by a protective order of the tribunal;
(e) not subpoena a lawyer in a grand jury or other criminal proceeding to present evidence about a past or present client unless the prosecutor reasonably believes:	(e) not subpoena a lawyer in a grand jury ~~or other~~proceeding, criminal proceeding, or civil proceeding related to a criminal matter to present evidence about a past or present client unless the prosecutor reasonably believes:

ABA Model Rule **Rule 3.8 Special Responsibilities of a Prosecutor**	**Commission's Proposed Rule** **Rule 3.8 Special Responsibilities of a Prosecutor**
(1) the information sought is not protected from disclosure by any applicable privilege;	(1) the information sought is not protected from disclosure by any applicable privilege or the work product doctrine;
(2) the evidence sought is essential to the successful completion of an ongoing investigation or prosecution; and	(2) the evidence sought is ~~essential~~reasonably necessary to the successful completion of an ongoing investigation or prosecution; and
(3) there is no other feasible alternative to obtain the information;	(3) there is no other ~~feasible~~reasonable alternative to obtain the information;
(f) except for statements that are necessary to inform the public of the nature and extent of the prosecutor's action and that serve a legitimate law enforcement purpose, refrain from making extrajudicial comments that have a substantial likelihood of heightening public condemnation of the accused and exercise reasonable care to prevent investigators, law enforcement personnel, employees or other persons assisting or associated with the prosecutor in a criminal case from making an extrajudicial statement that the prosecutor would be prohibited from making under Rule 3.6 or this Rule.	(f) ~~except for statements that are necessary to inform the public of the nature and extent of the prosecutor's action and that serve a legitimate law enforcement purpose, refrain from making extrajudicial comments that have a substantial likelihood of heightening public condemnation of the accused and~~ exercise reasonable care to prevent persons under the supervision or direction of the prosecutor, including investigators, law enforcement personnel, employees or other persons assisting or associated with the prosecutor in a criminal case from making an extrajudicial statement that the prosecutor would be prohibited from making under Rule 3.6~~ or this Rule~~.
(g) When a prosecutor knows of new, credible and material evidence creating a reasonable likelihood that a convicted defendant did not commit an offense of which the defendant was convicted, the prosecutor shall:	(g) When a prosecutor knows of new, credible and material evidence creating a reasonable likelihood that a convicted defendant did not commit an offense of which the defendant was convicted, the prosecutor shall:

ABA Model Rule **Rule 3.8 Special Responsibilities of a Prosecutor**	**Commission's Proposed Rule** **Rule 3.8 Special Responsibilities of a Prosecutor**
(1) promptly disclose that evidence to an appropriate court or authority, and (2) if the conviction was obtained in the prosecutor's jurisdiction, (i) promptly disclose that evidence to the defendant unless a court authorizes delay, and (ii) undertake further investigation, or make reasonable efforts to cause an investigation, to determine whether the defendant was convicted of an offense that the defendant did not commit.	(1) promptly disclose that evidence to an appropriate court or authority, and (2) if the conviction was obtained in the prosecutor's jurisdiction, (i) promptly disclose that evidence to the defendant unless a court authorizes delay, and (ii) undertake further investigation, or make reasonable efforts to cause an investigation, to determine whether the defendant was convicted of an offense that the defendant did not commit.
(h) When a prosecutor knows of clear and convincing evidence establishing that a defendant in the prosecutor's jurisdiction was convicted of an offense that the defendant did not commit, the prosecutor shall seek to remedy the conviction.	(h) When a prosecutor knows of clear and convincing evidence establishing that a defendant in the prosecutor's jurisdiction was convicted of an offense that the defendant did not commit, the prosecutor shall seek to remedy the conviction.

ABA Model Rule **Rule 3.8 Special Responsibilities of a Prosecutor** **Comment**	**Commission's Proposed Rule** **Rule 3.8 Special Responsibilities of a Prosecutor** **Comment**
[1] A prosecutor has the responsibility of a minister of justice and not simply that of an advocate. This responsibility carries with it specific obligations to see that the defendant is accorded procedural justice and that guilt is decided upon the basis of sufficient evidence, and that special precautions are taken to prevent and to rectify the conviction of innocent persons. The extent of mandated remedial action is a matter of debate and varies in different jurisdictions. Many jurisdictions have adopted the ABA Standards of Criminal Justice Relating to the Prosecution Function, which are the product of prolonged and careful deliberation by lawyers experienced in both criminal prosecution and defense. Competent representation of the sovereignty may require a prosecutor to undertake some procedural and remedial measures as a matter of obligation. Applicable law may require other measures by the prosecutor and knowing disregard of those obligations or a systematic abuse of prosecutorial discretion could constitute a violation of Rule 8.4.	[1] A prosecutor has the responsibility of a minister of justice and not simply that of an advocate. This responsibility carries with it specific obligations to see that the defendant is accorded procedural justice, that guilt is decided upon the basis of sufficient evidence, and that special precautions are taken to prevent and to rectify the conviction of innocent persons. ~~The extent of mandated remedial action is a matter of debate and varies in different jurisdictions. Many jurisdictions have adopted the ABA Standards of Criminal Justice Relating to the Prosecution Function, which are the product of prolonged and careful deliberation by lawyers experienced in both criminal prosecution and defense.~~ Competent representation of the ~~sovereignty~~sovereign may require a prosecutor to undertake some procedural and remedial measures as a matter of obligation. Applicable law may require other measures by the prosecutor~~ and knowing~~. Knowing disregard of those obligations, or a systematic abuse of prosecutorial discretion, could constitute a violation of Rule 8.4.
	[1A] The term "prosecutor" in this Rule includes the office of the prosecutor and all lawyers affiliated with the prosecutor's office who are responsible for the prosecution function.
	[1B] Paragraph (b) does not change the obligations imposed on prosecutors by applicable law. Paragraph (b) does not apply where there is no right to counsel. "Reasonable efforts" include determining, where appropriate, whether an accused has been advised of the right to, and the procedure for obtaining, counsel and taking appropriate measures if this has not been done.

ABA Model Rule **Rule 3.8 Special Responsibilities of a Prosecutor** **Comment**	**Commission's Proposed Rule** **Rule 3.8 Special Responsibilities of a Prosecutor** **Comment**
[2] In some jurisdictions, a defendant may waive a preliminary hearing and thereby lose a valuable opportunity to challenge probable cause. Accordingly, prosecutors should not seek to obtain waivers of preliminary hearings or other important pretrial rights from unrepresented accused persons. Paragraph (c) does not apply, however, to an accused appearing pro se with the approval of the tribunal. Nor does it forbid the lawful questioning of a an uncharged suspect who has knowingly waived the rights to counsel and silence.	[2] ~~In some jurisdictions, a defendant may waive a preliminary hearing and thereby lose a valuable opportunity to challenge probable cause. Accordingly, prosecutors should not seek to obtain waivers of preliminary hearings or other important pretrial rights from unrepresented accused persons.~~ Paragraph (c) does not ~~apply, however, to an accused appearing pro se with the approval of the tribunal. Nor does it~~ forbid the lawful questioning of ~~a~~ an uncharged suspect who has knowingly waived the ~~rights~~right to counsel and ~~silence.~~the right to remain silent. Paragraph (c) also does not forbid prosecutors from seeking from an unrepresented accused a reasonable waiver of time for initial appearance or preliminary hearing as a means of facilitating the accused's voluntary cooperation in an ongoing law enforcement investigation.
	[2A] The obligations in paragraph (d) apply only with respect to controlling case law existing at the time of the obligation and not with respect to subsequent case law that is determined to apply retroactively. The disclosure obligations in paragraph (d) apply even if the defendant is acquitted or is able to avoid prejudice on grounds unrelated to the prosecutor's failure to disclose the evidence or information to the defense.
[3] The exception in paragraph (d) recognizes that a prosecutor may seek an appropriate protective order from the tribunal if disclosure of information to the defense could result in substantial harm to an individual or to the public interest.	[3] The exception in paragraph (d) recognizes that a prosecutor may seek an appropriate protective order from the tribunal if disclosure of information to the defense could result in substantial harm to an individual or to the public interest.
[4] Paragraph (e) is intended to limit the issuance of lawyer subpoenas in grand jury and other criminal proceedings to those situations in which there is a genuine need to intrude into the client-lawyer relationship.	[4] Paragraph (e) is intended to limit the issuance of lawyer subpoenas in grand jury and other criminal proceedings to those situations in which there is a genuine need to intrude into the ~~client-~~lawyer-client or other privileged relationship.

ABA Model Rule **Rule 3.8 Special Responsibilities of a Prosecutor** **Comment**	**Commission's Proposed Rule** **Rule 3.8 Special Responsibilities of a Prosecutor** **Comment**
[5] Paragraph (f) supplements Rule 3.6, which prohibits extrajudicial statements that have a substantial likelihood of prejudicing an adjudicatory proceeding. In the context of a criminal prosecution, a prosecutor's extrajudicial statement can create the additional problem of increasing public condemnation of the accused. Although the announcement of an indictment, for example, will necessarily have severe consequences for the accused, a prosecutor can, and should, avoid comments which have no legitimate law enforcement purpose and have a substantial likelihood of increasing public opprobrium of the accused. Nothing in this Comment is intended to restrict the statements which a prosecutor may make which comply with Rule 3.6(b) or 3.6(c).	[5] Paragraph (f) supplements Rule 3.6, which prohibits extrajudicial statements that have a substantial likelihood of prejudicing an adjudicatory proceeding. ~~In the context of a criminal prosecution, a prosecutor's extrajudicial statement can create the additional problem of increasing public condemnation of the accused. Although the announcement of an indictment, for example, will necessarily have severe consequences for the accused, a prosecutor can, and should, avoid comments which have no legitimate law enforcement purpose and have a substantial likelihood of increasing public opprobrium of the accused. Nothing in this Comment~~ This comment is not intended to restrict the statements which a prosecutor may make ~~which~~that comply with Rule 3.6(b) or 3.6(c).
[6] Like other lawyers, prosecutors are subject to Rules 5.1 and 5.3, which relate to responsibilities regarding lawyers and nonlawyers who work for or are associated with the lawyer's office. Paragraph (f) reminds the prosecutor of the importance of these obligations in connection with the unique dangers of improper extrajudicial statements in a criminal case. In addition, paragraph (f) requires a prosecutor to exercise reasonable care to prevent persons assisting or associated with the prosecutor from making improper extrajudicial statements, even when such persons are not under the direct supervision of the prosecutor. Ordinarily, the reasonable care standard will be satisfied if the prosecutor issues the appropriate cautions to law- enforcement personnel and other relevant individuals.	[6] ~~Like other lawyers, prosecutors~~Prosecutors are subject to Rules 5.1 and 5.3. Ordinarily, ~~which relate to responsibilities regarding lawyers and nonlawyers who work for or are associated with~~ the ~~lawyer's office. Paragraph (f) reminds the prosecutor of the importance of these obligations in connection with the unique dangers of improper extrajudicial statements in a criminal case. In addition, paragraph (f) requires a prosecutor to exercise~~ reasonable care ~~to prevent persons assisting or associated with~~standard will be satisfied if the prosecutor ~~from making improper extrajudicial statements, even when such persons are not under~~issues the ~~direct supervision of the prosecutor~~appropriate cautions to law-enforcement personnel and other relevant individuals. Ordinarily, the reasonable care standard will be satisfied if the prosecutor issues the appropriate cautions to law-enforcement personnel and other relevant individuals.
	[6A] Like other lawyers, prosecutors are also subject to Rule 3.3, which requires a lawyer to take reasonable remedial measures to correct material evidence that the lawyer has offered when that lawyer comes to know of its falsity. See Rule 3.3, Comment [12].

ABA Model Rule Rule 3.8 Special Responsibilities of a Prosecutor Comment	Commission's Proposed Rule Rule 3.8 Special Responsibilities of a Prosecutor Comment
[7] When a prosecutor knows of new, credible and material evidence creating a reasonable likelihood that a person outside the prosecutor's jurisdiction was convicted of a crime that the person did not commit, paragraph (g) requires prompt disclosure to the court or other appropriate authority, such as the chief prosecutor of the jurisdiction where the conviction occurred. If the conviction was obtained in the prosecutor's jurisdiction, paragraph (g) requires the prosecutor to examine the evidence and undertake further investigation to determine whether the defendant is in fact innocent or make reasonable efforts to cause another appropriate authority to undertake the necessary investigation, and to promptly disclose the evidence to the court and, absent court-authorized delay, to the defendant. Consistent with the objectives of Rules 4.2 and 4.3, disclosure to a represented defendant must be made through the defendant's counsel, and, in the case of an unrepresented defendant, would ordinarily be accompanied by a request to a court for the appointment of counsel to assist the defendant in taking such legal measures as may be appropriate.	[7] When a prosecutor knows of new, credible and material evidence creating a reasonable likelihood that a person ~~outside the prosecutor's jurisdiction~~ was convicted of a crime that the person did not commit, and the conviction was obtained outside the prosecutor's jurisdiction, paragraph (g)(1) requires prompt disclosure to the court or other appropriate authority, such as the chief prosecutor of the jurisdiction where the conviction occurred. If the conviction was obtained in the prosecutor's jurisdiction, paragraph (g)(2) requires the prosecutor to examine the evidence and undertake further investigation to determine whether the defendant is in fact innocent. The scope of the inquiry under paragraph (g)(2) will depend on the circumstances. In some cases, the prosecutor may recognize the need to reinvestigate the underlying case; in others, it may be appropriate to await development of the record in collateral proceedings initiated by the defendant. The nature of a paragraph (g)(2) inquiry or investigation must be such as to provide a "reasonable belief," as defined in Rule 1.0.1(i), that the conviction should or should not be set aside. Alternatively, the prosecutor is required under paragraph (g)(2) to make reasonable efforts to cause another appropriate authority to undertake the necessary investigation, and to promptly disclose the evidence to the court and, absent court-authorized delay, to the defendant. Consistent with the objectives of Rules 4.2 and 4.3, disclosure to a represented defendant must be made through the defendant's counsel, and, in the case of an unrepresented defendant, would ordinarily be accompanied by a request to a court for the appointment of counsel to assist the defendant in taking such legal measures as may be appropriate. The post-conviction disclosure duty applies to new, credible and material evidence of innocence regardless of whether it could previously have been discovered by the defense.
[8] Under paragraph (h), once the prosecutor knows of clear and convincing evidence that the defendant was convicted of an offense that the defendant did not commit, the prosecutor must seek to remedy the	[8] Under paragraph (h), once the prosecutor knows of clear and convincing evidence that the defendant was convicted of an offense that the defendant did not commit, the prosecutor must seek to remedy the

ABA Model Rule **Rule 3.8 Special Responsibilities of a Prosecutor** **Comment**	**Commission's Proposed Rule** **Rule 3.8 Special Responsibilities of a Prosecutor** **Comment**
conviction. Necessary steps may include disclosure of the evidence to the defendant, requesting that the court appoint counsel for an unrepresented indigent defendant and, where appropriate, notifying the court that the prosecutor has knowledge that the defendant did not commit the offense of which the defendant was convicted.	conviction. Necessary steps may include disclosure of the evidence to the defendant, requesting that the court appoint counsel for an unrepresented indigent defendant and, where appropriate, notifying the court that the prosecutor has knowledge that the defendant did not commit the offense of which the defendant was convicted.
[9] A prosecutor's independent judgment, made in good faith, that the new evidence is not of such nature as to trigger the obligations of sections (g) and (h), though subsequently determined to have been erroneous, does not constitute a violation of this Rule.	[9] A prosecutor's independent judgment, made in good faith, that the new evidence is not of such nature as to trigger the obligations of sections (g) and (h), ~~though *subsequently determined to have been erroneous,*~~ does not constitute a violation of this Rule even if the judgment is *subsequently determined to have been erroneous*. For purposes of this rule, a judgment is made in good faith if the prosecutor reasonably believes that the new evidence does not create a reasonable likelihood that a convicted defendant did not commit an offense of which the defendant was convicted.
	[10] A current or former prosecutor, and any lawyer associated with such person in a law firm, is prohibited from advising, aiding or promoting the defense in any criminal matter or proceeding in which the prosecutor has acted or participated. See Business and Professions Code section 6131. See also Rule 1.7, Comment [16]

Model Rule 1.10 Imputation Of Conflicts Of Interest: General Rule

(a) While 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

(1) the prohibition is based on a personal interest of the disqualified lawyer and does not present a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm; or

(2) the prohibition is based upon Rule 1.9(a) or (b) and arises out of the disqualified lawyer's association with a prior firm, and

(i) the disqualified lawyer is timely screened from any participation in the matter and is apportioned no part of the fee therefrom;

(ii) written notice is promptly given to any affected former client to enable the former client to ascertain compliance with the provisions of this Rule, which shall include a description of the screening procedures employed; a statement of the firm's and of the screened lawyer's compliance with these Rules; a statement that review may be available before a tribunal; and an agreement by the firm to respond promptly to any written inquiries or objections by the former client about the screening procedures; and

(iii) certifications of compliance with these Rules and with the screening procedures are provided to the former client by the screened lawyer and by a partner of the firm, at reasonable intervals upon the former client's written request and upon termination of the screening procedures.

(b) When a lawyer has terminated an association with a firm, the firm is not prohibited from thereafter representing a person with interests materially adverse to those of a client represented by the formerly associated lawyer and not currently represented by the firm, unless:

(1) the matter is the same or substantially related to that in which the formerly associated lawyer represented the client; and

(2) any lawyer remaining in the firm has information protected by Rules 1.6 and 1.9(c) that is material to the matter.

(c) A disqualification prescribed by this rule may be waived by the affected client under the conditions stated in Rule 1.7.

(d) The disqualification of lawyers associated in a firm with former or current government lawyers is governed by Rule 1.11.

[Comments have been omitted. For the full text of the rule, visit: http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_10_imputation_of_conflicts_of_interest_general_rule.html.]

California Rule 3-110 Failing to Act Competently

(A) A member shall not intentionally, recklessly, or repeatedly fail to perform legal services with competence.

(B) For purposes of this rule, "competence" in any legal service shall mean to apply the 1) diligence, 2) learning and skill, and 3) mental, emotional, and physical ability reasonably necessary for the performance of such service.

(C) If a member does not have sufficient learning and skill when the legal service is undertaken, the member may nonetheless perform such services competently by 1) associating with or, where appropriate, professionally consulting another lawyer reasonably believed to be competent, or 2) by acquiring sufficient learning and skill before performance is required.

Discussion:

The duties set forth in rule 3-110 include the duty to supervise the work of subordinate attorney and non-attorney employees or agents. (See, e.g., *Waysman v. State Bar* (1986) 41 Cal.3d 452; *Trousil v. State Bar* (1985) 38 Cal.3d 337, 342 [211 Cal.Rptr. 525]; *Palomo v. State Bar* (1984) 36 Cal.3d 785 [205 Cal.Rptr. 834]; *Crane v. State Bar* (1981) 30 Cal.3d 117, 122; *Black v. State Bar* (1972) 7 Cal.3d 676, 692 [103 Cal.Rptr. 288; 499 P.2d 968]; *Vaughn v. State Bar* (1972) 6 Cal.3d 847, 857-858 [100 Cal.Rptr. 713; 494 P.2d 1257]; *Moore v. State Bar* (1964) 62 Cal.2d 74, 81 [41 Cal.Rptr. 161; 396 P.2d 577].)

In an emergency a lawyer may give advice or assistance in a matter in which the lawyer does not have the skill ordinarily required where referral to or consultation with another lawyer would be impractical. Even in an emergency, however, assistance should be limited to that reasonably necessary in the circumstances. (Amended by order of Supreme Court, operative September 14, 1992.)

Model Rule 1.3 Diligence

A lawyer shall act with reasonable diligence and promptness in representing a client.

[Comments have been omitted. For the full text of the rule, visit: http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_3_diligence.html.]

Model Rule 6.1 Voluntary Pro Bono Publico Service

Every lawyer has a professional responsibility to provide legal services to those unable to pay. A lawyer should aspire to render at least (50) hours of pro bono publico legal services per year. In fulfilling this responsibility, the lawyer should:

(a) provide a substantial majority of the (50) hours of legal services without fee or expectation of fee to:

(1) persons of limited means or

(2) charitable, religious, civic, community, governmental and educational organizations in matters that are designed primarily to address the needs of persons of limited means; and

(b) provide any additional services through:

(1) delivery of legal services at no fee or substantially reduced fee to individuals, groups or organizations seeking to secure or protect civil rights, civil liberties or public rights, or charitable, religious, civic, community, governmental and educational organizations in matters in furtherance of their organizational purposes, where the payment of standard legal fees would significantly deplete the organization's economic resources or would be otherwise inappropriate;

(2) delivery of legal services at a substantially reduced fee to persons of limited means; or

(3) participation in activities for improving the law, the legal system or the legal profession.

In addition, a lawyer should voluntarily contribute financial support to organizations that provide legal services to persons of limited means.

[Comments have been omitted. For the full text of the rules, visit: http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_6_1_voluntary_pro_bono_publico_service.html.]

Pro Bono Resolution

(Adopted by the Board of Governors of the State Bar of California
at its December 9, 1989 Meeting and amended at its June 22, 2002 Meeting)

RESOLVED that the Board hereby adopts the following resolution and urges local bar associations to adopt similar resolutions:

WHEREAS, there is an increasingly dire need for pro bono legal services for the needy and disadvantaged; and

WHEREAS, the federal, state and local governments are not providing sufficient funds for the delivery of legal services to the poor and disadvantaged; and

WHEREAS, lawyers should ensure that all members of the public have equal redress to the courts for resolution of their disputes and access to lawyers when legal services are necessary; and

WHEREAS, the Chief Justice of the California Supreme Court, the Judicial Council of California and Judicial Officers throughout California have consistently emphasized the pro bono responsibility of lawyers and its importance to the fair and efficient administration of justice; and

WHEREAS, California Business and Professions Code Section 6068(h) establishes that it is the duty of a lawyer "Never to reject, for any consideration personal to himself or herself, the cause of the defenseless or the oppressed"; now, therefore, it is

RESOLVED that the Board of Governors of the State Bar of California:

(1) Urges all attorneys to devote a reasonable amount of time, at least 50 hours per year, to provide or enable the direct delivery of legal services, without expectation of compensation other than reimbursement of expenses, to indigent individuals, or to not-for-profit organizations with a primary purpose of providing services to the poor or on behalf of the poor or disadvantaged, not-for-profit organizations with a purpose of improving the law and the legal system, or increasing access to justice;

(2) Urges all law firms and governmental and corporate employers to promote and support the involvement of associates and partners in pro bono and other public service activities by counting all or a reasonable portion of their time spent on these activities, at least 50 hours per year, toward their billable hour requirements, or by otherwise giving actual work credit for these activities;

(3) Urges all law schools to promote and encourage the participation of law students in pro bono activities, including requiring any law firm wishing to recruit on campus to provide a written statement of its policy, if any, concerning the involvement of its attorneys in public service and pro bono activities; and

(4) Urges all attorneys and law firms to contribute financial support to not-for-profit organizations that provide free legal services to the poor, especially those attorneys who are precluded from directly rendering pro bono services.

Model Rule 1.14 Client With Diminished Capacity

(a) When a client's capacity to make adequately considered decisions in connection with a representation is diminished, whether because of minority, mental impairment or for some other reason, the lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client.

(b) When the lawyer reasonably believes that the client has diminished capacity, is at risk of substantial physical, financial or other harm unless action is taken and cannot adequately act in the client's own interest, the lawyer may take reasonably necessary protective action, including consulting with individuals or entities that have the ability to take action to protect the client and, in appropriate cases, seeking the appointment of a guardian ad litem, conservator or guardian.

(c) Information relating to the representation of a client with diminished capacity is protected by Rule 1.6. When taking protective action pursuant to paragraph (b), the lawyer is impliedly authorized under Rule 1.6(a) to reveal information about the client, but only to the extent reasonably necessary to protect the client's interests.

[Comments have been omitted. For the full text of the rules, visit: http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_14_client_with_diminished_capacity.html.]

TAB 3

The Color of Money: Alternative Litigation Funding

THE COLOR OF MONEY: ALTERNATIVE LITIGATION FUNDING

Jennifer A. Becker, Panel Moderator **San Francisco, CA**

Jennifer Becker is an experienced trial lawyer with over 25 years of practice handling professional liability matters involving attorneys, architects, engineers and accountants. She is certified as a Legal Malpractice Specialist by the State Bar of California. She began her career as a plaintiffs' lawyer focusing on legal malpractice claims. Ms. Becker joined Long & Levit in 1999, where her unique perspective has served to effectively defend attorneys in legal malpractice actions. Ms. Becker presents on the topic of risk management, and has been Editor-In-Chief of the firm's Professional Liability Update publications since 2001. Ms. Becker was appointed to the California State Bar's Committee on Professional Responsibility and Conduct for a three year term commencing October 2012. Ms. Becker became the co-chair of the Legal Malpractice Committee of the Bar Association of San Francisco in 2014.

Peter H. Benzian **San Diego, CA**

Peter Benzian is a Managing Director of Burford. Previously, he was for many years a senior partner at Latham & Watkins, where he specialized in litigation and arbitration. As Chairman of the Litigation Department of Latham's San Diego office and lead counsel in dozens of trials, Mr. Benzian's practice emphasized complex business disputes, including antitrust, contract, intellectual property matters and securities-related actions. He has represented numerous large companies, directors and officers, accountants and investment banking firms in class action and derivative litigations, SEC investigations and enforcement actions, and federal criminal investigations involving securities, antitrust, environmental and government contract matters. Mr. Benzian is a member of the National Institute of Trial Advocacy and has served on the faculty at numerous NITA courses. He is a member of the Board of Governors and a past President of the Association of Business Trial Lawyers of San Diego. Currently, he serves on a number of boards of public interest and public service entities. Mr. Benzian is a graduate of the University of Minnesota Law School and Dartmouth College.

Carol M. Langford **Walnut Creek, CA**

Carol Langford has a solid educational background in professional responsibility matters through her adjunct professorships at the University of California Berkeley, Boalt Hall School of Law and the University of San Francisco School of Law. She has co-authored a nationally adopted legal case book entitled Legal Ethics in the Practice of Law (Lexis, Fourth Edition, 2014), as well as Legal Ethics: Rules, Statutes and Comparisons (Lexis, updated annually) and The Moral Compass of the American Lawyer: Truth, Justice, Power and Greed (Ballantine). In 2014 she was Chair of the Drafting Subcommittee of the Disciplinary Standards Task Force. She has published numerous articles on ethics and malpractice avoidance. She has spoken at well over 125 continuing education programs on ethics conduct issues. Ms. Langford also serves as a national expert witness on the ethical conduct of lawyers and has consulted with hundreds of lawyers, including individual law firms and individual and institutional clients. She has evaluated numerous legal malpractice claims and has been an expert witness or consultant on a variety of attorney conduct matters. She served as Chair of the State Bar of California's Committee on Professional Responsibility and Conduct and a Special Advisor to the Committee. She was Chair of the State Bar of California's Law Practice Management and Technology Committee and Chair of the Council of Section Chairs. She has also served as the Chair of the Ethics Committee of the Intellectual Property Section of the American Bar Association.

Maya Steinitz **Iowa**

Maya Steinitz is an Associate Professor of Law at the University of Iowa. She teaches civil procedure, international business transactions, international arbitration, and advanced issues in transnational litigation. She is one of the nation's leading experts in litigation finance and in that area her current research focuses on litigation finance contracting practices, claim valuation, and the finance of international arbitration and litigation. Her web-based research platform, A Model Litigation Finance Contract, is the first-ever instance of 'crowd-sourced' legal research. Prior to joining the University of Iowa College of Law as an Associate Professor in the fall of 2011, Professor Steinitz held a dual appointment as an Associate-in-Law and Lecturer at Columbia Law School (2009-2011). She has taught courses in comparative law, international law and international dispute resolution at Columbia Law School, Tel Aviv University and the Hebrew University of Jerusalem. Prior to joining Columbia Law School, Professor Steinitz served as a litigator at Latham & Watkins, LLP (2003-2009) and Flemming, Zulack & Williamson LLP (2001-2002). She also clerked for Israeli Supreme Court Justice Esther Hayut (1998-1999). She served in various capacities, including expert witness and consultant to law firms, finance firms, NGOs and the United Nations, advising on litigation finance, international arbitration, and transitional justice.

THE COLOR OF MONEY:
ALTERNATIVE LITIGATION FUNDING

LIST OF WRITTEN MATERIALS

1. Panel Outline

2. *A Model Litigation Finance Contract,* Maya Steinitz and Abigail C. Field, 99 Iowa L. Rev. 711(2014)

3. *What Every GC Needs to Know about Litigation Finance*, Burford Blog, March 2015

   http://www.burfordcapital.com/what-is-litigation-finance-myths-truths-and-what-every-gc-needs-to-know/

4. *Litigation Finance and Attorney Work Product*, Burford Blog, September 2013

   http://www.burfordcapital.com/litigation-finance-from-third-parties-may-help-decrease-litigation-in-the-long-run/

5. *Time to Shine a Light on Litigation Funding*, Carol Langford, The Recorder, March 2014

6. The Association of the Bar of the City of New York Committee on Professional Ethics Formal Opinion 2011-2: Third Party Litigation Financing

Written materials can be downloaded at:
http://www.calbar.org/ethics-symposium/2015_materials.html

THE COLOR OF MONEY: ALTERNATIVE LITIGATION FUNDING

I. INTRODUCTION

A. History of ALF

1. Roots in champetry and maintenance
2. Australia/UK

B. Analogous Issues that Overcame Ethical Concerns

1. Attorney Advertising; Contingency Fees

C. Scope of presentation: brief overview of the three ethical areas to be addressed

II. DEFINING ALF

A. Traditional Third Party Financing

1. Insurers
    a. Pre-event
    b. Tripartite relationship between funder and party and attorney
2. Co-Counsel arrangements, where one law is essentially acting as a banker
3. Contingency Fee Attorneys
    a. Tolerance for CFA → Tolerance for Third Party Financing

B. Emerging Third Party Financing

1. Loans to Plaintiffs
    a. Non-recourse
2. Loans to Attorneys
    a. Secured loans
        (1) Who pays the financing costs
3. Investments in Lawsuits/Direct Purchase
    a. Covered by securities law disclosure requirements?

C. Competence Duty Raised by ALF

1. Duty to Understand and Explain the Financing

2. Disclosure and client consent

   a. Is it possible to keep the attorney out of the arrangement?

D. Third Party Financing: Social Benefit or Social Ill?

1. Level the Playing Field

2. Access to justice or foment litigation

III. PRINCIPAL ETHICAL ISSUES

A. Is the Cost of Financing an Attorney Ethical Issue?

1. What is an attorneys' duty to secure economic resources for client?

2. Does the cost hinder access to justice; is the alternative to forgo litigation preferable?

B. Risks of Disseminating Confidential or Privileged Information

1. A-C Privilege:

   a. Is the financing entity a privileged person/entity – depends on the jurisdiction

      (1) Common-interest application

   b. Are there work-arounds?

      (1) Financier as agent of client?

      (2) Financer as consulting attorney evaluating case?

         (a) Financier/attorney --- > ethical duties to client

2. Work Product as tool to protect confidential information

   a. Protection conferred by considering information transmitted work product

      (1) Role of the confidentiality agreement

   b. Disputes at the trial level

C. **Risks of Serving Two Masters (Duty of Loyalty)**

1. Who Controls the Litigation

    a. Funder interference with independent judgement of attorney -- analogous to insurance company interference?

    b. Can or should control of litigation by client/party be waived?

2. Attorneys' "business" conflicts of interest

    a. Steering clients

    b. Interests in funders

IV. **CONCLUDING REMARKS**

References

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Fischer, James M. *Litigation Financing: A Real or Phantom Menace to Lawyer Professional Responsibility*? 27 Geo. J. Legal Ethics 191 (2014)

Giesel, Grace, *Alternative Litigation Finance and the Work-Product Doctrine,* 47 Wake Forest L. Rev. 1083, 1140 (2012)

Karsten, Paul, *Enabling the Poor to Have Their Day in Court: The Sanctioning of Contingency Fee Contracts, a History to 1940*, 47 DePaul L. Rev. 231 (1998)

Sebok, Anthony J. & Wendel, W. Bradley*, Duty in the Litigation –Investment Agreement: The Choice Between Tort and Contract Norms when the Deal Breaks Down,* 66 Vand. L. Rev. 1831 (2013)

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Yoo, Jihun, *Protecting Confidential Information Disclosed to Alternative Litigation Finance Entities*, 27 Geo. J. Legal Ethics 1005 (2014)

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Adolph, Tom & Spengler, Andrew*, Ethics and Alternative Litigation Financing for Patent Litigation*, State Bar of Texas 9th Annual Advanced Patent Litigation Course, Chapter 17 (2013)

www.burfordcapital.com/category/news-ideas-us/

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Walker Digital, LLC v. Google, Inc., No. 11-cv-309-SLR (D. Del. Feb. 12, 2013) [common interest doctrine applies to third party funder]

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A Model Litigation Finance Contract

Maya Steinitz & Abigail C. Field***

ABSTRACT: Litigation financing is nonrecourse funding of litigation by a non-party for a profit. It is a burgeoning and controversial phenomenon that has penetrated the United States in recent years. Since "most of the important phenomena of modern litigation are best understood as results of changes in the financing and capitalization of the bar," it is not surprising that litigation financing has been dubbed by RAND as one of the "biggest and most influential trends in civil justice" and by the Chamber of Commerce as "a clear and present danger to the impartial and efficient administration of civil justice in the United States."

Despite the growing importance of the practice, there is an absence of information about or discussion of litigation finance contracting, even though all the benefits and risks embodied in litigation funding stem from the relationships those contracts shape and formalize. In this Article, we: (1) set out the efficiency and justice cases for a model contract; (2) build on previous work to make the case for using venture capitalism as an analog and starting point for modeling litigation finance contracts; (3) describe the ethical and economic challenges faced by the parties entering into litigation finance contracts and explain the contractual solutions we suggest in order to minimize and in some cases eliminate such pitfalls; (4) provide a model contract; and (5) conclude by mapping out a research agenda for the new field of litigation finance contracting.

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INTRODUCTION

Litigation financing is nonrecourse funding of litigation by a non-party for a profit. It is a burgeoning and controversial phenomenon that has penetrated the United States in recent years, after flourishing in other common law jurisdictions. Since changes to the financing and capitalization of the bar "affect the outcome[s] of cases,"[1] it is not surprising that litigation financing has been dubbed by the RAND Institute for Civil Justice as one of the "biggest and most influential trends in civil justice."[2] Nor is it any surprise that it caught the attention of the leading daily press—as exemplified by the *New York Times* series "Betting on Justice"[3] and *Fortune* magazine's ongoing coverage[4] of the high-profile financing of the even more high-profile Chevron–Ecuador litigation.[5]

Last but not least, one of the nation's most powerful lobbying groups—the U.S. Chamber of Commerce—characterizes the practice as "a clear and present danger to the impartial and efficient administration of civil justice in the United States."[6] According to the Chamber, litigation funding can be expected to increase the volume of abusive litigation, undermine the control

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1. *See* Stephen C. Yeazell, *Re-financing Civil Litigation*, 51 DEPAUL L. REV. 183, 183 (2001); *see also* Herbert M. Kritzer, *Fee Regimes and the Cost of Civil Justice*, 28 CIV. JUST. Q. 344, 344 (2009) ("The problem of costs in civil justice processes is an enduring issue. . . . All fee systems create a mix of positive and perverse incentives. Proposals to modify fee arrangements, either coming from reformers or from individual clients, typically fail to grasp the complexity of fee systems and how those systems interact with other aspects of the justice system.").

2. *Third Party Litigation Funding and Claim Transfer*, RAND CORP., http://www.rand.org/events/2009/06/02.html (last modified Feb. 28, 2011).

3. *See* Binyamin Appelbaum, *Investors Put Money on Lawsuits to Get Payouts*, N.Y. TIMES (Nov. 14, 2010), http://www.nytimes.com/2010/11/15/business/15lawsuit.html; *see also* Peter Lattman & Diana B. Henriques, *Speculators Are Eager to Bet on Madoff Claims*, N.Y. TIMES DEALBOOK (Dec. 13, 2010, 9:21 PM), http://dealbook.nytimes.com/2010/12/13/speculators-are-eager-to-bet-on-madoff-claims; Susan Lorde Martin, Opinion, *Leveling the Playing Field*, N.Y. TIMES (Nov. 15, 2010), http://www.nytimes.com/roomfordebate/2010/11/15/investing-in-someone-elseslawsuit/leveling-the-playing-field.

4. Roger Parloff, *Have You Got a Piece of This Lawsuit?*, CNNMONEY (May 31, 2011, 5:00 AM), http://features.blogs.fortune.cnn.com/2011/05/31/have-you-got-a-piece-of-this-lawsuit; Roger Parloff, *Investment Fund: We Were Defrauded in Suit Against Chevron*, CNNMONEY (Jan. 10, 2013, 9:05 AM), http://finance.fortune.cnn.com/2013/01/10/burford-capital-chevron-ecuador/.

5. This ongoing litigation is the longest-running and largest-scale transnational environmental litigation in history. It stems from personal injuries and the pollution of the Ecuadorian Amazon as a result of oil operations conducted by Texaco, subsequently acquired by Chevron in 2001. In 2011, an Ecuadorian court issued an $18 billion dollar judgment against Chevron. The award is the largest judgment ever imposed for environmental contamination. For a description and analysis of Burford Capital's investment in the post-judgment phase of this litigation, see Maya Steinitz, *The Litigation Finance Contract*, 54 WM. & MARY L. REV. 455, 465–79 (2012).

6. U.S. CHAMBER INST. FOR LEGAL REFORM, STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENTS IN LITIGATION 1 (2012), *available at* http://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf.

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of plaintiffs and lawyers over litigation, deter plaintiffs from settling and thus prolong litigation, compromise the professional independence of attorneys, and more generally corrupt the attorney–client relationship.[7]

Consequently the big business lobby is advocating "a robust oversight regime to govern this type of [financing] at the federal level . . . [since the risks posed by this kind of financing] are simply too acute to be left to industry self-regulation."[8] Due to similar lobbying efforts, legislation to regulate at least some types of litigation funding is currently pending before twelve state legislatures—Illinois, Indiana, Iowa, Kansas, Louisiana, Missouri, Nevada, North Carolina, Rhode Island, South Carolina, Tennessee, and Texas.[9] These, in turn, follow on the heels of Maine, which became the first state to pass legislation regulating litigation finance in 2008,[10] followed shortly thereafter by Ohio, Nebraska, and Oklahoma, which also regulate lawsuit financing.[11]

In addition to the public debate and legislative responses described above, state bar associations have also begun addressing the ethical dimensions of litigation funding. Both the New York City Bar Association and the American Bar Association have recently issued cautiously favorable final or draft opinions, respectively.[12] Thus, despite dissenting voices,

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7. *Id.* at 1–2.

8. *Id.* at 2.

9. H.B. 2301, 98th Gen. Assemb., Reg. Sess. (Ill. 2013); H.B. 2300, 98th Gen. Assemb., Reg. Sess. (Ill. 2013); S.B. 378, 118th Gen. Assemb., 1st Reg. Sess. (Ind. 2013); H. Study B. 218, 85th Gen. Assemb., Reg. Sess. (Iowa 2013); S.B. 233, 2013 Gen. Assemb., Reg. Sess. (Kan. 2013); S.B. 166, 2013 Gen. Assemb., Reg. Sess. (La. 2013); H.B. 853, 97th Gen. Assemb., Reg. Sess. (Mo. 2013); S.B. 440, 97th Gen. Assemb., 1st Reg. Sess. (Mo. 2013); S.B. 361, 77th Gen. Assemb., Reg. Sess. (Nev. 2013); S.B. 648, 2013 Gen. Assemb., Reg. Sess. (N.C. 2013); H.B. 5599, 2013 Gen. Assemb., Reg. Sess. (R.I. 2013); S.B. 351, 2013 Gen. Assemb., Reg. Sess. (R.I. 2013); S.B. 788, 120th Gen. Assemb., Reg. Sess. (S.C. 2013); S.B. 1360, 108th Gen. Assemb., Reg. Sess. (Tenn. 2013); H.B. 1242, 108th Gen. Assemb., Reg. Sess. (Tenn. 2013); H.B. 1595, 83d Gen. Assemb., Reg. Sess. (Tex. 2013); H.B. 1254, 83d Gen. Assemb., Reg. Sess. (Tex. 2013); S.B. 1283, 83d Gen. Assemb., Reg. Sess. (Tex. 2013). A 2010 Delaware House Bill passed out of committee, but went no further. H.B. 422, 145th Gen. Assemb., Reg. Sess. (Del. 2010). We thank Eric Schuller from Oasis Legal Finance, LLC, for providing us this information.

10. Maine Consumer Credit Code Legal Funding Practices, ME. REV. STAT. tit. 9-A, §§ 12-101 to -107 (2008).

11. Non-recourse Civil Litigation Advances, OHIO REV. CODE ANN. § 1349.55 (West Supp. 2013); Nonrecourse Civil Litigation Act, NEB. REV. STAT. §§ 25-3301 to -3309 (Supp. 2012); Enrolled S.B. 1016, 2013 Gen. Assemb., Reg. Sess. (Okla. 2013) (to be codified at OKLA. STAT. tit. 14-A, §§ 3-701 to -717 (2013)).

12. The Ass'n of the Bar of the City of N.Y. Comm. on Prof'l Ethics, Formal Op. 2011-2 (2011) [hereinafter N.Y.C. Bar Opinion], *available at* http://www.nycbar.org/ethics/ethics-opinions-local/2011-opinions/1159-formal-opinion-2011-02 (discussing third-party litigation financing); ABA COMM'N ON ETHICS 20/20, WHITE PAPER ON ALTERNATIVE LITIGATION FINANCE 17–40 (2011), *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111019_draft_alf_white_paper_posting.pdf; *see also infra* Part II.B.1 (providing a more detailed discussion on champerty).

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litigation funding is growing globally and domestically at a fast clip[13] and gaining acceptance.[14]

The size of the current market is difficult to gauge because most funders are private companies and confidentiality agreements govern much of the funding industry's activities. Estimates vary, but all indicate a large market. According to the New York City Bar Association, "[t]he aggregate amount of litigation financing outstanding is estimated to exceed $1 billion."[15] The potential market is much larger. One indicator of how much money could be invested in the future in the U.S. alone is the litigation fees of the "Am Law 200" firms, which are the gatekeepers for the large commercial claims that litigation funders are targeting. Those total fees are estimated to have been over $84 billion in 2008.[16] Another measure of market potential is the total dollar value of settlements entered into and judgments rendered each year, increased by the value of meritorious claims that are not being filed due to lack of funds. This figure is likely more than $50 billion, which is a very conservative estimate of the annual amount paid to settle civil litigation.[17]

Potential market size, however, is an insufficient indicator of the dynamics driving the marketplace's rapid growth. Crucially, the emerging litigation finance industry is developing at a time when other investments with a similarly speculative profile have been discredited, leaving investors with an unmet demand. The insurance giant Lloyd's therefore projects that:

- Businesses should expect third party litigation funding to rise on both sides of the Atlantic, bringing increased risk as it can

13. LLOYD'S, LITIGATION AND BUSINESS: TRANSATLANTIC TRENDS 10 (2008), *available at* http://www.lloyds.com/~/media/6dab4dbcfe904aa7a2a5ffeba46f66c0.ashx. For perspectives on the global market, see, for example, CHRISTOPHER HODGES ET AL., LITIGATION FUNDING: STATUS AND ISSUES (2012), *available at* http://www.csls.ox.ac.uk/documents/Reporton LitigationFunding.pdf (examining the litigation funding market in England, Wales, and continental Europe); Jasminka Kalajdzic et al., *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 61 AM. J. COMP. L. 93 (2013) (discussing the litigation funding market in Australia, Canada, and the United States). *See generally* BURFORD GRP. LLC & BRIEFCASE ANALYTICS, INC., SUMMARY OF FINDINGS: 2012 LITIGATION FINANCING SURVEY (2012), *available at* http://www.burfordcapital.com/wp-content/uploads/2012/12/Web-summary-2012-12-03-FINAL-REPORT.pdf.

14. The 2012 edition of one of the most widely used civil procedure books now includes a section on third-party funding. *See* STEPHEN N. SUBRIN ET AL., CIVIL PROCEDURE: DOCTRINE, PRACTICE, AND CONTEXT 179–83 (4th ed. 2012). Arguably, inclusion in the mandatory first-year curriculum is as mainstream as it gets.

15. *See* N.Y.C. Bar Opinion, *supra* note 12.

16. Chris Johnson, *The Am Law 200's Haves and Have-Nots*, AM. LAW. (June 10, 2013), http://www.americanlawyer.com/PubArticleTAL.jsp?id=1202600856100&The_Am_Law_200s_Haves_and_HaveNots.

17. Stephen C. Yeazell, *Transparency for Civil Settlements: NASDAQ for Lawsuits?*, *in* CONFIDENTIALITY, TRANSPARENCY, AND THE U.S. CIVIL JUSTICE SYSTEM 143, 147 (Joseph W. Doherty et al. eds., 2012).

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help to make litigation more achievable for stakeholders with worthwhile claims.

- Current economic conditions may actually accelerate the growth of third party litigation, with investors keen to find new opportunities for investing capital not correlated with volatile financial market performance.
- . . . Small and medium-sized businesses, which often find legal costs too high to justify litigation, may benefit most.[18]

Indeed, a broad range of plaintiffs[19] bringing a wide variety of claims[20] stand to benefit from the development of markets in legal claims. This Article focuses on one type of plaintiff and claim: sophisticated plaintiffs such as companies or wealthy individuals bringing large commercial claims. We further break this category of plaintiffs down into two subtypes that we call "access-to-justice" plaintiffs—plaintiffs who could not access the courts but for third-party funding—and "corporate finance" plaintiffs—plaintiffs who seek financing in order to optimize their accounting, free up capital, or for other business reasons. One funder recently characterized both subgroups of plaintiffs and their motives for seeking funding:

> They fall into two buckets. One contains large or financially liquid companies that want litigation financing as a financing

18. LLOYD'S, *supra* note 13, at 10 (explaining the lack of correlation of this asset class and the wider market: "the investment opportunities [litigation funding] provides are potentially independent of economic conditions, since the prospects of winning a case depend on its merits, not the economy"). For more details on the forces driving litigation finance globally, see, for example, Maya Steinitz, *Whose Claim Is This Anyway?: Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1278–86 (2011).

19. Some non-corporate plaintiffs include divorcing couples, injured consumers, and injured workers. *See, e.g.*, Susan Lorde Martin, *Financing Litigation On-Line: Usury and Other Obstacles*, 1 DEPAUL BUS. & COM. L.J. 85 (2002); Susan Lorde Martin, *Financing Plaintiffs' Lawsuits: An Increasingly Popular (and Legal) Business*, 33 U. MICH. J.L. REFORM 57 (1999–2000) (examining the consumer claim market); Susan Lorde Martin, *Litigation Financing: Another Subprime Industry that Has a Place in the United States Market*, 53 VILL. L. REV. 83 (2008) [hereinafter Martin, *Another Subprime Industry*]; Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55 (2004); Binyamin Appelbaum, *Taking Sides in a Divorce, Chasing Profit*, N.Y. TIMES (Dec. 4, 2010), http://www.nytimes.com/2010/12/05/business/05divorce.html.

20. There are various claim types. *See, e.g.*, Cassandra Burke Robertson, *The Impact of Third-Party Financing on Transnational Litigation*, 44 CASE W. RES. J. INT'L L. 159 (2011) (discussing transnational litigation); Elizabeth Chamblee Burch, *Financiers as Monitors in Aggregate Litigation*, 87 N.Y.U. L. REV. 1273 (2012) (recognizing the claim of class actions, particularly internationally); Shyamkrishna Balganesh, *Copyright Infringement Markets*, 113 COLUM. L. REV. (forthcoming 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2233065. Interviews by the authors with chief executives of litigation funding firms indicate that some firms are trying to develop litigation funding services for corporate defendants. *See also* Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367 (2009) (providing a theoretical argument in favor of such a market for legal claims by the Georgetown law professor and Chief Investment Officer of Burford Capital).

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> technique. Their motivation may be budgetary, it may be accounting management, it may be liquidity, but they could easily pay cash for their legal services if they wanted to. . . .
>
> The other bucket contains businesses that—either for size, liquidity, or some other financial constraint—need financing to be able to pursue a litigation claim with the counsel of their choice. One classic example is a smaller technology company that is about to be outgunned on the legal front by a larger technology company that's using a strategy of grinding them down by overspending.[21]

The current economic environment provides a tailwind to the litigation funding industry in other ways. Cost-cutting corporations are looking much more closely at their legal departments—traditionally viewed as loss centers—and asking their general counsel to minimize their effect on the bottom line.[22] Shifting the cost of litigation to third-party funders is one way of doing so. Correspondingly, "Big Law" and other sectors of the legal profession have been modifying their business models and seeking to accommodate so-called alternative billing methods, including third-party funding.[23]

Responding to this growing, dynamic, and important legal market, the last couple of years have seen a wave of academic writing in which scholars tackle multiple dimensions of both the ethics and economics of litigation funding.[24] This recent literature builds on four categories of earlier scholarship. First is the scholarship on funding of consumer claims, a long-standing practice also called "law lending."[25] Second is early prospective–normative literature, arguing in favor of markets in legal claims.[26] Third is

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21. Brian Zabcik, *Burford CEO Christopher Bogart: Litigation Financing Loses Its Mystery*, AM LAW LITIG. DAILY (Feb. 1, 2013), http://www.americanlawyer.com/digestTAL.jsp?id=1202586775024&Burford_CEO_Christopher_Bogart_Litigation_Financing_Loses_Its_Mystery.

22. *See* Larry E. Ribstein, *The Death of Big Law*, 2010 WIS. L. REV. 749, 760, 769–71.

23. *See id.* at 798, 801–02 (discussing the rise of in-house counsel and litigation financing); *see also* Jonathan D. Glater, *Billable Hours Giving Ground at Law Firms*, N.Y. TIMES (Jan. 29, 2009), http://www.nytimes.com/2009/01/30/business/30hours.html (discussing pressures on the billable hour).

24. *See, e.g.*, Michele DeStefano, *Nonlawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup?*, 80 FORDHAM L. REV. 2791 (2012); Stephen Gillers, *Waiting for Good Dough: Litigation Funding Comes to Law*, 43 AKRON L. REV. 677 (2010); Paul H. Rubin, *Third-Party Financing of Litigation*, 38 N. KY. L. REV. 673 (2011).

25. For example, see the writings of Susan Lorde Martin, *supra* note 19. *See also* Ari Dobner, Comment, *Litigation for Sale*, 144 U. PA. L. REV. 1529 (1996).

26. *See, e.g.*, Michael Abramowicz, *On the Alienability of Legal Claims*, 114 YALE L.J. 697 (2005); Robert Cooter, *Towards a Market in Unmatured Tort Claims*, 75 VA. L. REV. 383 (1989); Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65 (2010); Richard W. Painter, *Litigating on a Contingency: A Monopoly of Champions or a Market for Champerty?*, 71 CHI.-KENT L. Rev. 625 (1995); Mariel Rodak, Comment, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effect on Settlement*, 155 U. PA. L. REV. 503 (2006).

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an analysis of the distinctive and long-standing markets in bankruptcy and patent claims in the United States.[27] Fourth is foreign and comparative scholarship discussing litigation funding as it operates in other jurisdictions and in international arbitration. This work builds on approximately two decades of experience with such funding in those jurisdictions.[28]

However, despite the importance of the industry and the robust academic debate, there is a complete absence of information about or discussion of litigation finance contracting, even though all the benefits and risks embodied in litigation funding stem from the relationships those contracts shape and formalize. Part I explains the dearth of such discussion and elaborates on the great need for it.

The Article proceeds as follows. Part I sets out the efficiency and justice arguments for a model contract against the backdrop of the secrecy that is currently shrouding the industry. It then makes the case for using venture capitalism as an analog and starting point for modeling efficient and just contracting practices. Parts II and III then adapt venture capital ("VC") solutions to analogous problems facing parties to litigation finance contracts. More specifically, Part II describes the ethical and economic challenges faced by the parties entering into litigation finance contracts and narratively explains the contractual solutions we have devised to eliminate or minimize such pitfalls. We also distinguish the needs of corporate finance plaintiffs and access-to-justice plaintiffs as relevant. Part III then provides model contracts for both plaintiff sub-types with provision-specific commentary.[29] For brevity's sake, the access-to-justice contract is used as a base, and the handful of alterations necessary for corporate finance plaintiffs are highlighted throughout. Unsurprisingly, the access-to-justice version contains protective provisions designed to compensate for unequal bargaining power. These provisions are absent from the corporate finance version. However, the core deal is the same.

Part IV concludes with some thoughts on additional issues implicated by litigation funding contracting practices that are beyond the scope of this Article—such as regulatory and tax implications of funding arrangements

27. *See, e.g.*, Bruce L. Beron & Jason E. Kinsella, *David vs. Goliath Patent Cases: A Search for the Most Practical Mechanism of Third Party Litigation Financing for Small Plaintiffs*, 38 N. KY. L. REV. 605 (2011); Robert D. Drain & Elizabeth J. Schwartz, *Are Bankruptcy Claims Subject to the Federal Securities Laws?*, 10 AM. BANKR. INST. L. REV. 569 (2002).

28. *See, e.g.*, HODGES ET AL., *supra* note 13. One must be cautious when analogizing to other jurisdictions. In both Australia and the U.K.—the jurisdictions that pioneered litigation funding some twenty years ago—third-party funding was legalized to substitute for contingency fee litigation, which is very limited in both jurisdictions. Further, both jurisdictions follow the "British rule which requires the losing party to pay the winner's attorneys' fees." Steinitz, *supra* note 18, at 1278 n.23. This rule radically changes litigation incentives and consequently limits access to justice. *Id.*

29. For brevity, we omit boilerplate provisions and those that relate to financing generally as opposed to litigation financing in particular.

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and possible structures other than those modeled on venture capital. As such, the Conclusion maps out a research agenda for the new field of litigation finance contracting.

A METHODOLOGICAL NOTE

Given the tremendous ambition of this project and its multi-disciplinary nature—the contract requires in-depth analysis of the litigation process (civil procedure), finance, contract theory, corporate governance, legal ethics, economic analysis, and transactional skills, to name a few—we created a web-based platform for developing the contract and fostering the related policy debate.[30] In it we presented, on a rolling basis, our suggested provisions with commentary and invited scholars, funders, funding critics, and attorneys to comment on and influence the shape of the final model contract. This Article reflects such contributions.

I. THE NEED FOR A MODEL CONTRACT AND THE CASE FOR DRAWING ON VENTURE CAPITAL CONTRACTING PRACTICES

A. *THE NEED FOR A MODEL CONTRACT*

Litigation finance is an opaque industry. Outside the consumer, personal injury context that we do not consider, litigation financing contracts are confidential, and only in litigation have a few come to light.[31] Litigation that reveals a contract or, more often, a contentious portion within a contract,[32] is itself rare, as the contracts generally require arbitration to resolve disputes. The contract terms that have emerged can be controversial, particularly those that appear to give control of the claim to the funder, or those that give returns that strike some as unconscionable.[33]

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30. *See* MODEL LITIG. FIN. CONT., http://litigationfinancecontract.com (last visited Nov. 6, 2013).

31. *See* Steinitz, *supra* note 5, at 465–66 (citing *In re* Parmalat Sec. Litig., 659 F. Supp. 2d 504 (S.D.N.Y. 2009), *aff'd in part, vacated in part*, Parmalat Capital Fin. Ltd. v. Bank of Am. Corp., 412 F. App'x 325 (2d Cir. 2011); Trust for the Certificate Holders of the Merrill Lynch Mortg. Investors, Inc. v. Love Funding Corp., 918 N.E.2d 889 (N.Y. 2009); Anglo–Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87 (Tex. App. 2006)); Funding Agreement Between Treca Financial Solutions and Claimants (Oct. 10, 2010) (on file with authors); *id.* at sched. 4 (Intercreditor Agreement) (on file with authors); Funding Agreement Between Satee GMBH, 88 Capital LLC, Jonaks Limited, Equitable Outcomes, Orin Kramer, and Claimants Minor (2010) (Minor Funder Agreement) (on file with authors). For the sake of comparison, standard forms of consumer funding contracts, developed to comply with different states' consumer protection laws, were also analyzed. *See* Purchase Agreement Between Oasis Legal Finance, LLC and Dean Plaintiff (Sept. 13, 2010) (on file with authors).

32. *See, e.g.*, S & T Oil Equip. & Mach., Ltd. v. Juridica Invs. Ltd., 456 F. App'x 481, 482 (5th Cir. 2012); Funding Agreement Between Treca Financial Solutions and Claimants, *supra* note 31, § 23.2–.4.

33. There are many examples relating to the return charged by the funder. *See, e.g.*, S & T Oil Equip. & Mach., Ltd. v. Juridica Invs. Ltd., Civil Action No. H–11–0542, 2011 WL 864837, at *2–5 (S.D. Tex. Mar. 10, 2011), *appeal dismissed*, 456 F. App'x 481 (5th Cir. 2012) (rejecting

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Further, the contract secrecy has prevented reputation markets from emerging and has reduced claimants' bargaining power.[34] Last but not least, the lack of publicly available sample contracts both raises the transaction costs of entering into funding arrangements—as each plaintiff negotiates from scratch and in the dark—and, consequently, creates a barrier for claimants to actually access litigation funding. It also raises the cost for new market entrants who may compete with existing litigation funding firms and who may, through their competition, lower the costs of financing for the plaintiff.

By drafting this model contract, we hope to bring transparency to litigation finance contracting, promote more efficient and fair contracting practices, and reduce the transaction costs of entering into such arrangements. Further, reducing economic theory to contractual language makes issues more concrete. It is one thing to note that the attorney–client privilege complicates assessing an investment opportunity or monitoring a lawsuit that one is invested in. It is another to draft language maximizing information sharing while minimizing the risk of privilege waiver and preserving the litigation counsel's ethical obligations.

We acknowledge that drafting litigation funding contracts for large commercial disputes is and will remain a bespoke service. Still, a model contract will help lawyers and their clients spot the issues they must address and provide concepts—such as accelerating investments between milestones, imposing fiduciary duties on funders, or requiring certain representations

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arguments that the funding agreement was unconscionable); Kraft v. Mason, 668 So. 2d 679, 683–84 (Fla. Dist. Ct. App. 1996) (noting that the plaintiff brought suit against her brother to enforce repayment of a litigation finance advance she had made to fund his prosecution of an antitrust lawsuit and the court rejected the brother's usury defense); Odell v. Legal Bucks, LLC, 665 S.E.2d 767, 772–76 (N.C. Ct. App. 2008) (rejecting arguments that funding agreement constituted an illegal gaming contract or, in the alternative, constituted champerty and maintenance); Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 217–21 (Ohio 2003) (stating that the plaintiff challenged the contract's enforceability as usurious/unconscionable and the court struck down the contract as champertous); *Anglo–Dutch Petroleum Int'l, Inc.*, 193 S.W.3d at 90 (rejecting arguments that funding agreements were usurious loans, unregistered securities, and against public policy). Examples relating to the funder's level of control include the landmark Australian case, *Campbells Cash & Carry Pty. Ltd. v. Fostif Pty. Ltd.* (2006) 229 CLR 386 (Austl.), in which the Australian High Court permitted the funder broad control, and the English Court of Appeal's equally groundbreaking decision, Arkin v. Borchard Lines Ltd., [2005] EWCA (Civ) 655, [2005] 4 Costs L.R. 643 (Eng.), in which it established that third-party funding is acceptable, even desirable, to increase access to justice, but fell short of sanctioning the transfer of control to funders. *See* Abu-Ghazaleh v. Chaul, 36 So.3d 691, 693–94 (Fla. Dist. Ct. App. 2009) (finding the level of control given the funder sufficient to treat it as a real party in interest).

34. On the centrality of reputational markets and their effect on bargaining in funding agreements, see Steinitz, *supra* note 5, at 511 (citing Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1086–88 (2003); D. Gordon Smith, *Venture Capital Contracting in the Information Age*, 2 J. SMALL & EMERGING BUS. L. 133, 157–62 (1998) (discussing the characteristics of the reputation market for venture capitalists)).

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from the counterparty—that can be tailored for each deal. Similarly, a model contract provides a framework for the kind of legal and economic analysis that should go into modifying the model contract for individual use, drafting a contract from scratch, or negotiating off of a draft contract developed by a funder. Thus, our goal is to create a commercially reasonable document that serves as a starting point for relatively sophisticated parties, represented by their own counsel, to negotiate an individualized contract.

As an additional benefit, drafting contract language makes latent commercial issues more visible and facilitates comparison of deal structures. For example, what are the tax implications of the venture-capital-type deal we model? What happens to investors if the plaintiff goes bankrupt and the proceeds of the funded litigation become part of the estate? Would an alternative deal structure, such as effectively incorporating the claim,[35] have more advantages than the VC model? Is the incorporation approach possible or barred by champerty concerns? How does either VC or incorporation stack up against the more traditional nonrecourse loan structure on all the issues? We revisit such issues in the Conclusion as suggestions for further research.

B. *THE VENTURE CAPITAL ANALOGY*

Prior scholarship has generally focused on the analogies between litigation finance, on the one hand, and contingency fees and insurance on the other. While such analogies have merit, they also have their limitations, as illustrated below, and can, at times, mislead. The Model Contract builds instead on an economic–theoretical foundation that was developed by one of the authors in a previous article that analyzed the parallels between litigation finance and venture capital financing.[36]

1. Contingency Fees and Insurance: Limited Analogies

Discussions of contingency fees and insurance provide powerful, yet incomplete analogies to litigation finance. Contingency fee attorneys are first and foremost precisely that: attorneys. Although contingency fee attorneys can have significant conflicts of interest with their clients (or with a class), they have myriad ethical and legal constraints on their actions that

35. *See* Maya Steinitz, *Incorporating Legal Claims* (forthcoming).

36. Steinitz, *supra* note 5, at 479–82. That article relies heavily on analyses of venture capital contracting practices and their economic analysis. *See generally* Gilson, *supra* note 34; Paul A. Gompers, *Grandstanding in the Venture Capital Industry*, 42 J. FIN. ECON. 133 (1996) [hereinafter Gompers, *Grandstanding*]; Paul A. Gompers, *Optimal Investment, Monitoring, and the Staging of Venture Capital*, 50 J. FIN. 1461 (1995). It also relies, though to a lesser degree, on Ronald J. Gilson et al., *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377 (2010) [hereinafter Gilson et al., *Braiding*], and Ronald J. Gilson et al., *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431 (2009).

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work to resolve these conflicts in their clients' favor. For example, attorneys owe their clients duties of loyalty and zeal and must avoid conflicts or get informed client consent to them. Litigation funders are not similarly constrained.

A funder's objective is to maximize profits for the benefit of its investors.[37] The funder also has a relationship with the plaintiff. These competing loyalties have a concrete consequence: in some scenarios, a funder may have objectives extrinsic to the claim, leading it to push for outcomes for its own benefit that disadvantage the plaintiff. We discuss funder–plaintiff conflicts further in Part II. The point here is simply that to analogize too closely to contingency fee arrangements is to oversimplify the complexities of the relationships involved. Nonetheless, on issues such as unconscionability of fees/investment returns and control of the claim, cases and scholarship relating to contingency attorneys can be instructive.

Insurers who fund and, at times conduct, the defense of their insured are also a limited analog, even though that relationship is commercial rather than attorney–client. First, the insurer finances a defense and counterclaim; most litigation finance is on the plaintiff side.[38] Second, the insurer can subrogate the insured, making their interests united in a way not matched in litigation finance.[39] Third, insurers and the insurance they provide do not, generally speaking, have access-to-justice implications. Finally, in contrast with litigation finance, insurance is a heavily regulated industry.[40] For example, insurers have capitalization requirements that ensure they can fulfill their obligations under a policy.[41]

Nonetheless, the insurer–insured relationship can provide some insight into litigation finance. Litigation finance functions partially as after-the-event insurance in that it shifts risk to the financier (as insurance shifts risk to the insurer). Similarities can be found particularly with regard to the attorney–client privilege, control/influence over attorney selection and settlement decisions, and moral hazard and the need to require the plaintiff's cooperation.[42]

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37. CFA INST., ASSET MANAGER CODE OF PROFESSIONAL CONDUCT 5 (2d ed. reprt. 2010), *available at* http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2009.n8.1 ("Managers must . . . [p]lace client interests before their own.").

38. *See supra* notes 19–21 and accompanying text (examining plaintiffs' claims and motives for acquiring financing services). Insurance is by definition on the defense side, with narrow exceptions such as after-the-event insurance.

39. *See* Michelle Boardman, *Insurers Defend and Third Parties Fund: A Comparison of Litigation Participation*, 8 J.L. ECON. & POL'Y 673, 691 (2012).

40. *See* John Patrick Hunt, *Rating Dependent Regulation of Insurance*, 17 CONN. INS. L.J. 101, 103–07 (2010–2011) (discussing the role of and justification for solvency regulation).

41. *Id.* at 104.

42. *See* Steinitz, *supra* note 18, at 1295–96.

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2. The Analogy Between Litigation Finance and Venture Capital

Venture capital provides a more powerful analogy. First and foremost, venture capitalists and litigation funders have a similar risk profile: they invest in high-risk assets with the hope that, even if many of their investments fail, a handful will be wildly successful.[43] Critically, in both cases, success hinges, to a great degree, on the efforts of others—entrepreneurs and claimants, respectively. Information asymmetry abounds and may actually increase during the life of the investment as more information about the asset is revealed.[44]

The similarities reach past risk. Venture capitalists and litigation funders have similar (mid-length) investment timelines; they represent pools of investors' capital; and their profitability is measured across a portfolio of investments, not a single investment.[45] These factors, as well as others, can misalign the incentives of funder and funded in both venture capital and litigation financing, creating agency problems.

Simultaneously, though, most venture capitalists and litigation funders have specialized expertise, reputations, connections, and other valuable input that they can offer as non-cash contributions to the success of the investment.[46] In fact, in both types of funding, these non-cash contributions can be paramount.[47] In the litigation context, these contributions are likely of most value to access-to-justice plaintiffs, but they can benefit even the repeat-player, deep-pocketed corporate finance type.

The next Part presents the specific challenges that create the extreme uncertainty, information asymmetry, and agency problems in litigation finance and presents, in narrative form, the contract solutions we have devised in order to solve, or at least minimize, these problems.

II. CONSTRAINTS, CHALLENGES, AND CONTRACT SOLUTIONS

In order to develop a robust model contract, we begin with a hypothetical fact pattern and certain assumptions we have made. The assumptions allow us to highlight the various litigation-finance-specific challenges a contract must address. We adopt solutions from VC, applying those in a straightforward manner where appropriate and modifying where necessary. Nuanced modifications are necessary, especially to staged funding, which is at the heart of The Model Contract, to reflect the

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43. *See generally* John H. Cochrane, *The Risk and Return of Venture Capital*, 75 J. FIN. ECON. 3, 4 (2005) ("This paper measures the expected return, standard deviation, alpha, and beta of venture capital investments.").

44. Steinitz, *supra* note 5, at 488 (citing Gilson, *supra* note 34, at 1076–77).

45. *See id.* at 489–90.

46. *Id.* at 498–500 (citing Gilson, *supra* note 34, at 1071–72); *see also* Christopher B. Barry et al., *The Role of Venture Capital in the Creation of Public Companies: Evidence from the Going-Public Process*, 27 J. FIN. ECON. 447, 449–51 (1990).

47. *See supra* note 46 and accompanying text.

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economic, regulatory, and normative differences between litigation and startup companies as asset classes. Finally, we describe conceptually our proposed contract solutions, distinguishing between access-to-justice and corporate finance solutions as needed. The actual provisions are in Part III.

A. *FACT PATTERN AND ASSUMPTIONS*

As noted in the Introduction, a broad range of funding scenarios, with different types of funders, claimants, claims, and jurisdictions, are emerging in the global marketplace.[48] Given that diversity, drafting a universal model contract is impossible. We must make certain assumptions about the nature of the claim, the characteristics of the funder and the claimant, and the governing law of the contract. That said, our goal is to suggest contractual arrangements that are as broadly applicable as possible. Our assumptions are set out in the following paragraphs.

The Funder. We assume the funder is a specialized litigation finance company. As such, our funder is a "repeat player," which will often have greater bargaining power and sophistication, as it relates to litigation and its funding, than access-to-justice claimants, though the difference likely does not exist with corporate finance plaintiffs.[49] Regardless of plaintiff type, the funder may have a strategic interest in the outcome of a case beyond winning the case at hand.[50] Its judgment is further influenced by portfolio management concerns.[51] In addition, our funder is susceptible to the pressures of a reputational market, should one develop.[52] Finally, our funder is typically founded and managed by attorneys and wishes to be actively involved in litigation strategy and conduct, monitoring and making other non-cash contributions.[53]

The Claimant and Claim. We assume the claimant is a corporation or an otherwise sophisticated business party or a wealthy, sophisticated individual seeking to bring a commercial claim. We are not considering tort cases, divorce cases, and other consumer litigation finance. While some of the contract issues are similar, other important aspects, such as public policy, are not.

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48. *See* Steinitz, *supra* note 18, at 1302–03 (providing a typology of funding scenarios).

49. *See id.* at 1271 (arguing that litigation funding may change the balance of power between weak and strong litigants).

50. *Id.* at 1300–01, 1312, 1315–16 (citing Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95, 97–103 (1974)).

51. *See id.* at 1312.

52. *See* Steinitz, *supra* note 5, at 502 (citing Gilson, *supra* note 34, at 1090).

53. We are not considering passive funding arrangements such as in *Anglo–Dutch Petroleum International, Inc. v. Haskell*, 193 S.W.3d 87, 104 (Tex. App. 2006) ("The agreements do not contain provisions permitting [the funder] to select counsel, direct trial strategy, or participate in settlement discussions, nor do they permit [the funder] to look to Anglo–Dutch's trial counsel directly for payment.").

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Another advantage of assuming a commercial claim relates to remedies. Money generally resolves commercial claims, but tort compensation can involve elements that, while costly, are not monetary in nature. Examples include medical treatment and monitoring, and environmental cleanup. Divorce cases may involve injunctions to resolve such issues as child custody or domestic violence. Litigation funding's potential to commodify claims by monetizing such remedies or eschewing them for straight damages is less problematic in the commercial context.

Just as we hew to commercial claims over personal claims, we focus on plaintiffs over defendants. That choice reflects the nonexistence, at the moment, of a market in defenses. Last, defense funding is so similar to insurance that the scholarly gap is much narrower.

Choice of Law. The doctrines of champerty, usury, and unconscionability affect the enforceability of litigation finance contracts.[54] The scope of the attorney–client privilege and work-product doctrine impacts contractual remedies to information asymmetry. In the United States, these doctrines are all creatures of state law and vary widely. Needing, therefore, to relate the contractual provisions to state law, we picked the law of the State of New York. We chose New York because its champerty doctrine is generally accommodating of litigation finance,[55] it is a premier commercial center, and its courts are well-regarded.

One should note that while litigation finance contracts often invoke foreign law[56] and current contracting practice often involves selection of international arbitration as a dispute resolution mechanism,[57] these selections are not always the optimal arrangements for a given contract. Most notably, such choices may structurally disadvantage the plaintiff relative to the funder, or vice-versa.

B. *Overcoming Champerty: The New York Example*

1. The Challenges

Litigation finance is prohibited by the champerty doctrine and thus is illegal in those jurisdictions that still enforce it. Broadly speaking, champerty is financing someone else's litigation for profit.[58] The prohibition against champerty arose in medieval England as a way to protect small property owners from the predations of feudal lords, based on the idiosyncratic

54. *See, e.g.*, Dobner, *supra* note 25, at 1543–46 (providing an overview of champerty's development); Martin, *Another Subprime Industry*, *supra* note 19, at 86–87 (discussing usury); *see also* cases cited *supra* note 33.

55. *See infra* Part II.B.

56. *See, e.g.*, Steinitz, *supra* note 5, at 478 (describing the choice of law arrangement in the Chevron–Ecuador investment: the provisions of the agreement were governed by English law, except for Burford's security interest, which was perfected under New York law).

57. *Id.*

58. *See* BLACK'S LAW DICTIONARY 262 (9th ed. 2009).

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political economy of the time.[59] America inherited champerty when the colonies imported English common law, with each state developing the doctrine differently. In recent years, some states have discarded the doctrine while others have reaffirmed it.[60] New York does not have a common law prohibition on champerty, but it does have a statutory bar against transferring claims in order to profit by instigating litigation that otherwise would not have been filed.[61] This obviously prohibits a stock-exchange-type market in claims that the original potential plaintiffs are not interested in pursuing, and some business models have been found champertous under the statute.[62]

Nonetheless, New York's courts have interpreted the statute as imposing a very narrow prohibition. The key element is the instigation of the litigation; the profit element has been interpreted in the jurisprudence as incidental.[63] In fact, in New York the prohibition is so narrow that even the purchase of a claim that the funder had no relationship to, before any litigation has been filed, and then filing suit to profit from it, is not necessarily champertous. For example, New York courts have held that purchasing a defaulted bond and trying to collect on it via litigation is not champerty, regardless of the profits derivable from the suit, because it is merely enforcing a right via litigation when other methods of vindicating the right—e.g., demanding payment—have failed.[64]

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59. *See* Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 125–26 & nn.262 & 264 (2011); Steinitz, *supra* note 18, at 1287.

60. *See* Sebok, *supra* note 59, at 98–120 (surveying and analyzing the law of maintenance, champerty, and assignment in all fifty-one jurisdictions, and concluding that the answer to the question of how states determine whether and to what degree non-lawyer third parties may support meritorious litigation is complex and that confusion reigns over the doctrine and its application).

61. N.Y. JUDICIARY LAW § 489 (McKinney 2005).

62. In a recent case, the court found a partnership between a law firm and a company champertous because the firm was "buying" distressed debt, suing on the debt, and remitting the proceeds less a fee to the original debt holders. In essence, the firm was buying the right to sue on the debt, not the underlying debt. *See* Justinian Capital SPC *ex rel.* Blue Heron Segregated Portfolio v. WestLB AG, 952 N.Y.S.2d 725, 733–34 (Sup. Ct. 2012).

63. *See* SB Schwartz & Co. v. Levine, 918 N.Y.S.2d 171, 172–73 (App. Div. 2011) (summarizing the champerty doctrine). Similarly, the Southern District of New York found champertous an agreement that transferred a legal claim in order for the assignee to sue on it. Am. Optical Co. v. Curtiss, 56 F.R.D. 26, 31–32 (S.D.N.Y. 1971). The fact that the assignee would be competitively helped by the suit's success and thus indirectly profit was not central. *See id.* at 29–30. The focus was the fact that the very purpose of the assignment was to have the assignee sue on the claim, and that neither the suit nor the assignment would have happened otherwise. *Id.* at 30.

64. Elliott Assocs. v. Banco de la Nacion, 194 F.3d 363, 372 (2d Cir. 1999). In such a case, the right to file suit is incident to the bond purchased; the transaction is not the sale of a "naked" claim. Anthony Sebok, *Incorporating the Claim*, MODEL LITIG. FIN. CONT. (Feb. 4, 2013), http://litigationfinancecontract.com/incorporating-the-claim/.

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Similarly, New York courts permit business models based on funding plaintiffs in exchange for a part of their eventual litigation recoveries, provided their suits were already in existence and control of the suit remained with the plaintiffs.[65] New York courts reach this result because they frequently distinguish between a claim and its proceeds[66] and because New York doctrine focuses on transfers for the sole purpose of initiating litigation where no prior right to the underlying claim exists or the transfer is not part of a larger complex transaction.[67] The assignment of proceeds, rather than the underlying claim, is closely analogous to a typical litigation finance scenario, and allowing it underscores New York's litigation-finance-friendly doctrine. Nonetheless, perhaps it is possible to have a champertous assignment of proceeds even if the underlying claim has not been transferred.[68]

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65. Echeverria v. Estate of Lindner, No. 018666/2002, 2005 WL 1083704, at *4–8 (N.Y. Sup. Ct. Mar. 2, 2005). The timing of the lawsuit is significant in champerty analysis in New York because the prohibition is against initiating litigation. However, "litigation" means more than the suit; assignments of claims or counterclaims for filing in an existing suit are champertous. *See id.* In addition, a judge held (and remanded) it would be champerty if after receiving financing the plaintiff filed new claims and counterclaims, provided the financiers were strangers to the underlying claim. Richbell Info. Servs., Inc. v. Jupiter Partners L.P., 723 N.Y.S.2d 134 (App. Div. 2001); *see also* Ehrlich v. Rebco Ins. Exch., Ltd., 649 N.Y.S.2d 672 (App. Div. 1996). This result is potentially problematic for litigation financiers regardless of deal structure.

66. *See* Fahrenholz v. Sec. Mut. Ins. Co., 788 N.Y.S.2d 546 (App. Div. 2004).

67. Commentators disagree on whether a funder must have a pre-existing interest in the transferred claim to avoid champerty, when the transfer was for the purpose of initiating litigation and the expectation was of proceeds greater than could otherwise be had. From both perspectives, commentators are responding to the Court of Appeals for the Second Circuit in the recent, seminal case, *Trust for the Certificate Holders of the Merrill Lynch Mortgage Investors, Inc. Mortgage Pass-Through Certificates, Series 1999-C1 v. Love Funding Corp.*, 556 F.3d 100 (2d Cir. 2009). *See, e.g.*, Lawrence V. Gelber & David J. Karp, *Champerty Clarified*, L.J. NEWSL., May 2010, *available at* http://www.srz.com/files/News/a95db2b9-c157-4245-87ea-14bf89d30b5c/Presentation/NewsAttachment/0892cf66-49ba-4524-813f-16a72636b36a/Gelber_Karp_The_Bankruptcy_Strategist_May_2010_Champerty_Clarified.pdf (noting that the issue is not whether the claim purchaser had a pre-existing interest but whether the purchase was to enforce a right or to profit from litigating the claim).

68. New York's anti-champerty statute prohibits transferring a claim directly or indirectly, thus if no claim transfer is occurring it is hard to see how champerty can be involved. Nonetheless, it is also hard to see why the assignment of proceeds is not the indirect transfer of a claim. Indeed, champerty is commonly understood as financing a claim in exchange for a profitable share of the proceeds. Regardless, New York cases distinguish between claim transfer and proceed transfer in personal injury cases. It is not clear if the distinction in the commercial context has the same bounds. In *Fahrenholz*, a commercial case, the judge did treat transferring proceeds as different than transferring a claim. *Fahrenholz*, 788 N.Y.S.2d 546. However, the existence of profit may have been a concern there in a way it has not in personal injury cases. In *Farenholz*, an insurer loaned $45,000 to the plaintiff in exchange for $45,000 of the policy proceeds the plaintiff sought via the lawsuit. *Id.* at 547. As a result, no profit was involved. While the judge did not cite that factor in distinguishing between the transfer of proceeds and the transfer of a claim in that case, the judge did note that the proceeds assigned were equal to the

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Reflecting this generally permissive state of New York law, the New York City Bar Association's 2011 formal opinion on the ethics of third-party litigation finance acknowledged that the Bar was "aware of no decision finding non-recourse funding arrangements champertous under New York law."[69]

2. The Model Contract Solutions

To avoid champerty issues, The Model Contract does not involve claim transfer. The funder gains influence over the litigation, but not control. In addition, the financing method focuses on the litigation proceeds, rather than the claim per se. Specifically, The Model Contract has claimants sell what we call "Litigation Proceed Rights" to funders.[70] A Litigation Proceed Right entitles its holder to one percent of the claim's proceeds. Litigation Proceed Rights are a direct analogy to the shares in a startup purchased by venture capitalists and allow the relatively direct importation of several standard clauses of stock sale and purchase agreements. Litigation Proceed Rights are privately offered securities that cannot be transferred without the plaintiff's consent, and then only if the transferee becomes a full party to the funding contract.[71] Coupled with the private nature of the financing and the sophistication of our assumed funder(s), this approach should create a minimum of securities law issues.[72]

Unlike typical venture capital securities that convert into common stock and often involve myriad control and other non-cash rights,[73] litigation proceed rights are only redeemable for cash, if and when the proceeds are

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loan amount. *Id.* Perhaps that fact was relevant to the judge's finding that the transaction was non-champertous.

69. N.Y.C. Bar Opinion, *supra* note 12.

70. For a comprehensive discussion of the use of securities to facilitate litigation funding, see Steinitz, *supra* note 35.

71. These features minimize the securities regulation implications. Because we assume funders are specialized litigation finance firms, the "Accredited Investor" requirement is also met.

72. Richard Painter, *The Model Contract and the Securities Laws, Part I*, MODEL LITIG. FIN. CONT. (July 15, 2013), http://litigationfinancecontract.com/the-model-contract-and-the-securities-laws-part-1/ [hereinafter Painter, *Part I*]; Richard Painter, *The Model Contract and the Securities Laws, Part II*, MODEL LITIG. FIN. CONT. (July 18, 2013), http://litigationfinancecontract.com/the-model-contract-and-the-securities-laws-part-ii/; Richard Painter, *The Model Contract and the Securities Laws, Part III*, MODEL LITIG. FIN. CONT. (July 22, 2013), http://litigationfinancecontract.com/the-model-contract-and-the-securities-laws-part-iii/; Richard Painter, *The Model Contract and the Securities Laws, Part IV*, MODEL LITIG. FIN. CONT. (July 25, 2013), http://litigationfinancecontract.com/the-model-contract-and-the-securities-laws-part-iv/; Maya Steinitz, *The Model Contract and the Securities Laws, Coda*, MODEL LITIG. FIN. CONT. (July 29, 2013), http://litigationfinancecontract.com/the-model-and-the-securities-laws-coda/.

73. VC securities convert into equity in the startup, and they can involve a large number of rights beyond cash flow. Steven N. Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281, 308–12 (2003).

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received. No control rights are included with litigation proceed rights. The profit comes from the difference between the risk-discounted purchase price of litigation proceed rights and their redemption value. These features make the rights more akin to speculative bonds than the equity that venture financiers acquire, and they again support a non-champertous result.[74]

The Recitals of The Model Contract state that the funder wishes to invest with Plaintiff "to facilitate the prosecution of its claim and to profit if the claim is successful."[75] This declaration should not make otherwise non-champertous provisions problematic.

While The Model Contract minimizes champerty risk under New York law, this area of law remains unsettled and parties are advised to proceed with caution. And, regardless of deal structure, champerty risk would be further reduced if the financing occurs after the suit has been filed and no new claims are asserted after the financing closes. In that scenario, it is hard to see how the financing produced litigation that would not otherwise exist.

C. Overcoming Information Barriers and Asymmetry

1. The Challenges

Litigation financiers face a systemic information asymmetry problem like that faced by venture capitalists. They both invest their money in developing an asset they are unfavorably positioned to understand relative to the asset's original owners. In the litigation context, the original owners are the plaintiff and its attorney.[76] The plaintiff is most familiar with the facts and documents of the case. Moreover, the plaintiff knows its predisposition to cooperate, and its effort and active participation is necessary to win, including its truthfulness, cooperation, and good judgment.[77] Litigation financiers cannot easily access this information and, thus, it is difficult for them to vet litigations for possible investment *ex ante*[78] and to monitor *ex post*. These asymmetries may result in leaving worthy plaintiffs without funding or in depriving funded litigations from valuable non-cash contributions by the funder, such as monitoring and strategy development.

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74. Speculative bonds (junk bonds) are rated BB or lower to reflect their high default risk. While the analogy to litigation proceed rights is not strict—because the bonds pay until they don't, rather than not paying until they do—pricing is similar because the risk–reward analysis is similar (high yield, high risk of worthlessness) and because future cash, rather than control rights, is the asset purchased.

75. *See infra* Part III (The Model Contract).

76. *See* Steinitz, *supra* note 5, at 488.

77. *Id.*; *cf.* Gilson, *supra* note 34, at 1076–77 (explaining that venture capitalists face a similar information asymmetry between themselves and the companies in which they invest).

78. *See supra* note 5 and accompanying text.

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a. The Attorney–Client Privilege: The New York Example

The attorney–client privilege worsens the information asymmetry by creating an incentive not to disclose information to funders.[79] The attorney–client privilege is, generally, extended to communication between a client and an attorney for the purpose of seeking legal advice, and it can be waived if the communication is disclosed to a third party. Waiver does not occur if the client and the third party are united by a "common legal interest."[80] A common commercial interest is universally deemed insufficient,[81] but courts differ, even within New York, on whether the common legal interest must be similar or identical.[82] Waiver of the privilege can damage plaintiff's chances of winning the claim, an undesirable outcome from both the plaintiff's and funder's perspectives.

In a litigation-financing life cycle, the existence of a common legal interest must be analyzed in three different contexts: communication between plaintiff and potential funders; communication between plaintiff and a retained funder; and communication between a funder and investors, whether shareholders in the funder, investors in a litigation-backed security, or investors purchasing part of the funder's investment in the particular claim. We refer to that last category of investors as "secondary funders," and see them as akin to reinsurers.

New York judges are unlikely to find a common legal interest between *potential* funders and plaintiffs or between investors in litigation-backed securities and plaintiffs.[83] Disclosure of privileged information to such

79. N.Y. C.P.L.R. 4503(a)(1) (McKinney 2007).

80. N.Y.C. Bar Opinion, *supra* note 12 (discussing common-interest doctrine in New York).

81. Stenovich v. Wachtell, Lipton, Rosen & Katz, 756 N.Y.S.2d 367, 378 (Sup. Ct. 2003) (finding that the common interest was commercial, not legal, and thus the privilege was not preserved); *see* Aetna Cas. & Sur. Co. v. Certain Underwriters at Lloyd's London, 676 N.Y.S.2d 727, 733–34 (Sup. Ct. 1998) (finding that the business and personal communications were not protected under the common-interest doctrine).

82. A recent case summarizing both lines of cases, and coming out on the substantially similar side is *GUS Consulting GmbH v. Chadbourne & Parke LLP*, 858 N.Y.S.2d 591, 593 (Sup. Ct. 2008).

83. The crucial questions are (1) whether a common interest exists at all, as the two parties are on opposite sides of the transaction, and if so, (2) whether it is a common legal or commercial interest. The federal district court in Delaware upheld a ruling by a magistrate judge that no common interest linked potential funders and litigants. Leader Techs., Inc. v. Facebook, Inc., 719 F. Supp. 2d 373, 376 (D. Del. 2010). In other investor contexts, courts do not hesitate to find privilege waiver. *See* Int'l Honeycomb Corp. v. Transtech Serv. Network, Inc., No. 90 CV 3737 (CBA), 1992 WL 314897, at *1–2 (E.D.N.Y. Oct. 9, 1992) (noting that disclosure to potential investors in the company waived privilege); *see also* Corning Inc. v. SRU Biosystems, LLC, 223 F.R.D. 189, 190–91 (D. Del. 2004) (finding that disclosure to past potential third-party acquirer waived privilege). *But see* Devon IT, Inc. v. IBM Corp., Civ. A. No. 10-2899, 2012 WL 4748160, at *1 n.1 (E.D. Pa. Sept. 27, 2012) (determining that communications with potential litigation funder who became funder waived neither work-product protection, nor, because of a common interest, attorney–client protection). When the

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parties almost certainly waives the privilege. Similarly, based on cases in the reinsurance context, disclosure to secondary funders risks waiver, but the analysis will be fact-specific and dependent on how involved in the case the secondary funder is.[84] Any disclosure to investors in a publicly traded litigation finance company of course waives the privilege.[85]

The central question is whether retained funders and plaintiffs share a privilege-protecting common legal interest. While there are no New York cases on point,[86] cases in other jurisdictions have come out both ways.[87] Federal courts have filled this vacuum,[88] but incoherently. One line of cases suggests plaintiffs and their funders would benefit from a common legal interest; another line of cases does not.[89] The New York Legislature has also

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disclosure is very limited, such as a general summary of legal opinions, the privilege is not waived. *See* Furminator, Inc. v. Kim Laube & Co., No. 4:08CV00367 ERW, 2009 WL 5176562, at *1–2 (E.D. Mo. Dec. 21, 2009). As a general matter, the common-interest doctrine is to be narrowly construed. *See* Gulf Islands Leasing, Inc. v. Bombardier Capital, Inc., 215 F.R.D. 466, 471 (S.D.N.Y. 2003). Further, under New York law, the doctrine can only apply with respect to "legal advice in pending or reasonably anticipated litigation in which the joint consulting parties have a common legal interest." *Aetna*, 676 N.Y.S.2d at 732.

84. *See, e.g.*, N. River Ins. Co. v. Columbia Cas. Co., No. 90 Civ. 2518 (MJL), 1995 WL 5792, at *7–8 (S.D.N.Y. Jan. 5, 1995) (finding no common interest between insurer and reinsurer). *North River Insurance Co. v. Columbia Casualty Co.* has spawned a long line of cases examining the question of whether ceding insurers and reinsurers have a common interest as a fact-based one that cannot be assessed categorically. *See, e.g.*, Fireman's Fund Ins. Co. v. Great Am. Ins. Co. of N.Y., 284 F.R.D. 132, 140–41 (S.D.N.Y. 2012); Am. Re-Ins. Co. v. U.S. Fid. & Guar. Co., 837 N.Y.S.2d 616, 621 (App. Div. 2007).

85. Disclosure to shareholders of a closely held, private corporation likely would constitute waiver as well. However, unlike with public companies, attorney work product could be shared with such shareholders pursuant to a confidentiality agreement.

86. The New York Court of Appeals has not decided a case applying the common-interest doctrine in a civil context, much less a litigation finance one. Indeed, it has only decided one in the criminal context, over twenty years ago. *See* People v. Osorio, 549 N.E.2d 1183 (N.Y. 1989).

87. *See* Berger v. Seyfarth Shaw LLP, No. C 07-05279 JSW (MEJ), 2008 WL 4681834 (N.D. Cal. Oct. 22, 2008) (finding that the funder and the plaintiff had a common commercial—not legal—interest and that the exception to waiver did not apply). *But see Devon IT, Inc.*, 2012 WL 4748160 (finding that the communications with the potential funder, who became the funder, waived neither work-product protection, nor, because of a common interest, attorney–client protection).

88. *See* U.S. Bank Nat'l Ass'n v. APP Int'l Fin. Co., 823 N.Y.S.2d 361, 363 (App. Div. 2006) (noting that "the federal courts have been instructive" in the applicability "of the common interest doctrine in the context of an attorney-client communication" (citing United States v. Schwimmer, 892 F.2d 237, 243–44 (2d Cir. 1989); *Gulf Islands Leasing, Inc.*, 215 F.R.D. at 470; Lugosch v. Congel, 219 F.R.D. 220, 236 (N.D.N.Y. 2003), *vacated and remanded on other grounds sub nom.* Lugosch v. Pyramid Co. of Onondaga, 435 F.3d 110 (2d Cir. 2006))).

89. *See* GUS Consulting GmbH v. Chadbourne & Parke LLP, 858 N.Y.S.2d 591, 593 (Sup. Ct. 2008) (summarizing both lines of cases where one line holds the common legal interest must be identical, while the other holds the interest can be substantially similar). The "identical interest cases" also often note that having an interest in the same outcome in the case is insufficient to create a common legal interest. *See Gulf Islands Leasing, Inc.*, 215 F.R.D. at 472–73. Furthermore, a concern shared by parties regarding litigation does not establish by itself that the parties hold a common legal interest. *See, e.g.*, SR Int'l Bus. Ins. Co. v. World Trade Ctr.

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failed to address the issue despite two different lobbying efforts by the New York City Bar Association, and thus it has left the doctrinal development to the common law.[90]

Without embracing the generous extension of the common-interest doctrine reflected in some cases, we believe funders and plaintiffs should be able to communicate without waiving privilege. We view litigation funders as real parties in interest, and they should therefore be seen as akin to co-clients of the plaintiff's litigation counsel, entitled to the protection of the privilege in their own right,[91] whether or not both the plaintiff and the funder have entered attorney–client relationships with the counsel. Conceptual support for such analysis can be found in the insurance context, where the insurer—which funds a litigation, but also subrogates the funded party, and has a duty to defend—is usually deemed a co-client and afforded the privilege.[92] Moreover, a Florida court held that a litigation funder that

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Props. LLC, No. 01 Civ. 9291(JSM), 2002 WL 1334821, at *3–4 (S.D.N.Y. June 19, 2002); *In re* FTC, No. M18–304 (RJW), 2001 WL 396522, at *5 (S.D.N.Y. Apr. 19, 2001); Shamis v. Ambassador Factors Corp., 34 F. Supp. 2d 879, 893 (S.D.N.Y. 1999), *reargued*, 187 F.R.D. 148 (S.D.N.Y. 1999). The other line, regarding a substantially similar common interest, has been used to apply the waiver exception even when the communicators are otherwise adverse. *See GUS Consulting GmbH*, 858 N.Y.S.2d at 593 ("The Appellate Division, First Department has implicitly adopted the latter approach, finding that the required 'interlocking relationship' existed between a plaintiff and a non-party despite the fact that they were a debtor and creditor." (citing 330 Acquisition Co. v. Regency Sav. Bank, F.S.B., 783 N.Y.S.2d 805 (App. Div. 2004))). If the New York Court of Appeals were ever to rule and take the identical interest approach, it is very hard to imagine the waiver exception applying.

90. In 1998, the Council on Judicial Administration of the New York City Bar Association advocated for the New York Legislature to adopt changes to the Civil Practice Law and Rules to enshrine the common-interest doctrine for both attorney–client privilege and work-product doctrine, noting that a limited common-interest doctrine had been recognized for attorney–client privilege and anticipating it would apply to work product. *See* COUNCIL ON JUDICIAL ADMIN., ASS'N OF THE BAR OF THE CITY OF N.Y., RECOMMENDATION THAT STATE CIVIL COURTS ADOPT THE COMMON INTEREST PRIVILEGE (1998), *available at* http://www2.nycbar.org/Publications/reports/show_html_new.php?rid=8.

91. Indeed, the common-interest doctrine originated to facilitate communication in representation of multiple clients. *See Shamis*, 34 F. Supp. 2d at 893; Int'l Ins. Co. v. Newmont Mining Corp., 800 F. Supp. 1195, 1196 (S.D.N.Y. 1992). A minority of New York courts would end the doctrine there. *See* N. River Ins. Co. v. Columbia Cas. Co., No. 90 Civ. 2518 (MJL), 1995 WL 5792, at *3 (S.D.N.Y. Jan. 5, 1995); N. River Ins. Co. v. Phila. Reinsurance Corp., 797 F. Supp. 363, 366–67 (D. N.J. 1992).

92. Merely being insurer–insured may not be enough in New York. *See N. River Ins. Co.*, 1995 WL 5792. However, a common interest exists between insured and insurer when the insurer picks the lawyer. *See* Goldberg v. Am. Home Assurance Co., 439 N.Y.S.2d 2, 5 (App. Div. 1981); Liberty Mut. Ins. Co. v. Engels, 244 N.Y.S.2d 983, 985–86 (Sup. Ct. 1963), *aff'd*, 250 N.Y.S.2d 851 (App. Div. 1964). In cases distinguishing reinsurer–insurer (no common interest) from insurer–insured, opinions frequently note the duty to defend between insurer–insured. *See* Am. Re-Ins. Co. v. U.S. Fid. & Guar. Co., 837 N.Y.S.2d 616, 621 (App. Div. 2007) ("[T]he relationship between an insured and insurer stands in stark contrast to a relationship between an insurer and a reinsurer. . . . [W]e find the common interest doctrine inapplicable.").

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had significant control over the litigation was a real party in interest.[93] Nonetheless, it is not obvious that, without subrogation, a funder and a plaintiff can be conceptualized as the attorney's co-clients, particularly since review of existing litigation funding contracts reveals that, at times, parties actually disclaim co-client status. The analogy is also weakened by conflicts of interest between the funder and plaintiff that could make it ethically impossible for an attorney to represent both.

In sum, under New York law, sharing attorney–client privileged material with potential funders would almost certainly waive attorney–client privilege; sharing it with a funder *may* waive the privilege and must be done with caution; and sharing it with most secondary investors almost certainly waives the privilege.

b. The New York Work-Product Doctrine

While information protected only by the attorney–client privilege cannot be shared without risking waiver, the resulting information asymmetry problem can be substantially addressed by sharing attorney work product. In a narrow sense, "attorney work product" has different definitions under the federal doctrine and New York doctrine (which one applies depends on the case). Federally, "work product" includes the materials prepared for litigation that we are referring to; New York's definition of "work product" more closely mirrors the normal attorney–client privilege. However, when considering a second category of material protected in New York—trial preparation materials—the scope of what is protected is essentially the same as under the federal definition. Combining both "attorney work product" and "trial preparation materials," New York protects an attorney's "mental impressions, conclusions, opinions or legal theories" or other "work product" as well as materials "prepared in anticipation of litigation or for trial by or for another party, or by or for that other party's representative."[94] This formulation mirrors the federal one.[95]

Fortunately for litigation finance, both federal and New York case law reflect a permissive approach to sharing work product with third parties without waiving the protection. The New York Court of Appeals explains its approach in terms of intent: "The qualified privilege governing trial

93. Analyzing whether a litigation funder counted as a real party in interest under a fee-shifting statute, a Florida district court of appeal concluded the funder was indeed the real party in interest because the funder had the right "to approve the filing of the lawsuit; controlled the selection of the plaintiffs' attorneys; recruited fact and expert witnesses; received, reviewed and approved counsel's bills; and had the ability to veto any settlement agreements." Abu-Ghazaleh v. Chaul, 36 So.3d 691, 693 (Fla. Dist. Ct. App. 2009).

94. N.Y. C.P.L.R. 3101(c) & (d)(2) (McKinney 2005).

95. FED. R. CIV. P. 26(b)(3)(A). The New York definition of what is protected under "work product" is really analogous to what is protected federally under the attorney–client privilege; it is the "trial preparation materials" that are the analog to the federal work-product protection. *Id.* R. 26(b)(3).

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preparation materials 'is waived upon disclosure to a third party where there is a likelihood that the material will be revealed to an adversary, under conditions that are inconsistent with a desire to maintain confidentiality.'"[96] Under that standard, work product can be shared freely with all three categories of litigation financiers—potential funders,[97] actual funders, and secondary funders—provided that the work product is shared pursuant to a confidentiality agreement and the information recipients are not associated with the opposing side.

2. The Model Contract Solutions

The Model Contract deploys multiple devices to reduce information asymmetry without waiving the privilege (absent informed consent). The most basic is structuring the financing as a sale of securities, which places the plaintiff under the burden of the anti-fraud provisions of the securities acts and, therefore, has the helpful effect of incentivizing the plaintiff toward disclosure.[98] In addition, specific provisions impose disclosure duties and facilitate information sharing. These provisions are included in both versions of The Model Contract.

First, various definitions, representations, warranties, and other provisions of The Model Contract are designed to ensure that the plaintiff shares all material non-privileged information and work-product-protected information before and throughout the funding. Attorney–client protected information is not shared prior to funding, and sharing during the funded litigation requires informed client consent that waiver may occur through such disclosure.

Second, the plaintiff and funder agree that the common legal interest exists and that information will be shared to further that common interest. While not dispositive (parties cannot create a privilege by agreement that does not otherwise exist) courts consider such agreement necessary when analyzing whether a common interest exists, though it need not have been written.[99] Additionally, The Model Contract defines a category of

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96. People v. Kozlowski, 898 N.E.2d 891, 906 (N.Y. 2008) (quoting Bluebird Partners, L.P. v. First Fid. Bank, N.A., N.J., 671 N.Y.S.2d 7, 12 (App. Div. 1998).

97. *See* Fractus, S.A. v. Samsung Elecs. Co., No. 6:09cv00203, 2011 U.S. Dist. LEXIS 110936 (E.D. Tex. Jan. 20, 2011) (pitching materials to potential investor in patent litigation protected under work-product doctrine).

98. The securities laws would not apply if the plaintiff is structured in certain ways. Michael Kaufman, *Structuring the Issuer*, MODEL LITIG. FIN. CONT. (May 28, 2013), http://www.litigationfinancecontract.com/structuring-the-issuer-2; Painter, *Part I*, *supra* note 72. However, the application of the securities laws, from our perspective, is a feature, not a bug.

99. *See* SEC v. Wyly, No. 10 Civ. 5760(SAS), 2011 WL 2732245, at *2 (S.D.N.Y. July 5, 2011) ("The party asserting the common interest r[u]le bears the burden of showing that there was 'an agreement, though not necessarily in writing, embodying a cooperative and common enterprise towards an identical legal strategy.'" (quoting Denney v. Jenkens & Gilchrist, 362 F. Supp. 2d 407, 415 (S.D.N.Y. 2004))). However, only communications otherwise protected by

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information as "common interest material," underscoring the parties' belief. The goal is to facilitate a ruling in favor of a common interest without unduly risking the privilege by blindly relying on one.

Third, the plaintiff represents that it has fully disclosed all material information and that all information is complete and correct, and it warrants that it will continue to thus keep the funder informed of material changes.

Fourth, the funder represents that it does not have any contractual obligations to monetize its interest within a time frame that will jeopardize the claim. This provides the plaintiff with some information on the organizational structure of the firm and the ensuing incentives.[100]

Finally, staged funding, discussed in detail below, reduces information asymmetries by tying the funder's increase in risk—the release of additional capital—with the revelation of information. This aligns incentives because plaintiffs are not guaranteed funding. Bad faith, e.g., failure to disclose, will backfire. Staged funding thus reinforces the pro-disclosure incentives created by the securities laws.[101]

D. *Minimizing Conflicts of Interest*

1. The Challenges

Litigation financing creates conflicts between the funder and the plaintiff and can create or exacerbate existing conflicts between the plaintiff and its attorney. While some conflicts may persist throughout the litigation, two phases are particularly prone to conflict. The first is the negotiation of the funding agreement itself. The second is the decision of when (and by implication, for how much) to settle.[102]

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the privilege are covered. *Id.* Moreover, as discussed *supra* Part II.C.1.a, whether the common interest exists will be assessed on the facts.

100. In addition to reducing information asymmetry, this representation also reduces conflicts. On the effects of the funder's organizational structure on conflicts, see Steinitz, *supra* note 5, at 496–501.

101. While it may seem that the securities laws and litigation are incompatible because material information might need to be withheld to protect privilege, several litigation-backed securities have traded successfully without giving rise to fraud claims. *See* Steinitz, *supra* note 35. Under The Model Contract, issues are less likely to arise because the private placement approach enables work product to be shared, something that cannot be done with a publicly traded security.

102. For a more elaborate description of the conflicts of interest, see Steinitz, *supra* note 18, at 1291–92, 1323–25 and Steinitz, *supra* note 5, at 481–88. For specific state rules, see N.Y. RULES OF PROF'L CONDUCT R. 1.2(d), 1.6(a), 1.7(a), 1.8(e)–(f), 2.1 & 5.4(c) (2012). The Model Rules of Professional Conduct provide more general rules. *See* MODEL RULES OF PROF'L CONDUCT R. 1.0(e) (2009) (defining informed consent); *id.* R. 1.6–1.11 (covering confidentiality, conflicts of interest, duties to former clients); *id.* R. 2.1 (defining counsel as "advisor"); *id.* R. 2.3 (covering counsel's evaluation of a matter for use by a third party). These are the rules addressed in the New York City Bar's formal 2011 opinion on the ethics of third-party litigation finance. *See* N.Y.C. Bar Opinion, *supra* note 12 (discussing third-party litigation

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a. Referrals and Repeat Play Between Funder and Attorney

A funder may wish to offer an attorney a referral fee to steer clients its way. Or, as repeat players, the funder and attorney may have an ongoing relationship (e.g., referring different matters to each other at different times). Such relationships may distort an attorney's incentives, leading her to refer a client to a suboptimal funder, e.g., one that is not the cheapest, most competent, most liquid, and so forth[103] Any repeat play (or prospect of repeat play) between the funder and attorney may also create an incentive for the attorney to comply with a funder's wishes regarding case management rather than the client's. An attorney may also wish to own or invest in a litigation finance firm, which would similarly align its interest with the funder rather than her client.

New York rules strive to resolve these conflicts in favor of the client. A New York attorney has a duty to "exercise independent professional judgment and render candid advice."[104] A New York attorney is under a direct duty to maintain such independence despite being paid by a third party, and she is prohibited from representing a client if "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests."[105]

Precisely how these rules apply in the context of litigation funding may depend on who is asked: the New York State Bar Association or the New York City Bar Association. In the mid-1990s, the New York State Bar stated that while lawyers can refer clients to litigation funders, they cannot receive referral fees or own part of the funding company.[106] However, in 2011, the New York City Bar treated an attorney's receipt of referral fees and ownership in a funding company as possibly open questions.[107]

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financing). The American Bar Association's draft opinion on the ethics of third-party litigation financing discusses conflicts of interest in light of the Model Rules of Professional Conduct. *See* ABA COMM'N ON ETHICS 20/20, *supra* note 12.

103. A part owner of a consumer litigation funder recently pled guilty to a kickback scheme in which the defendant steered certain investment opportunities to a broker who connected plaintiffs to the funder and the broker then kicked back part of the referral fees it received for steering plaintiffs to the funder. *See Former Part-Owner of Litigation Funding Company Admits Defrauding Business Partners in $869,492 Kickback Conspiracy*, FBI (June 17, 2013), http://www.fbi.gov/newark/press-releases/2013/former-part-owner-of-litigation-funding-company-admits-defrauding-business-partners-in-869-492-kickback-conspiracy.

104. N.Y. RULES OF PROF'L CONDUCT R. 2.1.

105. *Id.* R. 1.7(a)(2).

106. *See* N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 666 (73-93) (1994), *available at* http://www.nysba.org/CustomTemplates/Content.aspx?id=5318. The New York State Bar reiterated its assessment that a lawyer cannot be an owner of the financing company or receive a referral fee from it. N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 769 (2003), *available at* http://www.nysba.org/CustomTemplates/Content.aspx?id=5409.

107. The New York City Bar Association's take on referral fees relates to the whole industry, not just the commercial claims context, but even so it notes that such fees may be unethical:

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More generally, financial relationships, interests, and the potential conflicts involved mean the lawyer must fully inform the client and seek its consent, as well as recommend that the client seek independent counsel.[108]

b. Billing Structures and Payment Schemes

Funders often shape how litigation counsel gets paid, creating incentives that can distort the attorney's judgment and advice.[109] For example, attorneys are often given a financial incentive to settle early, perhaps earlier than the client might wish to settle and for a relatively low settlement value. In addition, attorneys are often required by funders to have "skin in the game," working on at least a partial contingent fee basis.[110] A well-known critique of contingency fees is that it incentivizes attorneys to settle early, but the concern can be more acute in funded litigation given the nuances the pay structure may reflect. The attorney's percentage "take" may depend on whether the matter settled before trial, settled during a trial, or went all the way to a verdict. Alternatively, funders require attorneys to accept a reduced hourly rate, at times with a promise of "uplift" (bonus) for a successful outcome.[111] Other billing arrangements are possible, each with its own set of conflicts.

> When making a referral, the lawyer is barred from accepting a referral fee from the company if the fee would impair the lawyer's exercise of professional judgment in determining whether a financing transaction is in the client's best interest and would compromise the lawyer's ethical obligation to provide candid advice regarding the arrangement; even where the fee is permitted, the lawyer may be required to remit the fee to the client.

N.Y.C. Bar Opinion, *supra* note 12; N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 671 (40-94) (1994), *available at* http://www.nysba.org/CustomTemplates/Content.aspx?id=4866 (stating that the lawyer is prevented from receiving a referral fee where the amount of the product or service purchased depends on attorney advice). Interestingly, N.Y.C. Bar Opinion, *supra* note 12, does not cite the New York State Bar's opinions more clearly on point (Opinions 666 and 769, *see supra* note 106), even though N.Y.C. Bar Opinion, *supra* note 12, cites Opinion 666 in a different footnote on a different issue. The ABA is somewhat more permissive than the New York City Bar. The ABA's analysis of the referral fee and related issues leads to the conclusion that informed client consent may be sufficient to address the problem. *See* ABA COMM'N ON ETHICS 20/20, *supra* note 12, at 18–19, 28–29. The ABA opinion notes that a repeat business relationship might also create a conflict that requires informed client consent to resolve. *See id.*

108. *See* N.Y. LAWYER'S CODE OF PROF'L RESPONSIBILITY DR 5-101 (2007); *see also* ABA COMM'N ON ETHICS 20/20, *supra* note 12, at 18–19 (discussing Model Rule 1.7(a)(2)).

109. The ethical ramifications of the funder's influence in structuring the attorney's compensation structure is outside the scope of this Article, not least because that influence is embodied in the attorney retention agreement, not the funding contract. The basic issue is highlighted here simply to note the source of conflicts.

110. Jonathan Wheeler & Felicity Potter, *Welcome to the Party*, 158 NEW L.J. 1491, 1491 (2008).

111. *Id.*

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Early settlement pressure can be further exacerbated because litigation funders, like venture capitalists, have a similar interest in "early harvesting" of their investments. This is so because they manage portfolios of cases and because they periodically need to go back to the markets to raise additional funds based on past performance.[112] Publicly traded funders may also have short-termism problems, being evaluated on a quarterly performance basis.[113]

The converse conflict is also possible: a funder wants to settle at an optimal or rational opportunity, but a plaintiff, who no longer bears the cost or who is emotionally invested in the conflict, may wish to protract the litigation.

Attorneys' incentives to pressure or avoid pressuring a client to settle early are ameliorated by ethical obligations that render such pressure unethical. Settlement-pressure conflicts of interest also implicate rules that are aimed at ensuring that an attorney exercises independent judgment, free from influence by financial considerations. The New York City Bar Association's Opinion frames tensions surrounding settlement decisions in terms of "control" of the lawsuit and suggests these issues may be resolved purely by disclosure and client consent:

> While a client may agree to permit a financing company to direct the strategy or other aspects of a lawsuit, absent client consent, a lawyer may not permit the company to influence his or her professional judgment in determining the course or strategy of the litigation, including the decisions of whether to settle or the amount to accept in any settlement.[114]

However, not all authorities agree informed client consent is sufficient. The ABA draft opinion notes that even if giving settlement authority to the funder may be permissible as a matter of contract law and champerty, the resulting restriction on the lawyer's independent judgment could be great enough that the lawyer could not ethically participate in the litigation.[115]

We believe that the conflict over control of the claim can be resolved if the funder pays fair value for control. And thus, as a normative matter, the funder should be able to pay for control of a claim (perhaps only in the commercial claim context this Article focuses on), and we do not think the

112. Steinitz, *supra* note 5, at 489; *see also* Gilson, *supra* note 34, at 1074–75; *see also* Gompers, *Grandstanding*, *supra* note 36, at 133–38.

113. *See, e.g.*, Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265 (2012).

114. N.Y.C. Bar Opinion, *supra* note 12.

115. *See* ABA COMM'N ON ETHICS 20/20, *supra* note 12, at 25.

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current regulatory regime (including New York's champerty doctrine[116]) makes bargaining for total control practical.

c. Portfolio Concerns

Another potential source of conflict is the funder's focus on its portfolio of cases versus the plaintiff's focus on its single case. Funders' portfolio concerns may drive them to litigate to create favorable precedent, rather than optimally resolve the case at hand.[117] While this conflict is probably the exception rather than the rule, the specialization of funders in particular areas of law and examples of such strategic behavior by insurance companies, the plaintiffs' bar, and hedge funds investing in awards against sovereigns, makes the conflict plausible.[118] Beyond investing in precedent, new funders in particular might wish to avoid a reasonable settlement in order to win a symbolic victory for reputational gains, for example, to raise capital for successive funds, as has been documented in the VC context, or to force higher settlement in future cases based on a credible threat to litigate through trial and appeals.[119] Portfolio concerns also mean that a funder may underinvest in the case at hand, as optimizing the portfolio involves weighing the comparative value of cases within a portfolio and assessing the comparative marginal utility of investing in any one of them. The plaintiff, on the other hand, wants optimal investment in its own case.

The most dramatic conflict of interest that can arise from the funder's portfolio management is the possibility that the funder invests in both sides of the same litigation. This conflict is unlikely unless the case involves a large claim and equally large counterclaim, such that the profit from either side swamps the cost of financing both. In that scenario, the dual investment would simply function as a hedge.

d. Funders' Duty to Its Investors

Although funders do not have a fiduciary duty to the plaintiff, they do have a duty to their investors to maximize profit. That can lead to two additional conflicts. First, as noted earlier, funders can push for monetary remedies over non-monetary ones such as injunctive relief, declaratory relief, a public apology, a change of an internal policy, or a change in the

116. In New York, champerty is tied to claim transfer, and claim transfer may occur if control transfers, even if the case caption or other indicia of ownership do not change.

117. Steinitz, *supra* note 18, at 1312–14. For example, Mitu Gulati and Robert Scott describe how hedge funds that purchased sovereign debt strategically litigated to have the *pari passu* clause in cross-border sovereign debt contracts reinterpreted to benefit their portfolio of such cases. *See* MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN 157–59 (2012).

118. Steinitz, *supra* note 18, at 1314–18.

119. *See* Zsuzsanna Fluck et al., Venture Capital Contracting: Staged Financing and Syndication of Later-Stage Investments (Nov. 26, 2006) (unpublished manuscript), *available at* http://www.bi.no/oslofiles/ccgr/fluck_garrison_myers.pdf.

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law.[120] Second, funders can profit not only from the litigation, but also from their access to the plaintiff's sensitive information. Absent contractual protection, nothing stops the funder from selling the information or otherwise profiting from it to the plaintiff's disadvantage.

The best tool to minimize the conflicts created by profit concerns (portfolio or otherwise) in favor of the plaintiff is a fiduciary duty. Creating such a duty would not be a panacea as it would be offset by the funders' duty to its shareholders, but it would go a long way. A fiduciary relationship between funder and plaintiff could be created by courts if they find that financiers—specifically, principals or staff lawyers who are licensed attorneys—are acting as the plaintiffs' attorneys when they invest in and manage lawsuits. However, this issue has not yet been brought before a New York (or other) court. Similarly a fiduciary relationship could be imposed if another regulatory body of law that imposes fiduciary duties (e.g., financial regulation) is held to apply. To date, no such regulation has been imposed, leaving it up to the private ordering of the parties. Because of the fiduciary duty's potency, a funder may simply refuse its imposition through contract. As an alternative, plaintiffs can negotiate for a duty to act reasonably and in good faith.[121]

2. The Model Contract Solutions

To address these conflicts, The Model Contract provides the following:

First, The Model Contract imposes a number of representations on the funder disclaiming conflicts. The funder represents that it has not paid a referral fee to the litigation attorney; that the litigation attorney does not own any part of the funder; and that any other financial relationships it has or has had with litigation counsel and any defendant are fully disclosed on a schedule so that the plaintiff may give informed consent to the conflicts. The funder further represents that it has not invested adversely to the plaintiff and that it is not bound by fund liquidation or other internal requirements to stop financing the claim after a few years.

Second, we suggest the plaintiff seek independent counsel—from an attorney who is not the litigation counsel and who has no ties to the funder—on the funding agreement prior to its execution and on settlement offers. To memorialize independent counsel's role during negotiation, The Model Contract has the plaintiff represent it received independent counsel about the terms of the agreement and about the relationships, if any,

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120. An example is Burford's investment in the Chevron–Ecuador dispute, which penalized plaintiffs for receiving clean-ups rather than funds by requiring them to pay the funder for its pro-rated share of such a remedy. *See* Funding Agreement Between Treca Financial Solutions and Claimants, *supra* note 31; *see also supra* note 5.

121. *See generally* Anthony J. Sebok & W. Bradley Wendel, *Characterizing the Parties' Relationship in Litigation Investment: Contract and Tort Good Faith Norms*, 67 VAND. L. REV. (forthcoming 2013) (discussing good faith in litigation funding).

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between the funder and litigation counsel and between the funder and any defendant before entering the agreement. Both of these plaintiff-protective provisions may not be useful to the corporate finance plaintiff who as a repeat player may have an ongoing relationship with a funder. Thus, The Model Contract makes these provisions the default in the access to justice version and optional in the corporate finance version.

Third, The Model Contract allows the funder to acquire influence but not control over the plaintiff's settlement decision by requiring the plaintiff to give prior notice to the funder of settlement offers and to give good faith consideration to the funder's analysis of the settlement offer. However, the plaintiff retains control of the settlement decision. We strike this balance to avoid the potential ethical and champerty issues of ceding greater control to the funder, but nonetheless give the funder an opportunity to monitor, protect, and maximize its investment.

Fourth, The Model Contract requires strict confidentiality and limits information sharing to protect plaintiff's sensitive information.

Fifth, The Model Contract protects the plaintiff's interest in seeking non-monetary remedies by excluding them from the definition of the term "Award," the proceeds of which are shared with the funder.

Sixth, The Model Contract contains a representation and warranty that the funder has not and will not sell part or all of its interest in the claim without the plaintiff's written consent. This is meant to prevent securitization of litigation which, if it were to occur, would create insurmountable conflicts, and to prevent the plaintiff from having to rely on a stranger for further funding.

Seventh, The Model Contract provides language for a comprehensive solution in the form of a fiduciary duty between the funder and the plaintiff and a weaker but viable alternative of a duty to act reasonably and in good faith. The fiduciary duty approach is the default in the access-to-justice case; the good faith duty is the default in the corporate finance case.

Finally, staged funding aligns funders' and plaintiffs' interests and further reduces conflict, as discussed in detail below.

E. STAGING THE FUNDING OF LITIGATION[122]

1. The Challenges

Staged funding in venture capital aligns the entrepreneur's interest with the funder's by making the entrepreneur's access to capital dependent on meeting the funder's contractually stated expectations. Whether or not the entrepreneur is meeting those expectations is assessed at points in time called "milestones," a concept we explain further below. If the funder is

122. Maya Steinitz, *How Much Is That Lawsuit in the Window? Pricing Legal Claims*, 66 VAND. L. REV. 1889(2013) (discussing the theory underlying staged funding and claim valuation).

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satisfied when the milestone is reached, it may invest further; if not, it does not. Staged funding also aligns the funder with the entrepreneur, because as the company develops and its value builds, the funder is incentivized to continue funding at milestones in order to realize the benefit it has bargained for.

As a matter of risk management and agency control, staged funding is well suited for litigation investment. However, the adaptation of staged funding to litigation finance must be done with great care to account for the differences between litigation and start-up companies, which are quite different assets. We extensively discuss the important economic and structural differences between venture capital and litigation finance elsewhere.[123] These differences, in a nutshell, include the fact that the "markets" to which plaintiffs sell are comprised of judges and juries who render a judgment or a defendant who makes a settlement offer. These markets cannot be expanded and the "product" cannot be scaled-up or otherwise significantly modified.[124] More generally, claim value does not grow by orders of magnitude, as it might in the case of a start-up company, but rather moves up and down unpredictably with its ultimate value capped by the value of the harm underlying the cause of action.[125] Other differences include the fact that ventures have competitors whereas litigants have opponents and the fact that litigants face a timeline that is wholly externally dictated (by rules of procedure and a judge). There are also societal differences, the different needs of the two plaintiff types, and the challenges both pose for mapping staged funding onto litigation finance. These latter differences are our focus here.

Unlike startup companies, litigation is partially a public good, dependent on the state for its existence and effectiveness far more so than a business idea turned into a company. Litigation resolves disputes, determining culpability, harm, rights, and remedies. Startup companies may provide jobs, useful products—even economically transformative ones—and otherwise be socially important. Nonetheless their existence and function are categorically different from litigation.

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123. *See id.*; Maya Steinitz & Abigail C. Field, *Staging Litigation Funding*, MODEL LITIG. FIN. CONT., http://litigationfinancecontract.com/staging-litigation-funding/ (last visited Nov. 9, 2013).

124. *See* Steinitz, *supra* note 122; Steinitz & Field, *supra* note 123.

125. On the nonmonotonic and discontinuous nature of settlement values, see generally Steinitz, *supra* note 122, which, in turn, builds on earlier works that bring financial theory of options analysis to bear on the analysis of the option to settle. *See, e.g.*, Oren Bar-Gill, *Pricing Legal Options: A Behavioral Perspective*, 1 REV. L. & ECON. 203 (2005); Bradford Cornell, *The Incentive to Sue: An Option-Pricing Approach*, 19 J. LEGAL STUD. 173 (1990); Joseph A. Grundfest & Peter H. Huang, *The Unexpected Value of Litigation: A Real Options Perspective*, 58 STAN. L. REV. 1267, 1272–82 (2006); Robert J. Rhee, *The Effect of Risk on Legal Valuation*, 78 U. COLO. L. REV. 193 (2007).

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When a venture capitalist ceases funding a startup simply because another investment in its portfolio potentially offers better returns, even if the consequence is that the startup fails, society is and should be indifferent. Not so with most categories of litigation. As a general normative matter, plaintiffs with meritorious claims who wish to bring them should not be blocked by the invisible hand of the market. However, there is one type of litigation in which this kind of market discipline can be justified: commercial claims brought by corporations or wealthy individuals; that is, precisely the kind of claims we explicitly assumed when drafting The Model Contract.

Commercial claims are generally only about money. When a case is fundamentally about money damages, it is easiest to view it as an investment opportunity that can be abandoned for better opportunities. Other forms of litigation that currently receive financing, such as divorce cases, involve many issues beyond money, particularly when the couple has children. Staged funding of such litigation, with its ability to eliminate a plaintiff's ability to continue its claim, is hard to justify normatively.

Beyond identifying the claim type's influence on the appropriateness of staged funding, contracting parties need to recognize the importance of claimant type. Access-to-justice plaintiffs are in a very vulnerable bargaining position vis-à-vis funders, particularly now when the market for litigation funding is opaque and underdeveloped compared to the venture capital market. Corporate finance plaintiffs, in contrast, need not fear staged funding.

The fundamental difference in bargaining power, coupled with the normative concern that meritorious claims brought by willing plaintiffs should be resolved by the plaintiff rather than by market discipline, implies that staged funding should not be adopted identically for both types of plaintiffs. And indeed, the funding terms in the two versions of the models differ. Ramifications of those differences also show up in provisions related to milestones and termination rights.

In venture capital, milestones mark the startup's progress through various stages of development, each stage revealing new information.[126] The information revealed is of three sorts: first, about the performance of the underlying asset; second, about the effectiveness of the agents developing the asset; and third, about the larger context from which the asset's value ultimately derives. The amount of each type of information revealed at a given milestone varies depending on the milestone, but the point of designating the milestone is to recognize that material information has been

126. *See* Maya Steinitz, *Milestones Generally and in the Model Contract*, MODEL LITIG. FIN. CONT. (Jan. 25, 2013), http://litigationfinancecontract.com/milestones-generally-and-in-the-model-contract-2/.

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revealed, creating a meaningful opportunity for funders to reassess their commitment to the investment and the accuracy of the investment's price.

As a general matter, at milestones funders can either refuse further funding, "exiting" the investment, or provide an additional infusion of the capital that the funders committed at the outset, either on the same terms or on new ones based on a re-pricing of the asset. The re-pricing, in turn, is based on the new information that has been revealed.

An example of a good milestone in litigation is the close of discovery, when the evidentiary record to be used in the litigation is complete. It is a discrete point in time at which all of the information revealed during discovery can be incorporated into pricing. If a funder exited a litigation investment after the close of discovery, it is plausible that the plaintiff could find another funder, particularly if a transparent market develops. In fact, milestones could facilitate the development of that market, enabling funders to develop expertise as early and late-stage litigation funders.[127]

At least that is how staged funding works in theory: invest at one milestone, reach the next milestone, and invest again or exit. In the real world, funding invested at one milestone can run out before the next milestone is reached. In venture capital, the parties simply negotiate "bridge financing," or even an entirely new round of funding, or the investment ends. That approach would also work for corporate finance plaintiffs, as they can prevent any disruption in the litigation by self-funding while the negotiations are ongoing. Access-to-justice plaintiffs, however, would be doubly vulnerable to funders during negotiations. Not only do they need the financing, but in between milestones they may face deadlines imposed by the court or other litigation-specific constraints[128] that make it impossible for them to engage in lengthy negotiations or find other funders soon enough.

In venture capital parlance, the plaintiffs are confronted with a "hold-up" problem and potentially forced to accept lopsided terms.[129] The venture capital solution to hold-up is syndication—creating a competition among funders to drive prices up—which is not a sufficient solution for access-to-justice plaintiffs unless the litigation finance market develops to the point where plaintiffs could reliably have multiple funders participate in each round of negotiations. Until such time, other solutions are needed.

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127. Indeed, funders already specialize by stage to some extent. Some are focused on appeals or enforcement actions, for example.

128. Steinitz, *supra* note 122; Steinitz & Field, *supra* note 123.

129. For more on hold-up, see Steinitz, *supra* note 122 and Steinitz & Field, *supra* note 123. Research shows, specifically, that staged funding by monopolistic VC funds (as opposed to syndicates of funders) produces sub-optimal outcomes—meaning companies fail that would have succeeded if not held-up. Steinitz, *supra* note 122; Steinitz & Field, *supra* note 123. The same sources identify research that shows that the entrepreneur's ownership share increases with the value of the project when later stages of the investment are syndicated. Steinitz, *supra* note 122; Steinitz & Field, *supra* note 123.

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2. The Model Contract Solutions

For both plaintiff types, The Model Contract's core adaptation is structuring the financing as a series of securities sales to the funders, with the sales occurring at the investment milestones at prices negotiated at each such milestone. The securities are "shares" in the litigation proceeds.[130] At the outset, the plaintiff and funder agree on the potential value of the litigation, the funder "commits" a certain amount of capital that it is willing to invest at each milestone, and the plaintiff and funder negotiate the price of the initial investment. At each investment milestone thereafter, the purchase price of the next batch of securities is negotiated anew to incorporate the information received at that point.

This adaptation treats the entire litigation as a single funding round. In a VC-staged funding round, the investor will "commit" a certain amount of capital to the round but only invest a part of it at each milestone closing within the round. This approach makes sense for litigation funding in that the analogy between litigation finance and venture capital is strongest at the "seed" or "early" stage of VC funding. The single-funding-round approach is modified, however, by The Model Contract's provision for the re-pricing of the "shares" at investment milestones.

Each purchase price is based on an "Initial Claim Value"—a number negotiated at the outset—and a "Risk Discount Factor" that is negotiated to reflect the uncertainty that the Initial Claim Value will be realized, or realized in a timely way. Unless the "Claim" has proved much less valuable than expected, the Initial Claim Value plays no other role; a Litigation Proceed Right-holder gets one percent of the actual proceeds.

The suggested provisions identify only one investment milestone after the initial investment: the close of discovery. Parties can negotiate for more. Critically, the re-pricing focuses not on the value of the claim, but on the risk discount applied to the Initial Claim Value. The Initial Claim Value is unlikely to have changed, unless new claims have been added or original ones dropped. At the completion of discovery however, the parties can better assess the risk that the claim will fail to lead to a favorable settlement or judgment. As a result, they can decide whether a "share" should cost twenty percent of its agreed potential value (high risk) or fifty percent (low risk) or any other number.[131]

The transaction costs of re-pricing at the discovery closing should be low, because the focus is on the change in the information about risk more than it is on valuing the claim. That said, if during discovery a plaintiff found information enabling it to make new, valuable claims, the parties could

130. *See supra* Part II.B.2.

131. The value can also be affected by the negotiation process. If a syndicate of funders bid at the discovery milestone closing, the risk discount should be less than if there is no syndicate even though the revealed information is the same in both scenarios.

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negotiate a new claim value and amend the contract accordingly, and vice versa. While the transaction costs would rise, the milestone would still further its purpose of allowing parties to more accurately price the investment.

Although this basic deal applies to both types of plaintiffs, The Model Contract provisions then diverge. For the access-to-justice plaintiff, the suggested provisions address the bargaining disparity in between milestones by preventing a funding shortfall in between milestones. The funder is required to finance through to the next milestone, even if the initially invested capital falls short, unless the funder brings in a replacement financier or is willing to surrender all value already purchased. Mechanistically, The Model Contract requires the accelerated investment of capital "committed" to financing at the next milestone and the investment of new "supplemental" capital if committed funding is nearly spent but the milestone/completion of the Claim has not been reached.[132]

Acceleration and supplementation are justified by the differences between claims brought by access-to-justice plaintiffs and startup companies, discussed above, and their effect is tempered by the fact that the funder can still exit at the milestone or before, if it is willing to find a replacement funder or lose its sunk costs (i.e., investment to date). The Model Contract assumes the funder will want a discounted purchase price for "shares" purchased with the supplemental investment but that the discount is not required for an accelerated investment as that capital is not "new" capital; however, parties can customize these terms.

Returning to provisions that apply to both plaintiff types, The Model Contract reduces the extreme uncertainty by providing limited downside protection to both funder and plaintiff. If the Claim is revealed to be much less valuable than expected, by an otherwise acceptable settlement offer or

132. If the capital invested is spent prior to the milestone because of relative incompetence or padded billing of the litigation counsel, it may be appropriate to have the litigation counsel forego fees or take litigation proceed rights in lieu of payment, rather than have the accelerated investment of committed capital. *See* Edward A. Reilly, Jr., *4 Thoughts on "Funding Through to Milestones: Accelerated and Supplemental Investments,"* MODEL LITIG. FIN. CONT. (Jan. 31, 2013, 5:33 PM), http://litigationfinancecontract.com/funding-through-to-milestones-accelerated-and-supplemental-investments/#comments.

For a real world example of an access-to-justice funding that highlights the appropriateness of the VC analogy and many of the provisions herein, consider the financing of Crystallex International Corporation's arbitration against Venezuela. That deal involved staged financing pegged to litigation related milestones, the acceleration of committed capital to bridge a funding shortfall between milestones, and the issuance of a special class of stock to give the funders control rights if sufficient financing was used. *See Management's Discussion and Analysis for the Year Ended December 31, 2012*, CRYSTALLEX INT'L CORP. 5 (Aug. 16, 2013), http://www.crystallex.com/files/KRY%202012%20Year%20end%20MDnA_v001_u9xz34.pdf. This example is discussed in detail in Steinitz, *supra* note 35.

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by a final judgment, then the funder is issued additional "shares."[133] If possible, the funder is issued sufficient "shares" to gain the value expected by owning the funder's original number of "shares" of proceeds worth the Initial Claim Value. This type of re-pricing is limited, however, by the plaintiff's downside risk protection—its right to a minimum recovery.

We set a minimum plaintiff recovery because of the public policy concern—indeed, one of the main critiques of litigation funding—that plaintiffs will be exploited[134] and that funders profiteer from others' actionable injuries.[135] By providing a minimum, the parties reduce the risk that courts will refuse to enforce the finance agreement on grounds such as unconscionablility.[136] While corporate finance funders are not as vulnerable, we believe it is good practice in every contract to set the minimum recovery as it is a basic deal term.

While the plaintiff's minimum recovery will be heavily negotiated, the standard for minimum recovery set by the courts in the contingency fee context is a logical guideline.[137] This minimum also minimizes the risk of buyers'-remorse-type satellite litigation in which plaintiffs decide, after having received the funding and an award actually having been rendered, to challenge the enforceability of the finance agreement.[138]

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133. The VC analog for conserving the initial bargain and limiting the funder's downside risk as value changes over time are conversion-price, anti-dilution provisions. *See* Michael A. Woronoff & Jonathan A. Rosen, *Understanding Anti-Dilution Provisions in Convertible Securities*, 74 FORDHAM L. REV. 129 (2005). Other types of anti-dilution provisions can be used. For example, Robert Rhee has suggested using a time-triggered provision to reflect the time value of money. Robert J. Rhee, *Litigation Financing and Time Dilution*, MODEL LITIG. FIN. CONT. (Jan. 23, 2013), http://litigationfinancecontract.com/litigation-financing-and-time-dilution/.

134. *See* Ronen Avraham & Abraham L. Wickelgren, *Third Party Litigation Funding—A Signaling Model* (Univ. of Tex. Sch. of Law, Law & Econ. Research Paper No. 521, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2302801 (discussing a consumer funding case in which the plaintiff settled for $150,000 but ended up with $111 because the third-party funder walked away with the bulk of the recovery).

135. The underlying theory of such critiques being that legal claims are a unique, personal kind of asset. *See generally* Sebok, *supra* note 59. This idea is quite intuitive in the context of tort and divorces cases, which are increasingly receiving third-party funding. *See generally id.*

136. *See supra* notes 33 and 134 (discussing cases concerning unconscionablility of funders' returns).

137. No ceiling is set under Rule 1.5 of the New York Rules of Professional Conduct, which instead offers a balancing test. *See* N.Y. RULES OF PROF'L CONDUCT R. 1.5 (2012). Contingency fees of forty and fifty percent have been upheld. *See* Quinones v. Police Dep't of N.Y., No. 10 Civ. 6195(JGK)(JLC), 2012 WL 2148171 (S.D.N.Y. Apr. 12, 2012); Ross v. Mitsui Fudosan Inc., No. 97 Civ. 0975 PKL RLE, 1999 WL 799534, at *2 (S.D.N.Y. Oct. 6, 1999) ("Courts have found forty or fifty percent contingency fee agreements conscionable in certain circumstances, such as when the litigation is complex, lengthy or specialized in knowledge."); Lawrence v. Miller, 901 N.E.2d 1268, 1272 (N.Y. 2008) (finding that a forty percent fee was not unconscionable as a matter of law, but the amount of the fee should be proportionate to the value of services rendered).

138. Since it is easier to sign away *X* percentage of nothing *ex ante* than to actually pay *X* percentage of something once a settlement or court victory is won, hindsight litigation to

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Importantly, the suggested terms state that the purpose of this type of re-pricing is strictly to preserve the economic equilibrium of the bargain, not to allow for renegotiating that equilibrium *ex post*. Re-pricing is mechanistic because the expected value that the re-pricing aims to replicate is known; the actual value and how much it deviates from the expected value is known; and how many additional "shares" can be issued is known at any given time. Therefore, this risk-management re-pricing should not increase transaction costs significantly.[139]

The Model Contract makes it easier for plaintiffs to optimize their funding level by making fundraising transparently linked to claim proceeds. While the plaintiff will have to strike a difficult balance when deciding how many "shares" to offer at each closing, the ability to offer some and then more, and then more still, makes it easier for the plaintiff to avoid over-selling at the outset. The plaintiff does not have to decide at the outset how much of its potential proceeds it is willing to give up. This flexibility should help protect the financing arrangement from unconscionability concerns and buyers'-remorse litigation. We presume, based on the analogy to the contingency fee case, that a plaintiff will not want to sell more than one third of the total "shares" in its proceeds. But the plaintiff may well succeed at selling significantly less than one-third of the proceeds while still funding its whole claim. Or the plaintiff may end up selling every "share" it can until it reaches the limit imposed by the minimum recovery.

There is still unallocated residual risk: it is possible that the plaintiff will run out of "shares" to sell and money to conduct the claim. However, the risk that plaintiffs' funding demands will exceed what funders want to invest mid-litigation is present in all structures.[140] In such scenarios, the parties can

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challenge the deal terms is not uncommon. *See, e.g.*, S & T Oil Equip. & Mach., Ltd. v. Juridica Invs. Ltd., 456 F. App'x 481 (5th Cir. 2012); Kraft v. Mason, 668 So.2d 679 (Fla. Dist. Ct. App. 1996); Odell v. Legal Bucks, LLC, 665 S.E.2d 767, 772–73 (N.C. Ct. App. 2008); Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217 (Ohio 2003); Anglo–Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87 (Tex. App. 2006).

139. *See, e.g.*, J. LUIS GUASCH, GRANTING AND RENEGOTIATING INFRASTRUCTURE CONCESSIONS: DOING IT RIGHT (2004), *available at* http://crgp.stanford.edu/events/presentations/gcr2/Guasch3.pdf; Philippe Aghion & Patrick Bolton, *An Incomplete Contracts Approach to Financial Contracting*, 59 REV. ECON. STUD. 473 (1992); James Bergin & W. Bentley MacLeod, *Efficiency and Renegotiation in Repeated Games*, 61 J. ECON. THEORY 42 (1993); Arthur J. Robson, *Duopoly with Endogenous Strategic Timing: Stackelberg Regained*, 31 INT'L ECON. REV. 263 (1990).

140. And current incremental funding practices, to the extent that the Burford–Ecuador deal is representative, *see supra* note 5, seems to leave this risk completely (rather than partially) unaddressed. There is reason to believe that incremental funding practices in the market currently are no more sophisticated than what can be gleaned from the Burford–Ecuador investment. Burford is "'the largest and most experienced international dispute funder in the world' . . . so we're not looking here at some aberrational outlier . . . . [And,] we can be assured that Burford's conduct probably represents the very best practices the young industry has to offer." Roger Parloff, *Have You Got a Piece of this Lawsuit?*, CNNMONEY (June 28, 2011, 2:06 PM), http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-

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agree that the funder will bear the risk and will continue funding without receiving additional "shares" in order to receive some value for its sunk costs; that the plaintiff will bear the risk by selling more "shares" and reducing its minimum (and thus, potentially, create an unconscionability or buyer's remorse problem); or that they share the risk.

The next Part sets out The Model Contract (excluding boilerplate or otherwise typical finance provisions). For brevity, we provide both the access-to-justice and corporate finance contracts in an integrated fashion. Specifically, we lay out the access-to-justice contract, and after each provision that would be deleted or modified for the corporate finance plaintiff, we highlight the deletion or state the modification. (For visual simplicity, we do not attempt to correct the section numbering to reflect the deletions/alterations.) In addition, while the contract is drafted for one funder, it can be easily adapted for multiple funders. Where the inclusion of multiple funders would require more drafting changes than conforming ones, we have included relevant language.

III. THE MODEL CONTRACT

This Litigation Finance Agreement (Agreement) is dated as of [date], and is by and between [Plaintiff's name] (Plaintiff) and [Funder's name] (Funder).

The Plaintiff has a valid and substantial claim against the Defendant(s). The Funder wishes to invest with the Plaintiff to facilitate the prosecution of its claim and to profit if the claim is successful. The Funder agrees that its financing is nonrecourse; the litigation proceed rights it shall purchase represent no value if there are no proceeds of the litigation.

Now, therefore, it is agreed as follows:

1.0 Definitions

Acceleration Event: The balance of the Litigation Account falls below [$] and the Litigation Counsel in good faith reasonably believes the amount remaining in the Litigation Account is insufficient to finance the conduct of the Claim through to the Milestone Event marking the next Closing. [Despite such certification, an Acceleration Event has not occurred if the Plaintiff and [Funder/Funders holding a majority of issued Litigation Proceed Rights] agree the funding shortfall is due to Attorney Waste, as defined in the Retainer Agreement, between the Plaintiff and Litigation Counsel entered [date]. In such case, the related provisions in the Retainer Agreement shall apply.]

2/. Anthony Sebok has noted that the Burford–Ecuador deal contained "nothing unusual from [the] point of view of the litigation finance world" in its contract. Daniel Fisher, *Litigation-Finance Contract Reveals How Investors Back Lawsuits*, FORBES (June 7, 2011, 7:12 AM), http://www.forbes.com/sites/danielfisher/2011/06/07/litigation-finance-contract-reveals-how-investors-back-lawsuits/ (internal quotation marks omitted).

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Comment: The optional "Attorney Waste" language is one way to protect the funder from the risk that litigation counsel fails to effectively use funds because he knows he can force additional funding.[141] *However, this definition must be very narrow to cover only obvious waste, or else it creates a conflict between the plaintiff and the attorney.*[142]

Corporate Finance Version Comment: *This provision should be deleted as corporate finance plaintiffs do not need the bargaining power protection of Accelerated Investments.*

Award: The total monetary amount owed the Plaintiff on account of or as a direct or indirect result of the Claim, whether by negotiation, arbitration, mediation, lawsuit, judgment, settlement, or otherwise. For the avoidance of doubt, "Award" includes both cash and the monetary value of non-cash assets at the time the Award is paid, and it excludes the value of injunctive, declaratory, or other non-monetary relief.

Comment: This definition should be customized to the claim. The definition should be very broad to capture the full monetary value, but minimize claim commodification by excluding the cash equivalent value of remedies that were not intended to be fungible with cash, such as injunctive relief.

Claim: The lawsuit [filed by the Plaintiff/the Plaintiff will file] against [name] arising from [name's] breach of [specify], including any refiling, counterclaim, appeal, settlement, enforcement action, arbitration, or other action or process related to the lawsuit, whether primary, ancillary, or parallel.

Comment: Investing after the lawsuit has been filed should further reduce the risk of a champerty finding under New York law. Generally, this provision should be customized to reflect the claim.

Closing: Any or all of the following events, as context requires:

Acceleration Closing: The sale and purchase of Litigation Proceed Rights thirty (30) days after an Acceleration Event.

Defendant[s]: [Name(s) of defendant(s)].

Discovery Closing: The sale and purchase of Litigation Proceed Rights eight days after the Conclusion of Discovery.

Initial Closing: [Date the Initial Investment is made, location/other description.]

[Supplemental Closing: The sale and purchase of Litigation Proceed Rights thirty (30) days after a Supplemental Investment Event.]

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141. This is an example of "braiding"— the intertwining of two or more contracts such that each contract includes provisions that operate as implicit terms in support of the arrangements contained in the other. *See* Gilson et al., *Braiding*, *supra* note 36, at 1386, 1422–23. On the braiding of the litigation finance contract and the retention agreement, see Steinitz, *supra* note 5, at 512–15.

142. Kenneth A. Linzer, *Conflicts Created by the Funding Terms in the Model Contract*, MODEL LITIG. FIN. CONT. (Apr. 29, 2013), http://litigationfinancecontract.com/conflicts-created-by-the-funding-terms-in-the-model-contract/.

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Comment: If more investment milestones are negotiated, they will need their own closing definitions. Supplemental Investments, and all their related terms (such as Supplemental Closings) are optional as the parties may not wish to allocate this risk ex ante.

Corporate Finance Version Comment: *The Acceleration and Supplemental Closings should be deleted as corporate finance plaintiffs do not need the bargaining power protection of Accelerated or Supplemental Investments.*

Committed Capital: [$], the total amount pledged to finance the conduct of the entire Claim through to the Conclusion of the Claim [as set forth in Exhibit [X]].

Comment: If multiple funders are involved, the Exhibit becomes necessary to identify how much each is willing to invest and when. Funders and Plaintiff should use their expertise to determine how much capital is likely to be needed for the whole claim and ensure that the amount committed is at least that number.

Common Interest Material: Any discussion, evaluation, negotiation, and any other communication and exchanges of information relating to the Claim in any way, whether written or oral, between or among the Plaintiff, Litigation Counsel, Funder, and/or Funder's Representatives, *provided* that such communication would be protected by attorney–client privilege between Litigation Counsel and the Plaintiff, work-product doctrine, or other discovery protection if not disclosed to a third party lacking a common legal interest.

Comment: The more traditional way of defining this material would have the language after "provided" *simply state that the material was subject to one of the discovery privileges, a restriction that narrows the otherwise sweeping language before* "provided." *However, if the definition is contingent on the material* actually *being protected by such privilege and a judge were later to rule a common legal interest did not exist, so that waiver occurred and none of the material was so protected, the definition would be invalidated. If the definition were invalidated, the ramifications elsewhere in the contract might produce material consequences.*

Conclusion of the Claim: The final resolution of the Claim, whether by settlement, the entry of a non-appealable final judgment against the Plaintiff, or the enforcement of a final, non-appealable judgment in favor of the Plaintiff.

Confidential Information shall mean:

(i) the Common Interest Material;

[(ii) discussions and negotiations related to this Agreement, including drafts of this Agreement;]

[Alternate: (ii) this Agreement, including: (a) its existence and the existence of the financing it provides; (b) its terms; (c) the parties to it; and (d) any discussions and negotiations related to this Agreement, including drafts of this Agreement;]

(iii) to the extent not already covered as Common Interest Material, the Claim, including: (a) the information, of any type, relevant to

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understanding the Claim; (b) the parties', Litigation Counsel's, or Funder's Representatives' strategies, tactics, analyses, or expectations regarding the Claim or Award; and (c) any professional work product relating to the Claim or the Award, whether prepared for the Plaintiff, Litigation Counsel, the Funder, or the Funder's Representatives.

(iv) [Add customized provisions.]

Notwithstanding the foregoing, information is not Confidential Information that (a) was or becomes generally available to the public other than by breach of this Agreement; (b) was, as documented by the written records of the receiving party, known by the receiving party at the time of disclosure to it or was developed by the receiving party or its representatives without using Confidential Information or information derived from it; (c) was disclosed to the receiving party in good faith by a third party who has an independent right to such subject matter and information; or (d) is required to be disclosed by law.

Comments: 1. We included information common to all situations; parties must customize the definition to meet their needs. Plaintiffs must take great care with this definition, and, if they wish, add an additional defined category of Proprietary Information because absent explicit contractual protections, nothing prevents the Funder from profiting by misusing the Plaintiff's sensitive information. 2. Although parties can agree to keep the contract confidential, we believe it is likely discoverable under New York law.[143] *Even if discoverable, however, its admissibility at trial may be a different question.*

Costs: Costs are the expenses incurred by or on behalf of the Plaintiff for conducting the Claim and complying with the terms of this Agreement and include: professional fees, whether for attorneys, advisors, experts, or witnesses; and procedural fees relating to court, arbitration, or other process, including filing and arbitrator fees; provided that the amounts in each case are approved by Litigation Counsel.

Comment: Plaintiffs may be advantaged by having the Funder monitor these invoices, particularly for Litigation Counsel's own work. However, privilege issues may arise.

Exiting Funder: A Funder that decides to stop funding the Claim prior to the Conclusion of the Claim.

Expected Value: The result of multiplying one percent (1%) of the Initial Claim Value by the number of Litigation Proceed Rights that Funder owns.

Funder[s]: [Name(s).]

Funder's Representatives: [Name of counsel] and any successor counsel or supplemental counsel the Funder retains to represent its interests regarding the Claim and this Agreement.

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143. *See* Maya Steinitz, *Discoverability of Funding Contracts*, MODEL LITIG. FIN. CONT. (Feb. 8, 2013), http://litigationfinancecontract.com/discoverability-of-funding-contracts/.

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Independent Counsel: [Name of counsel] and any successor or supplemental counsel retained by the Plaintiff to advise on this Agreement's terms, amendments, and assignments, on settlement proposals and on privilege issues. Such counsel has and shall have no direct or indirect economic relationship with the Funder prior to the Conclusion of the Claim.

Comment: This role could be played by the Litigation Counsel provided potential conflicts are disclosed to the Plaintiff and waived by it. Like minimum plaintiff recovery, this predominantly protects plaintiffs but also provides funders with protection—indeed, a defense, against "buyers'-remorse" litigation.

Corporate Finance Version Comment: *This provision is optional for corporate finance plaintiffs, not least because such companies have sophisticated in-house counsel who would typically play this role.*

Initial Claim Value: [$.]

Comment: This is a negotiated amount that reflects the good faith expectations of the parties ex ante *of what a reasonably favorable verdict or settlement would bring.*

Investment: Any or all of the following as context requires:

Accelerated Investment: The amount of money the Funder invests at an Acceleration Closing.

Discovery Investment: The amount of money the Funder invests at the Discovery Closing.

Initial Investment: The amount of money the Funder invests at the Initial Closing.

[Supplemental Investment: The amount of money the Funder must invest at a Supplemental Investment Closing.]

Comment: If any other investment milestones are included, they will need their own definition. Supplemental Investments are optional as the parties may not wish to allocate this risk ex ante.

Corporate Finance Version Comment: *The Acceleration and Supplemental Investments should be deleted as corporate finance plaintiffs do not need the bargaining power protection they provide.*

Litigation Account: [Identify bank account.] The Litigation Account is subject to the Escrow Agreement by and among [parties], dated [date] "Escrow Agreement." Pursuant to the Escrow Agreement, the Escrow Agent (as defined therein) shall use the funds in the Litigation Account to pay the Costs and its fee.

Comment: The Escrow Agreement should contain the right, if any, of the Funder to review and/or approve invoices prior to the Escrow Agent's payment of them. In addition it should contain notice provisions tied to the Acceleration and Supplemental Investment Events, if those concepts are used.

Litigation Counsel: [Counsel name] and any successor or supplementary counsel retained by the Plaintiff to conduct the Claim.

Litigation Proceed Right: The right to receive one percent (1%) of the Proceeds.

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Litigation Proceed Right Certificate: A document in the form of Exhibit [ ] (i) reflecting ownership of a certain number of Litigation Proceed Rights; (ii) bearing a legend stating that the certificate and the rights it represents may not be transferred without the express, written consent of the Plaintiff and then only if the transferee becomes a party to this Agreement; (iii) acknowledging the rights and obligations created by Subsection 5.6 of this Agreement; and (iv) certifying the existence of a perfected senior security interest in the Proceeds Account [and in the Claim].

Comment: Although this financing is nonrecourse, after the Proceeds have been received by the Plaintiff but before they are disbursed to the Funder, there is a brief possibility that the Plaintiff could convert money due to the Funder. This security interest is intended to thwart that possibility; however, the securities fraud liability that would result from such conversion should be a sufficient deterrent.

Litigation Proceed Right Purchase Price: Each Litigation Proceed Right purchased at a Closing shall cost an amount equal to one percent (1%) of the Initial Claim Value multiplied by the relevant Risk Discount Factor.

Milestone Events: The following events: (a) Completion of Discovery; (b) Motion to Dismiss Milestone; (c) Summary Judgment Milestone; and (d) Judgment Milestone.

Completion of Discovery: The date as defined by court order.

Judgment Milestone: The date at which the judge enters a verdict as a judgment.

Motion to Dismiss Milestone: The entry of an order resolving a motion to dismiss against the Plaintiff.

Summary Judgment Milestone: The entry of an order resolving a summary judgment motion against the Plaintiff, *provided that* the motion is dispositive of [the entire Claim]/[identify material issues/causes of action].

Comment: Parties should choose milestones carefully, balancing the competing goals of allowing the Funder to manage its investment by exit, the Plaintiff to manage the risk of losing funding at a particularly destabilizing moment, and both to manage value by incorporating new pricing information and minimize transaction costs. Exit-only milestones such as the Motion to Dismiss and Summary Judgment Milestones are necessary because of the Accelerated and Supplemental Investment provisions. Those milestones ensure that a Funder can terminate on notice pursuant to Subsection 6.1 and eliminate any chance that a Plaintiff that chooses to use its remaining funds to pursue an appeal the Funder does not support will not cause the Funder to make Accelerated or Supplemental Investments.

Corporate Finance Version Comment: *Because corporate finance plaintiffs do not need the bargaining power protection of Accelerated or Supplemental Investments, the Motion to Dismiss and Summary Judgment Milestones are not necessary for them and should be deleted.*

Plaintiff: [Name(s).]

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Proceeds: (i) Any and all value received to satisfy the Award, if the Award results from settlement or other negotiated agreement, and (ii) any and all value received to satisfy the Award, less any state, federal, or international taxes owed on such value, if the Award is a judgment, order, or other determination by an independent party, such as a court or arbitrator.

Comment: The binary definition is intended to highlight that the parties need to allocate the tax burden associated with the Proceeds. In a negotiated outcome, the Plaintiff has discretion to structure the resolution in a tax-advantaged way. With a judgment, the Plaintiff may not have such freedom (although it may be able to negotiate payment of the judgment in a tax-advantaged manner). Thus the Litigation Proceed Rights are worth one percent (1%) of the gross Proceeds in a negotiated outcome and one percent (1%) of the tax-net Proceeds in a judgment outcome. This default should be customized as the parties prefer.

Proceeds Account: [Specify account], which is governed by the Control Agreement among the Plaintiff, Funder, and [the financial institution in which the deposit account is located] dated as of [same date or earlier as this Agreement.] As provided in the Control Agreement, the Plaintiff may not access the funds in the Proceeds Account until after the Funder is paid the value of its Litigation Proceed Rights, whether from the Proceeds Account or from any other source owned or controlled by the Plaintiff. As specified in the Control Agreement, the Control Agreement shall terminate upon the Funder's receipt of the value of its Litigation Proceed Rights.

Comment: This account is empty until the Proceeds are received, and then they are deposited in this account for disbursement. To make the security interest in the account effective, the parties have to enter a "control agreement" which makes clear the Plaintiff has no control over the account and the financial institution should instead take direction from the Funder.[144]

[Proprietary Information:]

Comment: If either party has a subset of Confidential Information that it believes is so sensitive it must be destroyed or returned rather than kept secret for a fixed number of years after the Agreement's termination, they should define it here. Two corollary provisions are then necessary. First, add Proprietary Information to the Confidential Information definition, and, second, insert under "Common Interest and Confidentiality" language to the effect that notwithstanding the Non-Disclosure provision of Subsection 4.2, Proprietary Information must be destroyed or returned after the Agreement is terminated.

144. For an alternative approach to securing an interest in the proceeds, see Max Volsky, *Creating and Perfecting Security Interests in a Claim: Part I, Purpose and Creation*, MODEL LITIG. FIN. CONT. (Aug. 12, 2013), http://litigationfinancecontract.com/creating-and-perfecting-security-interests-in-a-claim-part-i-purpose-and-creation/; Max Volsky, *Part 2, Perfecting Security Interests: Notice to the Attorney, and the Uniform Commercial Code*, MODEL LITIG. FIN. CONT. (Aug. 29, 2013), http://litigationfinancecontract.com/part-2-perfecting-security-interests-notice-to-the-attorney-and-the-uniform-commercial-code/.

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Qualified Replacement Funder: A Funder which (a) agrees to become a party to this Agreement; (b) commits at least as much capital to financing the Claim as the Exiting Funder is withdrawing by exiting; and (c) is an Accredited Investor as defined in Rule 501 of Regulation D promulgated under the 1933 Securities Act.

Comment: This provision ensures that the private placement exception to the securities laws applies.

Re-pricing Event: The issuance of additional Litigation Proceed Rights to existing owners of Litigation Proceed Rights as a result of a Re-pricing Milestone.

Re-pricing Milestone: The following are the Re-pricing Milestones: (1) A proposed settlement that has a value less than the Initial Claim Valuation by at least [33%], and (2) the Judgment Milestone, if the Judgment has a value less than the Initial Claim Valuation by at least [33%].

Comment: Thirty-three percent (33%) is an arbitrary value; parties should negotiate their own percentages.

Risk Discount Factor: The number, less than one, that one percent (1%) of the Initial Claim Value is multiplied by to set the Litigation Proceed Right purchase price at the Closing.

Acceleration Closing Risk Discount Factor: The Risk Discount Factor used at the Closing immediately prior.

Discovery Closing Risk Discount Factor: [0.40] [OR a number to be negotiated in the [60] days prior to the Discovery Milestone].

Initial Closing Risk Discount Factor: [0.20.]

[Supplemental Closing Risk Discount Factor: The Risk Discount Factor used at the Closing immediately prior.]

Comment: The lower the number, the bigger the return when Litigation Proceed Rights are cashed in. Because funding a claim is riskiest at the beginning, the Initial Closing Risk Discount Factor should be relatively low, conferring a risk premium if the Claim is successful, while the coefficient at the Close of Discovery should be higher, to reflect the dramatic increase in information about the Claim's value. (If the new information is unfavorable, presumably a funder will exit or demand a lower number.) The bracketed numbers are arbitrary and should be negotiated by the parties. If other investment milestones are negotiated, they will need their own Risk Discount Factors. Supplemental Investments are optional because the parties may not wish to allocate the risk ex ante*, and if not used, the corresponding Risk Discount Factor should be deleted.*

Corporate Finance Version Comment: *Because corporate finance plaintiffs do not need the bargaining power protection of Accelerated or Supplemental Investments, the corresponding Risk Discount Factors should be deleted.*

[Supplemental Investment Event: A Supplemental Investment Event occurs when the balance of the Litigation Account has fallen below [$], all Committed Capital investments have been made, and the Litigation Counsel in good faith reasonably believes the amount remaining in the Litigation

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Account is insufficient to finance the conduct of the Claim through to the next Milestone Event or the Conclusion of the Claim, whichever comes sooner. [Despite such certification, a Supplemental Investment Event has not occurred if the Plaintiff and the Funder agree the funding shortfall is due to Attorney Waste, as defined in the Retainer Agreement. In such case, the related provisions in the Retainer Agreement shall apply.]]

Comment: This provision is optional, as the parties may simply wish not to allocate the risk ahead of time.

Corporate Finance Version Comment: *This provision should be deleted because corporate finance plaintiffs do not need the protection of Supplemental Investments.*

2.0 Representations and Warranties

2.1 Plaintiff's Representations and Warranties

2.1.1. Common Interest: The Plaintiff has received [Independent/ Litigation] Counsel's advice regarding the common-interest doctrine in New York.

2.1.2 Full Disclosure: The Plaintiff represents that, as of the date of this Agreement, the Plaintiff has provided the Funder all material information relating to the Claim, excluding information protected solely by the attorney–client privilege.

Comment: By using a securities approach, the anti-fraud provisions of the securities laws apply, strengthening this duty. While there is obvious tension between the securities laws' disclosure requirements and the confidential duties imposed by litigation, publicly traded securities tied to litigation have demonstrated that the tension can be resolved.[145]

2.1.3. Fully Informed: The Plaintiff represents that it [and its Independent Counsel] [has/have reviewed] the disclosures by the Funder in Schedules A, B, and C, and the Plaintiff does not object to the conflicts or potential conflicts described therein.

Corporate Finance Version Comment: *This representation may need to be tailored or deleted for the corporate finance plaintiff as it may not find all of the schedules—or any of them—necessary.*

2.1.4 No Impairment:

2.1.4.1 Other than as already disclosed to the Funder, the Plaintiff has not taken any action (including executing documents) or failed to take any action, which

(a) would materially and adversely affect the Claim, or

(b) would give any person or entity other than the Funder an interest in the Award or the Proceeds.

2.1.4.2 The Plaintiff agrees and undertakes that

145. See, for example, securities whose only value derives from the possibility that a lawsuit is successful that have been traded on the NASDAQ. These are discussed at length in Steinitz, *supra* note 35.

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(a) it will not institute any action, suit, or arbitration separate from the Claim arising from the same facts, circumstances or law giving rise to the Claim;

(b) it will not take any step reasonably likely to have a materially adverse impact on the Claim or the Funder's share of any Proceeds; and

(c) it will not take any step that would give any person or entity an interest in the Claim, Award, or potential Proceeds except as otherwise permitted by this Agreement.

Comment: Funders must have certainty that they are getting what they bargain for and that the Plaintiff is not selling "damaged goods." Funders should customize this language as necessary, given the Claim, to provide that certainty.

2.1.5 Solvency: The Plaintiff has no bankruptcy proceedings outstanding or written notice of potential proceedings against it.

2.1.6 Independent Counsel: The Plaintiff represents that its Independent Counsel advised it about the terms of this Agreement.

[Alternate:

2.1.6 Advice on this Agreement: The Plaintiff represents that, based on the disclosures in schedules A, B, and C and the Funder's representations in this Agreement, and based on the Plaintiff's discussion of the schedules and representations with Litigation Counsel, the Plaintiff is comfortable relying on Litigation Counsel's advice regarding the terms of this Agreement and has so relied.]

Comment: If Independent Counsel is not used, Litigation Counsel must ensure as a matter of professional ethics that the Plaintiff is fully aware of any potential conflicts created by the funding arrangement and consents to them. [146]

Corporate Finance Version Comment: *Subsection 2.1.6 should be deleted as unnecessary; again, in-house counsel should serve this function.*

2.1.7 Completeness and Accuracy: The Plaintiff represents that as of the date of this Agreement,

(a) all material information it and Litigation Counsel provided to the Funder is true and correct, and

(b) all its representations and warranties in this Agreement are true and correct.

2.2 Funder's Representations

2.2.1 Funds: The Funder represents that it is fully capitalized and has and will continue to have sufficient funds available to fulfill its obligations under this Agreement.

Comment: This provision is important to Plaintiffs because unlike regulated insurers, funders need not insure they have the capital to honor their commitments. Further, funders have an incentive to recycle capital to successor funds.

2.2.2 Fully Informed: The Funder has thoroughly reviewed all the information about the Claim provided to it.

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146. *See supra* note 102.

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2.2.3 No Conflicts of Interest:

2.2.3.1 The Funder has not, as of the date of this Agreement:

(a) paid a referral fee to Litigation Counsel in connection with the Claim, the Plaintiff, or this Agreement;

(b) entered any transaction with Litigation Counsel that has or would make Litigation Counsel a part owner of the Funder;

(c) contracted with any other party or potential party to the Claim other than has been disclosed on Schedule A;

(d) engaged in negotiations with any other party or potential party to the Claim other than has been disclosed on Schedule B; or

(e) entered into any relationship with the Plaintiff's Litigation Counsel [or Independent Counsel] that potentially conflicts with the Plaintiff's interests regarding the Claim other than has been disclosed on Schedule C. For the avoidance of doubt, Schedule C at a minimum details the Funder's history of engaging such counsel or paying such counsel referral fees, including approximate dates, total fees paid, and the nature of the engagement; and, whether such counsel has an ongoing financial connection to the Funder other than those created by this Agreement or the Retainer Agreement.

2.2.3.2 The Funder will not, prior to the Conclusion of the Claim, pay a referral fee to Litigation Counsel in connection with the Claim, the Plaintiff, or this Agreement; transfer or agree to transfer any ownership in the Funder to Litigation Counsel; or engage in any activity that would have been disclosed on Schedules A, B, or C if it had occurred as of the date of this Agreement. This provision shall survive the termination of this Agreement if the Agreement is terminated prior to the Conclusion of the Claim.

2.2.3.3 The Funder does not have a duty, contractual obligation, or other requirement to monetize its interest in the Claim within any particular time frame or which would require the Funder to cease funding the Claim. For the avoidance of doubt, the preceding sentence does not include a fiduciary duty that would require the Funder to cease funding the Claim because of the Funder's assessment of the merits of the Claim.

[Alternate:

2.2.3.3 According to its Partnership Agreement, the Funder must liquidate the investments and return capital to investors [X] years from the effective date of this Agreement.]

Comment: These provisions are designed to eliminate or minimize the relevant conflicts of interest, or allow the Plaintiff to give informed consent to them.

Corporate Finance Version Comment: *Subsection 2.2.3 should be tailored or deleted, as corporate finance plaintiffs might not care about some or all of the above conflicts. Indeed, such plaintiffs might have an ongoing relationship with a funding firm that is akin to its relationships with outside counsel.*

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2.2.4 No Waiver of Privilege:

2.2.4.1 As of the date of this Agreement, the Funder and the Funder's Representatives have not disclosed any Common Interest Material to anyone without the prior written consent of the Plaintiff; and

2.2.4.2 Notwithstanding Subsection 4.2, the Funder and the Funder's Representatives shall not disclose any Common Interest Material to anyone without prior written consent of the Plaintiff. For the avoidance of doubt, this prohibition prevents disclosure without prior written consent to the Funder's investors and/or any party to whom the Funder wishes to transfer part or all of its interest in the Claim. If consent is given, the Funder shall enter into an agreement with such secondary recipients to preserve the confidentiality of the Common Interest Material on terms no less restrictive than those set forth in this Agreement for Confidential Information. This provision shall survive the termination of this Agreement and remain in effect until the Conclusion of the Claim.

Comments: 1. If the Funder stops funding the Claim, nothing (other than Subsection 2.2.4.2 above) stops the Funder from using the information against the Plaintiff's interests in the Claim. 2. Section 4.2 allows disclosure of Confidential Information as necessary to perform under this Agreement; this provision intends to exempt Common Interest Material from that provision and protect privilege in line with the other provisions.

2.2.5 Secondary Market Financing:

2.2.5.1 The Funder represents that as of the date of this Agreement it has not sold or entered negotiations to sell part or all of its interest in the Claim or the Proceeds to anyone.

2.2.5.2 The Funder will not securitize its interest in the Claim or the Proceeds.

Comment: Securitization creates a significant moral hazard and public policy concerns.[147]

3.0 Additional Covenants

3.1 Covenants of Plaintiff

3.1.1 Representations Remain True: The Plaintiff covenants that all of its representations and warranties shall continue to be true throughout the term of this Agreement.

3.1.2 Duty to Cooperate: The Plaintiff covenants to cooperate in the prosecution of the Claim. Specifically, the Plaintiff [will/will cause its officers, executives, and employees to] promptly and fully assist Litigation Counsel as reasonably necessary to conduct and conclude the Claim. For the avoidance of doubt, such assistance includes all actions any Plaintiff may reasonably expect undertaking such as: submitting to examination; verifying statements under oath; and appearing at any proceedings. The examples in

147. *See* Steinitz, *supra* note 18, at 1282–85.

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the preceding sentence are illustrative and do not limit the Plaintiff's duty to cooperate in any way.

Comment: Insurance contracts have very broad duty-to-cooperate provisions to address the agency problem insurers face with their insured. The provisions are appropriate in litigation finance contracts for the same reason.[148]

3.1.3 Duty to Inform: The Plaintiff agrees and undertakes to keep the Funder fully informed about the progress of the Claim. Specifically,

(a) Non-Privileged Information: The Plaintiff hereby irrevocably instructs Litigation Counsel, and if further instructions are needed, undertakes to instruct Litigation Counsel, to provide the Funder's Representatives with all material non-privileged information as soon as practicable, regardless of the information's source, confidentiality, or form, unless the Funder already possesses or controls such information.

(b) Attorney Work Product: Acknowledging that this Agreement contains provisions requiring the parties to protect the confidentiality of any Confidential Information disclosed to it and that such information includes attorney work product, the Plaintiff hereby irrevocably instructs its Litigation Counsel, and if further instructions are needed, undertakes to instruct its Litigation Counsel to provide the Funder's Representatives with all material attorney work product relating to the Claim as soon as practicable.

(c) Attorney–Client Privileged Information:

Relying on the parties' agreement that they share a common legal interest and that communicating attorney–client privileged information to the Funder in the furtherance of that interest does not waive the privilege, the Plaintiff undertakes to share such information on a topic-by-topic basis, *provided that* neither the Plaintiff nor Litigation Counsel shall disclose attorney–client protected information to the Funder or the Funder's Representatives unless (i) the Plaintiff has discussed with [Litigation Counsel/Independent Counsel] the information to be shared, the reason for the sharing, and the probable consequences if the sharing is ultimately held to waive the privilege; and (ii) the Plaintiff has given written consent to such information sharing.

Comments: Arguably, the anti-fraud requirements of the securities laws render (a) unnecessary, however it is prudent to include it. One of the advantages of the private placement approach is that (b) is possible. As New York common-interest doctrine develops, (c) may need modifying. While waiving the privilege would not advantage Funders, and while the Plaintiff's attorneys should engage in this process for ethical reasons even absent a contract provision, the language of (c) creates information asymmetry risk.

148. *See* 1 ALLAN D. WINDT, INSURANCE CLAIMS & DISPUTES: REPRESENTATION OF INSURANCE COMPANIES & INSUREDS § 3:2 (5th ed. 2007) ("Liability policies always contain a requirement that the insured cooperate with the insurance company in its investigation, defense, settlement, or other handling of a claim against the insured.").

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3.1.4 No Change in Litigation Counsel Without Funder Notice: The Plaintiff agrees and undertakes that it will not engage a new attorney or law firm to conduct the Claim, either as replacement or supplemental Litigation Counsel, without giving the Funder [X] days' prior notice and without giving good faith consideration to the Funder's response, if any. For the avoidance of doubt, "engage" in the immediately preceding sentence means "execute a retainer agreement or other contract to employ such attorney or law firm."

Comment: This provision and Subsection 3.1.5 give the Funder significant influence over the conduct of the Claim, though short of control. We believe this right to influence should be paid for either by a direct payment that is not reimbursable if the Claim is successful or by a lower percentage payout/higher Risk Discount Factor than otherwise warranted.[149]

3.1.5 Funder Participation in Settlement Decision Making:

(a) The Plaintiff will immediately notify the Funder upon receiving a settlement offer, providing the Funder with the complete details of the offer in such notice. The Plaintiff will not respond to the settlement offer until after giving good faith consideration to the Funder's analysis of the offer, *provided that* the Funder communicates its analysis within [X] days of receiving notice of the offer.

(b) The Plaintiff will not make a settlement offer without first notifying the Funder of the proposed offer, including its complete details, and giving good faith consideration to the Funder's analysis, *provided that* the Funder communicates its analysis within [X] days of receiving the proposed offer.

3.1.6 Independent Counsel: The Plaintiff will obtain Independent Counsel before agreeing to any material amendment to this Agreement and before engaging replacement or supplemental counsel to conduct the Claim.

3.2 Covenants of the Funder:

3.2.1 Fiduciary Duty: The Funder agrees and undertakes to be a fiduciary to the Plaintiff in regards to the Funder's actions, analysis, and advice regarding the Claim and the conduct of the Claim for so long as the Funder has a financial interest in the Conclusion of the Claim.

Comment: While this provision would go a long way toward minimizing conflicts of interest, it would be a major change to current contracting practice.

[Alternate:

3.2.1 Good Faith Dealings: The Funder agrees it will act reasonably and in good faith toward the Plaintiff in every action the Funder takes in relation to the Claim and Funders' performance under this Agreement. For the avoidance of doubt, and without limiting the foregoing, pressuring Plaintiff

149. Control premiums exist in other contexts and, importantly, in VC. *See* Steinitz, *supra* note 5, at 509; *see also* Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets*, 47 J. FIN. ECON. 243, 252–53, 258–59 (1998).

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to negotiate or accept a settlement that the Plaintiff believes is not in its best interest shall violate this covenant. Notwithstanding the previous sentence, the Funder's mere exercise of its right to terminate without cause, including the Funder's refusal to invest Committed Capital at a Milestone Event, shall not constitute breach of this covenant.

Comment: This provision would also protect the Plaintiff from the Funder's conflicts of interest, and the Funder may be more willing to accept it than the fiduciary duty provision. A parallel duty need not be imposed on the Plaintiff for three reasons. First, the Plaintiff is already under several specific duties that cover the kinds of bad faith actions a Funder should be concerned about, such as failure to disclose material information or impairing the Claim. Second, the Plaintiff is motivated to act in good faith to increase the chances that the Funder will continue to invest in the Claim at Milestone Events. Third, the Plaintiff is subject to the implied duty of good faith and fair dealing.

Corporate Finance Version Comment: *The good faith version should be the default for Subsection 3.2.1.*

4.0 Common Interest and Confidentiality

4.1 Common Interest: The Plaintiff and the Funder agree they share a common legal interest and, to the degree necessary to further their common legal interest, agree to share Common Interest Material in accordance with the provisions of Subsections 2.2.4.2 and 3.1.3. The Plaintiff and the Funder agree the material would not be shared if the common legal interest did not exist.

4.2 Non-Disclosure Generally: During the term of this Agreement and for [X] years following its termination, the recipient of Confidential Information shall not disclose, use, or make available, directly or indirectly, any Confidential Information to anyone, except as needed to perform its obligations under this Agreement or as the disclosing party otherwise authorizes in writing. When disclosing, using, or making Confidential Information available in connection with the performance of its obligations under this Agreement or as permitted by the disclosing party, recipient shall enter into an agreement with such secondary recipients to preserve the confidentiality of the Confidential Information on terms no less restrictive than as set forth in this Agreement. The recipient agrees that neither the execution of this Agreement nor the provision of Confidential Information thereto enables the recipient to use the Confidential Information for any purpose or in any way other than as specified in this Agreement.

Comment: If a subset of information has been defined as "Proprietary Information," a term should be added describing how that information should be handled.

4.3 Potentially Enforceable Disclosure Requests: If a party receives a potentially enforceable request for the production of Confidential Information, including without limitation a subpoena or other official process, that party will promptly notify the other party in writing, unless such

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notice is prohibited by law. If allowed, such notice shall be given before complying with the request and shall include a copy of the request.

If the request is of the recipient of Confidential Information, and notice to the disclosing party is prohibited by law, the recipient must make a good faith effort to contest the disclosure, if appropriate. The recipient shall also make a good faith effort to obtain an agreement protecting the confidentiality of the Confidential Information prior to disclosing it.

If a party elects to contest the request, no party shall make any disclosure until a final, non-appealable or non-stayed order has been entered compelling such disclosure. The contesting party shall pay its own expenses and control its contest, *provided that*, if the recipient contests a request when forbidden by law to give the disclosing party notice of the disclosure request, the disclosing party shall reimburse the recipient's reasonable expenses promptly after being notified of them.

5.0 Funding Terms

5.1 Committed Capital: Subject to the terms and conditions of this Agreement, the Funder[s] commit[s] [$] to finance the conduct of the Claim through to the Conclusion of the Claim [as specified in Exhibit [X]].

Comment: This Exhibit is different than the one contemplated by the definition of Committed Capital. This Exhibit is to show how much capital is invested at each milestone; the other schedule, used only if sufficient multiple funders are participating, lists each funder and how much total capital they are committing.

5.2 Purchase of Litigation Proceed Rights: Subject to the limitations of Sections 6 and 7 and Subsections 5.4, 5.5, 5.6, and 5.7, at each Closing the Funder shall purchase Litigation Proceed Rights by depositing its Investment in the Litigation Account, such Investment being the Funder's committed capital amount specified on Exhibit [X] less any Accelerated Investments previously made from that committed capital. The Funder may invest more than such amount only with the prior written agreement of the Plaintiff.

Corporate Finance Version Comment: *All internal references are accurate for the access to justice version, however, the corporate finance version will need conforming changes throughout to reflect the deletions and the related renumbering.*

5.3 Sale of Litigation Proceed Rights: Subject to the terms and conditions of this Agreement, at each Closing the Plaintiff shall sell to the Funder the number of Litigation Proceed Rights the Funder is due based on the applicable purchase price and the total amount of capital the Funder deposits in the Litigation Account at such Closing. At each Closing, the Funder shall receive Litigation Proceed Right Certificates evincing its purchases.

5.3.1 The Initial Closing: At the Initial Closing the Plaintiff will sell [10] Litigation Proceed Rights. The Litigation Proceed Right Purchase Price for the Initial Closing is [$] per Litigation Proceed Right.

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Comment: The number of shares indicated is arbitrary. Parties should negotiate an appropriate number keeping in mind the considerations discussed above.

5.3.2 The Discovery Closing: At the Discovery Closing the Plaintiff will sell [20] Litigation Proceed Rights to the Funder. The Litigation Proceed Right Purchase Price for the Discovery Closing is [$] per Litigation Proceed Right. Subject to the limitation imposed by Subsection 5.7, if the Plaintiff chooses, in its sole discretion, it may sell more than [20] Litigation Proceed Rights at the Discovery Closing.

Comment: The number of shares indicated is arbitrary. If accelerated investments occur, this number will be reduced accordingly. The Model Contract assumes a different Risk Discount Factor will be used to set the price, reflecting the information revealed to date. If additional milestones are negotiated, they will need their own closings.

5.4 Accelerated Investment: If an Acceleration Event occurs, Litigation Counsel shall so certify to the Funder. Within [30] days of receiving such certification, the Funder shall purchase [a pro-rata share of] [5] Litigation Proceed Rights at the Litigation Proceed Right Purchase Price used at the Closing immediately prior by depositing the Funder's total purchase price into the Litigation Account. This Accelerated Investment shall not represent a new capital commitment; instead it is the acceleration of a portion of the capital intended for investment at the next Closing. The number of Litigation Proceed Rights sold at an Acceleration Closing shall reduce the number of Litigation Proceed Rights offered for sale at the [Discovery Closing/at the next Milestone Event Closing] by a like amount.

Comment: The bracketed language regarding next Milestone Event Closing reflects the idea that additional such closings may be negotiated.

Corporate Finance Version Comment: *This provision should be deleted as corporate finance plaintiffs do not need the bargaining power protection provided by Accelerated Investments.*

[5.5 Supplemental Investment: If a Supplemental Investment Event occurs, Litigation Counsel shall so certify to the Funder. Within [30] days of receiving such certification, the Funder shall purchase [a pro-rata share of] [5] Litigation Proceed Rights at [the Litigation Proceed Right Purchase Price used at the Closing immediately prior/at a price [10%] less than the price used at the Closing immediately prior] by depositing the Funder's Supplemental Investment into the Litigation Account.]

Comment: This provision is optional, as the parties may not wish to allocate this risk ahead of time. If used, the number of rights indicated is arbitrary; parties should negotiate the number. Funders will likely want a premium for being forced to make a supplemental investment; the language suggests one way it could be paid.

Corporate Finance Version Comment: *This provision should be deleted as corporate finance plaintiffs do not need the bargaining power protection provided by Supplemental Investments.*

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5.6 Re-pricing Litigation Proceed Rights:

5.6.1 Invoking Right to Re-price: Within [7] days of receiving certification from Litigation Counsel that a Re-pricing Milestone has occurred, [the/a majority of] Funder(s) may trigger a Re-pricing Event by serving notice on the other part(y/ies).

5.6.2 Purpose of Re-pricing: Subject to the limitation in Subsection 5.7, the parties agree that the purpose of re-pricing pursuant to this Subsection 5.6 is to preserve the Expected Value of the Funder ['s/s'] Litigation Proceed Rights and not to renegotiate it.

5.6.3 Mechanism of Re-pricing: Subject to the limitation imposed by Subsection 5.7, the Plaintiff shall immediately transfer additional Litigation Proceed Rights to the Funder until the total number of Litigation Proceed Rights owned by the Funder has the Expected Value, and the Plaintiff shall document this transfer by promptly delivering additional Litigation Proceed Right Certificates, *provided that*, if the Re-pricing Milestone is a proposed settlement, such transfers shall occur simultaneously with the consummation of the settlement. If the settlement is not consummated and the Claim continues, the number of Litigation Proceed Rights owned by the Funder shall not change.

Comment: The purpose of re-pricing is to preserve the underlying economic bargain. A different type of re-pricing could be time-triggered, again with the goal of preserving the underlying economic bargain.

5.7 Minimum Plaintiff Proceeds: Under no circumstances shall the Plaintiff sell more than [50] Litigation Proceed Rights, nor shall the issuance of additional Litigation Proceed Rights pursuant to Subsection 5.6.3(a) result in the Plaintiff receiving less than [50%] of the Proceeds.

Comment: The percentage should be negotiated to avoid claims of unconscionability, based on legal precedent.

5.8 No Commitment for Additional Financing: The Plaintiff acknowledges and agrees that [no Funder has/the Funder has not] made any representation, undertaking, commitment, or agreement to provide or assist the Plaintiff in obtaining any financing, investment, or other assistance, other than the investments as set forth herein. In addition, the Plaintiff acknowledges and agrees that (i) no statements, whether written or oral, made by [any/the] Funder or its Representatives on or after the date of this Agreement shall create an obligation, commitment, or agreement to provide or assist the Plaintiff in obtaining any financing or investment; (ii) the Plaintiff shall not rely on any such statement by [any/the] Funder or its representatives; and (iii) an obligation, commitment, or agreement to provide or assist the Plaintiff in obtaining any financing or investment may only be created by a written agreement, signed by [such/the] Funder and the Plaintiff, setting forth the terms and conditions of such financing or investment and stating that the parties intend for such writing to be a binding obligation or agreement.

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5.9 New Funder Participation: The Plaintiff can invite other potential funders to participate in any Closing at its sole discretion, provided that existing the Funder[s] [is/are] allowed to continue participating according to the capital commitment [it/they] had already made. The Funder[s] can invite additional potential funders to participate in Closings, but the Plaintiff, in its sole discretion, must approve both the new funder's participation and the size of its investment before the potential funder can participate. For the avoidance of doubt, no Litigation Proceed Rights shall be sold to any person unless such person joins this Agreement.

6.0 Funder Right to Terminate Investment Without Cause

6.1 Termination at Milestones:

Within [7] days after receiving certification from Litigation Counsel that a Milestone Event has occurred, the Funder may give notice to the Plaintiff of its intention to terminate investing under this Agreement. If the Funder gives such notice it shall not participate in any Closing related to the Milestone Event unless its notice fails to become effective. For such notice to become effective, within [90] days of giving notice the Funder must deliver an executed amendment to this Agreement in the form of Exhibit [X]. Such amendment provides that (i) the Funder shall retain the Litigation Proceed Rights it previously purchased except that such rights will no longer be subject to re-pricing pursuant to Subsection 5.6, and (ii) certain other provisions of this Agreement remain in effect. If the executed amendment is not timely sent to the Plaintiff, the Funder's investment termination notice is void as if never given and the Funder must immediately make the Investment that was due at the Closing related to the Milestone Event.

Comment: The Funder "pays" for exiting early without providing Plaintiff with replacement funding by losing its ability to mitigate its downside risk.

6.2 Termination at Any Time: At any time, the Funder may give notice to the Plaintiff of its intention to terminate its investment in the Claim. To make its notice effective, within [90] days the Funder must return a fully executed Amendment in the form of Exhibit [X] and return all of its Litigation Proceed Right Certificates. The Amendment shall reflect that the Funder (i) no longer owns any Litigation Proceed Rights, and (ii) certain other provisions of this Agreement remain in force.

Comment: If Accelerated and Supplemental Investments are not part of the contract, this provision is not necessary. This provision allows a Funder to avoid Accelerated or Supplemental Investments, but it is designed to provide a strong disincentive to discontinue funding in between milestones without lining up a replacement investor.

Corporate Finance Version Comment: *Accelerated and Supplemental Investments are not part of the corporate finance deal, as such plaintiffs do not need their bargaining power protection. Thus, Subsection 6.2 should be deleted.*

6.3 Termination at Any Time with Replacement Funding: At any time the Funder has the right to propose exiting the Agreement by assigning its

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rights and obligations to a Qualified Replacement Funder. Such assignment requires (i) the Plaintiff's consent, which shall not be unreasonably withheld; and (ii) the Qualified Replacement Funder's joinder to this Agreement. The ownership of the exiting Funder's Litigation Proceed Rights will be retained by the exiting Funder or transferred to the Qualified Replacement Funder pursuant to their agreement.

Comment: This provision, like Subsection 6.2, is only necessary if Accelerated and Supplemental Investments are used.

Corporate Finance Version Comment: *Accelerated and Supplemental Investments are not part of the corporate finance deal, as such plaintiffs do not need their bargaining power protection. Thus, Subsection 6.3 should be deleted.*

7.0 Termination for Cause

Either party may terminate this Agreement for cause if the other party commits a material breach as defined in this Section, with the consequences as specified in this Section. After such termination, Section 4.0 and Subsection 2.2.4.2 relating to confidentiality and privilege, Subsection 2.2.3.2 relating to conflicts of interest, Subsection 2.2.5.2 relating to securitization of litigation proceed rights, and Section 9 shall remain in force. If the termination is pursuant to Subsection 7.1, then Subsection 5.6 relating to re-pricing litigation proceed rights shall also remain in effect.

7.1 Material Breach by the Plaintiff:

7.1.1 Material Provisions: The provisions of this contract relating to complete and accurate disclosure of material information about the Claim; to cooperation in conducting the Claim and of non-impairment of the Claim; and to the potential award and any proceeds thereof. These provisions are the very essence of this agreement and any breach by the Plaintiff of those provisions is presumptively material. For the avoidance of doubt, the material provisions are: Subsections 2.1.2 and 3.1.3 (relating to disclosures), Subsection 2.1.4 (no impairment), and Subsection 3.1.2 (cooperation). The presumption of materiality can be rebutted by the Plaintiff by showing that such breach did not reduce the potential value of the Funder's Litigation Proceed Rights by more than [10%] compared to the Expected Value of those Litigation Proceed Rights.

7.1.1.1 Notwithstanding Subsection 7.1.1, failure to disclose material information about the claim that supports the claim, strengthens the claim, or otherwise cannot reasonably be believed to have influenced the Funder to avoid investing or re-investing in the claim had it been disclosed when required is not a material breach of the disclosure provisions.

Comment: The purpose of defining presumptively material provisions is to facilitate dispute resolution by making material breach relatively easy to prove; the purpose of making it rebuttable is to prevent the Funder from abusing the provision by claiming a technical breach that has little or no impact.

7.1.2 Material Breach of Other Provisions: The breach by the Plaintiff of any other provision is material if it, by itself, reduces the potential value of

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the Funder's Litigation Proceed Rights by more than [33%], compared to the Expected Value of those Litigation Proceed Rights.

Comment: The bracketed number is arbitrary and should be negotiated. This is just one way of defining material breach. Whatever is adopted should be a significant bar as the crucial provisions are dealt with in Subsection 7.1.1.

7.1.3 Notice of Material Breach by the Plaintiff: If the Funder believes the Plaintiff has materially breached this contract it shall promptly serve notice on the Plaintiff. If the breach can be cured the Plaintiff then has [30] days to do so. Breaches of the following provisions cannot be cured: the failure to disclose material information not covered by Subsection 7.1.1.1 or attorney–client privilege at the time of contract execution and the failure to disclose existing claim impairment at contract execution.

7.1.4 Consequences of Material Breach by the Plaintiff: If the Plaintiff commits an incurable material breach under Subsection 7.1.1 or Subsection 7.1.2 or fails to timely cure material breach as defined therein, the Funder is entitled to an immediate refund of all of its Investment remaining in the Litigation Account and is entitled to keep its Litigation Proceed Rights. The Funder shall have no further obligations under this Agreement other than the provisions that explicitly survive the termination of this Agreement. This provision shall not limit the Funder's other remedies at law or equity.

7.1.4.1 If the existence of a material breach is disputed by the Plaintiff the Disputed Refund provisions of the escrow agreement governing the Litigation Account shall apply.

Comment: The purpose of this provision is to make the Funder as whole as possible by providing the refund and to deter the Plaintiff from committing material breaches because the result is the total loss of its funding. However, Subsection 7.1.4.1 prevents the Funder from threatening to destabilize the Plaintiff, or from actually destabilizing the Plaintiff, by demanding a refund based on a breach that does not justify it. The precise mechanism for handling a "disputed refund" belongs in the Litigation Account escrow agreement, as it will have to be instructions to the escrow agent on what it is supposed to do. As a result, we are not proposing substantively what that mechanism should look like.

[Alternate:

7.1.4 Consequences of Material Breach by the Plaintiff: If the Plaintiff commits an incurable material breach under Subsection 7.1.1 or Subsection 7.1.2 or fails to timely cure material breach as defined therein, the Funder may seek damages from said breach at law or equity.]

Corporate Finance Version Comment: *We propose that for corporate finance plaintiffs, Alternate Subsection 7.1.4 become the default and vice-versa.*

7.2 Material Breach by the Funder:

7.2.1 Material Provisions: The Funder recognizes that its representations regarding its ability to honor its capital commitments, its commitments to protect Plaintiff's privileged information [and Proprietary Information], and its assumption of [a fiduciary duty/duty of good faith and

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fair dealing] are of the essence of this Agreement. For the avoidance of doubt, these are the material provisions: Subsection 2.2.1 (funds), Subsection 2.2.4 and Section 4.1 (privilege and common interest), [and] Subsection 3.2.1 ([fiduciary duty/good faith]) [, and Section 4.3 (Proprietary Information)]. A material breach of Subsection 2.2.1 occurs if the Funder is unable to invest Committed Capital when required. A material breach of Subsection 2.2.4 or Subsection 4.1 occurs if the disclosure could result in waiver of the privilege if any other party to the litigation learned of the disclosure, regardless of how the other party to the litigation learned of the disclosure. A material breach of Subsection 4.1 has occurred if a judge, arbiter, or other third-party dispute resolution mechanism so rules. [A material breach of Subsection 4.3 Proprietary Information occurs if the breach results, by any method, in the Proprietary Information being received by any person or entity that could use it to its commercial advantage or to commercially disadvantage the Plaintiff.]

7.2.2 Material Breach of Other Provisions: The breach by the Funder of any other provision is material if it, by itself, reduces the potential value of the Award or Proceeds by more than [10%] as measured against the Initial Claim Value.

7.2.3 Notice of Material Breach by the Funder: If the Plaintiff believes the Funder has materially breached this Agreement, the Plaintiff shall promptly serve notice on the Funder. If the breach can be cured by the Funder, then it has [30] days to do so.

7.2.4 Consequences of Material Breach by Funder: If the Funder commits an incurable breach under Subsection 7.2.1 or Subsection 7.2.2 or fails to timely cure a material breach as defined therein, the Funder's Litigation Proceed Rights are canceled and the Funder must promptly return its Litigation Proceed Right Certificates. This provision shall not limit any other remedies the Plaintiff may have in law or equity.

7.2.4.1 If the Funder disputes the existence of a material breach, the Disputed Rights provisions of the Escrow Agreement governing the Proceeds Account shall apply.

[Alternate:

7.2.4 Consequences of Material Breach by Funder: If the Funder commits an incurable breach under Subsection 7.2.1 or Subsection 7.2.2 or fails to timely cure a material breach as defined therein, the Plaintiff may seek damages at law or other remedy in equity.]

Corporate Finance Version Comment: *We propose that for corporate finance plaintiffs, Alternate Subsection 7.2.4 become the default and vice-versa.*

8.0 Security Interest

8.1 Proceeds Account: The Plaintiff hereby irrevocably instructs, and, if further instructions are needed, will instruct, Litigation Counsel to receive any Proceeds that the Plaintiff becomes entitled to on behalf of the Plaintiff, and to immediately deposit all such Proceeds in the Proceeds Account.

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8.2 Security Interest in the Proceeds Account: To secure its obligation to the Funder represented by the Litigation Proceed Rights owned by the Funder, the Plaintiff hereby grants the Funder a security interest in the Proceeds Account and any and all property therein, whether such property is in the account now or is after-acquired. Such security interest shall terminate at the earlier of the Plaintiff paying the Funder the full value of the Funder's Litigation Proceed Rights or the Conclusion of the Claim, if, at the Conclusion of the Claim, the Plaintiff is not entitled to receive any Proceeds from any Defendant.

8.3 No Other Security Interests: The Plaintiff shall not grant a security interest in the Proceeds Account [or the Claim] to anyone other than the Funder without the Funder's prior written consent.

9.0 Miscellaneous

9.1 Governing Law: This agreement shall be governed by New York law.

9.2 Forum Selection: Each of the parties hereto hereby irrevocably and unconditionally consents to submit to the exclusive jurisdiction of the courts of the State of New York and of the United States of America located in the City of New York for any actions, suits, or proceedings arising out of or relating to this Agreement and the transactions contemplated hereby, and agrees not to commence any action, suit, or proceeding relating thereto except in such courts. Each of the parties hereto irrevocably and unconditionally waives any objection to the laying of venue of any action, suit, or proceeding arising out of or relating to this Agreement and the transactions contemplated hereby in the courts of the State of New York and of the United States of America located in the City of New York, and hereby further irrevocably and unconditionally waives and agrees not to plead or claim in any such court that any such action, suit, or proceeding brought in such court has been brought in an inconvenient forum.

CONCLUSION

In the foregoing, we have identified the core challenges of negotiating funding arrangements that are fair, economically sound, and in the public interest—promoting access to justice without corrupting the civil justice process. We have provided model provisions, many of which, on their own, contribute new, practical thinking on how to address the challenges presented by third-party funding. And, we have explained the interaction between the various provisions.

In the course of so doing, we have identified additional issues that are implicated by litigation funding and that parties to most commercial litigation funding are likely to encounter in their contract negotiations but are beyond the scope of this Article. These include: the securities regulatory implication of different deal structures; the question of how tax

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optimization, for both funder and plaintiff, may affect deal structures;[150] how deal structure impacts funders' claim if plaintiff goes bankrupt and the proceeds are part of the bankruptcy estate; how provisions should change if the claim is a tort or other personal claim; and how the closely related retainer agreement between attorney and client should be structured. Last but not least, there is a need in creating conceptual frameworks for altogether different funding structures, given that funding scenarios vary widely based on such variables as the business model of the funder, the type of claim, the type of plaintiff (or even defendant), the jurisdiction that governs the contract, and more.[151]

We call on other scholars to join us in this exciting new field of litigation finance contracting.

150. *Cf.* Ronald J. Gilson & David M. Schizer, *Understanding Venture Capital Structure: A Tax Explanation for Convertible Preferred Stock*, 116 HARV. L. REV. 874 (2003).

151. For a taxonomy of funding scenarios, see generally Steinitz, *supra* note 18. For an example of how deal structures can vary widely based on the type of claim, see Balganesh, *supra* note 20 (suggesting four different finance structures for copyright claims).

What is Litigation Finance? Myths, Truths, and What Every GC Needs to Know

***Burford Blog*, March 19, 2015 3:14 pm**

Burford's CEO, Chris Bogart, is contributing to a multi-part column on the ins and outs of litigation finance for Inside Counsel. Below is the first in a series of six articles on the subject. This article was first published by Inside Counsel and is available here.

In the aftermath of the financial crisis, ever-tightening corporate budgets are forcing companies to look for smarter ways to spend their money. And legal departments are being put under the microscope.

Litigation is a necessary part of doing business—and yet it's never been more expensive. Facing increased pressure to control legal costs, in-house lawyers often must make a difficult choice: Either they must forego (potentially significant) claims against culpable defendants, or else they risk reducing corporate profits and diverting cash from growing the business. Fortunately, the unhappy predicament of the general counsel may soon be a thing of the past.

With litigation finance, general counsel have a new alternative—one that satisfies the financial executive's budgetary concerns as well as the general counsel's interest in pursuing meritorious legal claims. And that alternative is litigation finance.

In the simplest of terms, litigation finance is effectively a synthetic contingency fee, with the funder acting as an intermediary between the client and the law firm. In other words, the funder provides the resources needed to pay lawyers' fees and other costs related to a case. In return, the funder receives a negotiated return on its capital at the conclusion of the case.

In recent years, litigation finance has seen something of a meteoric rise among lawyers and CFOs alike. And yet, the practice still remains something of a mystery.

In an effort to dispel some of the misconceptions I often hear about litigation finance, I've outlined some of the most common myths about litigation finance as well as some of its key benefits.

So, what are the myths?

1. Litigation finance only covers case costs.

While litigation financing can be used to cover case costs, that is by no means the only way in which it can be used. More and more frequently, litigation finance is being used in other ways: to monetize pending legal claims to raise capital for other corporate

purposes, for example, or to fund portfolios of matters. Additionally, litigation finance can be used to manage the ongoing costs of defense matters; although less common, this is obviously of enormous interest to CFOs.

2. Litigation finance is prohibitively expensive.

The cost of a funder's capital is reflective of the amount of risk inherent to litigation matters, but the total cost is typically comparable to a contingency fee. Also—importantly—these investments are typically non-recourse, meaning the funder gets paid only when the case is successful.

3. Litigation finance raises issues surrounding control and attorney work product.

As passive investors, funders don't get any rights to manage the litigation in which they invest. Nor do they get any rights to control the settlement of the litigation—that remains wholly in the litigant's control. Likewise, a funder's passive role as an outside investor does not in any way alter attorney-client relationships or put work product at risk. (The courts and legislatures have been clear on these two points.)

And how about the truths?

1. Litigation finance has been established as a fully financeable capital asset.

The underlying essence of litigation finance is that a litigation claim is an intangible asset that can be bought, sold, hypothecated and securitized. This fact is supported by a recent opinion issued by the 11th Circuit, which affirmed that litigation claims are just as amenable to financing as any other asset.

2. Litigation finance can actually improve the corporate balance sheet.

At present, legal expenses paid by a company directly are immediately recorded as expenses. That means that any legal fees paid out immediately reduce a company's profits; for a commercial case of any complexity, that reduction is likely to be substantial and last for years. Litigation financing removes that hit to profits.

3. Litigation finance is growing rapidly in popularity, especially among in-house counsel and CFOs.

In fact, a November 2014 survey found that the number of in-house counsel and financial executives saying they've made use of litigation finance for their own cases more than doubled over the year prior.

Why do you need to know about litigation finance?

Litigation finance relieves budget and accounting pressures, solves liquidity problems, and is generally a significant addition to corporate counsel's toolkit to manage litigation

cost. In a short period of time, it has become an indispensible part of the litigation tapestry.

In the current legal climate, you simply can’t afford not to know about litigation finance. Litigation finance means that no general counsel ever has to walk away from—or struggle to finance—a meritorious case due to budgetary constraints or fear of risk. It enables in-house counsel to hire their law firm of choice, without worrying about how subsequent hourly fees will impact the corporate balance sheet. In short, litigation finance is the solution to a problem that will not be going away any time soon.

Litigation Finance and Attorney Work Product

***Burford Blog*, September 18, 2013 5:34 pm**

Burford continues its series of articles addressing the common ethical considerations surrounding the use of litigation finance. This month, we focus on attorney work product. In particular, we note rulings in several federal courts around the country, which have held that work product disclosed to a litigation funder under a non-disclosure agreement does not entitle a litigation opponent to access the work product in question.

We are often asked about the protection of attorney work product in connection with our diligence or investment activities. The short answer is that the policy underlying work product doctrine and court decisions that have thoroughly considered the matter are consistent in permitting litigation financiers to access work product without any waiver of work product protection.

Like any provider of capital, litigation finance firms need to conduct due diligence before committing capital. And when millions of dollars of capital are at stake, which is usually the case in Burford's investments, that diligence is extensive and needs to encompass material that is often protected by the attorney work product doctrine.

While Burford has need of that material and probably can't make an informed investment decision without it, it is obviously not in either Burford's or the litigant's interest for the provision of that material to Burford to open the door to its disclosure to a litigation opponent.

Such a result – a "gotcha" from an opponent – would be entirely inconsistent with the policy grounds on which the work product protection rests, which is "to protect information against opposing parties". *United States v. AT&T*, 642 F.2d 1285, 1299 (D.C. Cir. 1980). The idea that a litigant seeking financing is put to the invidious choice of not getting financing or risking having to disclose its work product to its opponent is nonsensical and unfair.

The courts have agreed.

As long as the work product is disclosed to a litigation funder under a non-disclosure agreement, several federal courts around the country have held that such disclosure is not a waiver and does not entitle a litigation opponent to access the work product in question.

- *Mondis Tech. Ltd. v. LG Elecs. Inc.*, No. 2:07-cv-565, 2011 WL 1714304, at *3 (E.D. Tex. May 4, 2011)

"All of the documents were prepared . . . with the intention of coordinating potential investors to aid in future possible litigation. The Court holds that these documents are protected by the work product protection." The court further held that disclosure to third parties did not create a waiver because "they were disclosed subject to non disclosure agreements and thus did not substantially increase the likelihood that an adversary would come into possession of the materials."

- *Devon IT, Inc. v. IBM Corp.*, No. 10-2899, 2012 WL 4748160, at *1 n.1 (E.D. Pa. Sept. 27, 2012)

  On an extensively briefed record, the court quashed third-party subpoenas of litigation funders and held that the documents sought were all "protected from disclosure as work-product" and that production of the subpoenaed documents "would intrude upon attorney-client privilege under the 'common-interest' doctrine."

- *Walker Digital, LLC v. Google, Inc.*, No. 11-cv-309-SLR (D. Del. Feb. 12, 2013)

  The court found that the common interest doctrine applies to litigation funders and their clients and that disclosure to a third-party litigation funder does not act as a waiver of attorney-client privilege or work product doctrine.

The limited academic writing in the area agrees:

This Article concludes that the involvement of ALF entities should not affect work-product protection. Materials evaluating litigation and created in the context of ALF should enjoy (and courts will likely conclude that they enjoy) the protections of the work-product doctrine, even if an ALF entity creates those materials. Second, sharing protected materials with ALF entities should not waive that protection if ALF entities enter into binding nondisclosure agreements with regard to any shared materials.

Grace M. Giesel, *Alternative Litigation Finance and the Work-Product Doctrine*, 47 Wake Forest L. Rev. 1083, 1140 (2012).

This issue is settled in other jurisdictions. Indeed, it is unfathomable in England (an early adopter of litigation funding) that work product or other privileged materials would be provided to an adversary simply because they were provided to litigation funders.[i] And litigation funding is clearly recognized as not only permissible but important to ensure access to justice, as set forth at length by Lord Neuberger, the President of the UK Supreme Court: "[T]he public policy rationale . . . appears positively to support the development of litigation funding, as a means of securing effective access to justice". Lord Neuberger, President, Supreme Court of the United Kingdom, From Barretry, Maintenance and Champerty to Litigation Funding 21 (May 8, 2013)[ii]. Allowing a "gotcha" as the price of seeking funding would clearly be entirely inconsistent with that rationale.

We are aware of only one case that is arguably inconsistent with these rulings, and that case shows more than anything else how important issues can get short shrift in pre-trial discovery litigation. In *Leader v. Facebook*, 719 F.2d 373 (D. Del. June 24, 2010), the parties were engaged in a bitter dispute over Leader's desire to have access to some of Facebook's sensitive technical documents to prove its patent infringement claim, and much briefing and oral argument ensued on that issue. Unfortunately, the question of the disclosure of a handful of documents to some potential litigation funders by Leader was added on to the same discovery motion. The relative import of the issue is shown even in Leader's own brief to the trial court which devoted only two paragraphs to the litigation funding issue, cited no authority at all and did not even mention the work product doctrine. Not surprisingly, the court found against Leader in its own two paragraph summary decision, although not without noting that it was a "close question." Given that *Mondis, Devon* and *Walker Digital* have all been decided after *Leader* and contrary to it, *Leader* appears simply to be an outlier – a case where other things were more important.

It bears repeating that Burford is entirely aligned in interest with a litigant seeking financing to avoid disclosure of work product to an adversary and thereby harming the prospects of the underlying litigation. Thus, we take these issues very seriously, including consulting with two eminent legal ethics scholars, and we encourage you to discuss them further with us. Moreover, while *Devon* and *Walker Digital* both held that the attorney client privilege (in addition to attorney work product protection) was not waived by disclosure to a litigation funder, we do not yet encourage disclosure to us of material that is not work product but is privileged; we'd rather be conservative in this area.

In conclusion, our experience in this area tells us that the attorney work product protection extends to documents shared with third-party litigation funders. Courts that have considered the issue agree that the rationale behind the work product protection is completely in alignment with sharing material under a confidentiality agreement with an entity providing services in connection with the litigation. We encourage you to contact us to talk further about these issues.

This article is intended as an introduction to the issue of the work product protection in litigation finance, and does not constitute legal advice, which in any case will be dependent on the facts of the individual situation. Burford Capital LLC is not a law firm, and should not be relied upon; rather, legal counsel should be consulted. We are happy to – and often do – facilitate conversations with third-party counsel about these issues.

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[i] See generally Meriam N. Alrashid, Jane Wessel and John Laird, Impact of Third Party Funding on Privilege in Litigation and International Arbitration, 6 Disp. Resol. Int'l 101 (2012).

[ii] Full text of Lord Neuberger's speech is available at: http://www.supremecourt.gov.uk/docs/speech-130508.pdf.

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Viewpoint: Time to Shine a Light on Litigation Funding

By Carol Langford, The Recorder, March 6, 2014

The funding of class actions and other high-end litigation like patent matters no longer just comes from the firm itself or a law firm line of credit.

Alternative litigation funders-called "ALFs"-have seen the profits to be made and stepped up their funding efforts. Alan Zimmerman, president of Law Finance Group, said last year he "funded $9 million dollars in financings during Thanksgiving week alone with time off for turkey and stuffing."

Litigation funding is not new. It was prohibited in ancient Greece, and then sprung up later in Australia and in England. It came to America in the 1990s.

But now, litigation funding is booming. It is also completely unexamined and unregulated, with even hedge funds getting in on the action. Surprisingly, there is little to no real guidance to lawyers on the ethical issues that arise from working with ALFs in California. Even most legal malpractice policies do not address the liability of a lawyer for issues involved in litigation funding.

The firms providing the funds are betting on the plaintiff winning, but it is a bet without any real chance of losing; they are both betting on the outcome and loaning funds based on what they consider winning chances. Either the lawyer or the client can get a loan. It is troubling if either gets it because of the lack of any guidance on what the lawyer must convey to the client about the client getting gouged by the lender, especially where the case goes on forever and the interest just racks up.

So what are the lawyer's duties regarding advising the client about the fact that a typical charge of 2.94 percent compounded monthly can end up being around 40 percent or more a year? And what happens when opposing counsel asks the client in an interrogatory if it was funded and when the answer is yes, opposing counsel claim the right to view all the documents the company gave the funder and to know everything it and its lawyer said to the funder?

Few courts have opined on the confidentiality of the funding process, but *Leader Technologies, Inc. v. Facebook, 719 F.Supp. 2nd 373,376 (D. Del. 2010)* an ethics opinions from the New York City Bar Association (Formal Opinion 2011-2) and an American Bar Association informational report issued by the Ethics 20/20 Commission suggest lawyers must be mindful of waiving the privilege.

In addition, funding is infested with potential conflicts of interest traps for the unwary lawyer. Among them are:

· When the attorney provides a letter of the worth of the claim;

· When the client wants to settle for quick cash while the lawyer wants to negotiate further to get more, but the client pays the compounding interest rate;

· Where a lender wants to prolong the litigation to recover on its investment and refuses to allow the client to settle by forcing the settlement issue to arbitration,

· Where so much interest is owed that the lawyer simply cannot settle and has to try for more at trial;

· Where funding is withdrawn and the attorney cannot afford to fund the discovery needed to prepare the case;

· When the lawyer may recover his fee but the client could potentially recover nothing because of what the client owes in interest.

These issues are exacerbated by the fact that litigation funding is a completely unregulated industry. Look at the high-end funders that usually fund lawyers involved in commercial cases. One such funder is Gerchen Keller. Three of the four men behind that company are lawyers, the other an investment banker. One of the lawyers was a former analyst at Alyeska Investment Group. Gerchen funds corporations in lawsuits and assists "parties in evaluating the strengths and weaknesses of litigation claims or defenses, the potential costs of litigation, the range of potential damage awards, and the expected economic benefit or cost of maintaining particular claims or defenses," according to the company's website.

How do they do that without hurting the client by waiving confidentiality? They say that they enter into a "consulting" agreement with the party or law firm. "Thus, before any non-public information is shared ... we ensure that we share a common interest in the litigation."

Wait a minute. Isn't non-public information considered confidential information of the client too? Yes, it can be in California. Would the lawyer or the client want the world to know how the suit was funded? And how does calling yourself a "consultant" change what is discoverable? Is information told at the beginning of a case somehow not confidential?

Frankly, I think it is all lawyer hokum.

There are similar problems with funding contracts with sophisticated investors as there are with low-end funders; look no further than the Chevron/Ecuadorian lawsuit that made news again this past week. There, the opposing counsel got the funding documents, all 75 pages, and found there were eight tiers of funders. Do you think the Ecuadorians would benefit much from any judgment? I doubt it. What are the arguments in favor of litigation funders? Well, they provide money to people who would not otherwise have the funds to prosecute a lawsuit. True, their funding helped lawyers prosecute the recent BP oil cases. They argue that they are not subject to the usurious interest rate laws because they are making an investment and not a loan. They contend that a typical car or home loan is secured and is not near as risky as an investment in a lawsuit. They argue that they are taking on a big risk so they are entitled to 40 percent interest.

I could not disagree more. When passengers get on a United Airlines flight and the plane crashes due to a faulty engine repair they will definitely get some money from someone, whether it is United or Boeing. That is not much of a risk, especially where the funder comes in to fund after discov-

ery closes. In truth, ALFs are giving non-recourse loans; they recover nothing if there is no recovery, but if there is any recovery they take from it, and take a lot.

ALFs argue that they are no different than an insurance company that is funded by a pool of law firms to provide defense of malpractice suits, or a fund set up by contractors to fund homeowner suits. The difference is this and it is essential: insurance companies are highly regulated. Funders are not regulated at all. And insurance companies don't charge 40 percent a year to people already hurt by someone (because that is usually why people sue).

Lastly, ALFs contend that the funding agreements are bespoke so it would be impossible to regulate them. But in reality, the agreements are not truly bespoke; there are typical template provisions that carry forth through them all. They 1) charge a usurious interest rate; 2) allow the funder to withdraw funding at any point if they are not pleased with how the case is going, leaving the client broke and without money and maybe counsel; 3) allow the funder to force the client and lawyer to arbitrate settlements the funder deems not good enough to give the funder the profit they want; 4) claim to not seek to control the lawyer or the litigation but contain provisions that actually can control the course of the case; 5) allow information sharing by the funder with other investors perhaps waiving the attorney-client relationship and 6) have negative covenants that disallow the plaintiff to execute any documents that might reduce the value of the funder's investment (even if the documents might be beneficial to the plaintiff).

With no real guidance, lawyers must conduct themselves with the utmost care when referring a client to a funder or when seeking funding themselves. The lawyer should explain to the client specifically what issues can arise with a compounding interest rate. Whether the client or the lawyer obtains the funding potential discoverability of the statements and documents provided to the funder must be discussed along with the ramifications to the client's case of discovery. In addition, conflicts must be explored and consented to well in advance of the case getting to the point that any settlement would be too low to square the bill with both the funder and the lawyer. This is assuming a lawyer should even try to get consent to such conflicts-particularly where the lawyer gets the funding. I have my doubts at the current rate of interest charged.

This greed must stop. When funders and lawyers have the potential to leave the damaged party client with little to show for the suit then it is time for regulation, both from the State Bar and from the Legislature.

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The Association of the Bar of the City of New York Committee on Professional Ethics

Formal Opinion 2011-2: THIRD PARTY LITIGATION FINANCING

TOPIC: Third-party litigation financing

DIGEST: It is not unethical *per se* for a lawyer to represent a client who enters into a non-recourse litigation financing arrangement with a third party lender. Nevertheless, when clients contemplate or enter into such arrangements, lawyers must be cognizant of the various ethical issues that may arise and should advise clients accordingly. The issues may include the compromise of confidentiality and waiver of attorney-client privilege, and the potential impact on a lawyer's exercise of independent judgment.

RULES: 1.2(d); 1.6(a); 1.7(a); 1.8(e), (f); 2.1; 2.2; 5.4(c)

QUESTION: What ethical issues may arise when a lawyer represents a client who is contemplating or has entered into a non-recourse litigation financing agreement?

OPINION

I. Background

Third party litigation financing first emerged as an industry in the United States in the early 1990s, when a handful of small lenders began providing cash advances to plaintiffs involved in contingency fee litigation. Within a decade, as many as one hundred companies were offering financing to lawyers, their clients, or both.[1] As of 2011, this industry has continued to grow, both as to the number and types of lawsuits financed and financing provided. The aggregate amount of litigation financing outstanding is estimated to exceed $1 billion.[2]

This opinion addresses non-recourse litigation loans, *i.e.*, financing repaid by a litigant only in the event he or she settles the case or is awarded a judgment upon completion of the litigation. Under these arrangements, financing companies advance funds that will be reimbursed, if at all, solely from any proceeds of the lawsuit. As compensation, the financing companies are entitled to receive specified fees, often calculated as a percentage of any settlement or judgment.

Non-recourse loans are extended most often to plaintiffs in personal injury cases. These loans may be used to pay the costs of litigation, but also may be used to cover the plaintiff's living expenses during the pendency of the lawsuit.

Non-recourse financing of commercial claims is a more recent development, although it has become increasingly common.[3] The providers of this financing typically undertake an analysis of the merits of the contemplated claim that is more rigorous than the analysis employed in personal injury cases. If the claim appears meritorious, the financing company will advance amounts to cover attorneys fees and the other costs of the litigation.[4] These advances typically are made to the claimant or its outside litigation counsel, in return for a percentage of any eventual recovery.

The growing use of non-recourse litigation financing recently has attracted increasing attention, both within and outside the legal profession,[5] in part because the arrangements are largely unregulated, and, in the view of some critics, may require the payment of relatively exorbitant financing fees that appear usurious, create the potential for expanding the volume of litigation, and raise the specter of reviving the historically reviled practice of champerty, defined broadly as the support of litigation by a stranger in return for a share of the proceeds.

From the legal ethics perspective, perhaps the greatest concern stems from a financing company's involvement in the details of a claimant's case. Because a financing company's decision to fund will hinge on the company's analysis of the merits of the lawsuit, i.e., the likelihood and size of the expected return, the availability of financing necessarily depends on the company's ability to obtain access to information relevant to its assessment of risks of its investment, both before and after a decision to fund has been made. As part of this process, a financing company may contact the claimant's lawyer to obtain confidential and privileged information regarding the case before making any loan commitment. And even after funding has been provided, the financing agreements may require litigation counsel to periodically update the financing company with developments in the case and/or provide the company with direct access to the claimant's file.

Providing financing companies access to client information not only raises concerns regarding a lawyer's ethical obligation to preserve client confidences, it also may interfere with the unfettered discharge of the duty to avoid third party interference with the exercise of independent professional judgment. While litigation financing companies typically represent that they will not attempt to interfere with a lawyer's conduct of the litigation, their financial interest in the outcome of the case may, as a practical matter, make it difficult for them to refrain from seeking to influence how the case will be handled by litigation counsel.

II. Analysis

Against this backdrop, we discuss below the ethical issues potentially implicated by non-recourse financing arrangements and examine how lawyers may properly address these issues as they arise.

A. Legality of the Agreement

Whether a particular financing arrangement comports with the law will depend on its terms and governing law, matters outside the scope of this opinion. Nevertheless, under Rule 1.2(d) of the New York Rules of Professional Conduct, if the arrangement is unenforceable under applicable laws, such as those governing champerty and usury, or is otherwise unlawful, an attorney should so advise the client and refrain from facilitating a transaction that is unlawful.

1. Usury

A financing company generally makes its funding determination based on the "merits" of the lawsuit, *i.e.,* on the likelihood of success and the amount of any anticipated recovery. In the same vein, it will seek to set the fee it collects for providing funds based on its assessment of the likelihood of recovery. Fee arrangements vary widely as a result.

Critics have focused on fee arrangements that ultimately require litigants to pay financing companies a substantial portion of any recovery, noting that if the advances made in exchange for these fees were characterized as "loans," the fees could be deemed usurious.[6] While financing companies generally characterize non-recourse financing arrangements as a "purchase" or "assignment" of the anticipated proceeds of the lawsuit (and therefore not subject to usury laws),[7] lawyers should be aware that in certain circumstances, courts have found that non-recourse litigation financing agreements violate usury laws.[8]

2. Champerty

Champerty is a form of maintenance in which a nonparty furthers another's interest in a lawsuit in exchange for a portion of the recovery. The law of champerty varies by jurisdiction.[9] While we are aware of no decision finding non-recourse funding arrangements champertous under New York law, lawyers should be mindful that courts in other jurisdictions have invalidated certain financing arrangements under applicable champerty laws.[10]

B. Attorney as Advisor

A lawyer may be asked by a client to recommend a source of third party funding or to review or negotiate a non-recourse financing agreement for a client. If the lawyer does so, Rule 2.1 requires the lawyer to provide candid advice regarding whether the arrangement is in the client's best interest.[11]

In providing candid advice, a lawyer should advise the client to consider the costs and the benefits of non-recourse financing, as well as possible alternatives.[12] With respect to costs, a common criticism of non-recourse financing is that the fees charged to clients may be excessive relative to other financing options, such as bank loans, thereby significantly reducing the client's recovery.[13] A lawyer thus should bear in mind the extent to which non-recourse financing will limit a client's recovery. And before recommending financing companies, a lawyer should conduct a reasonable investigation to determine whether particular providers are able and willing to offer financing on reasonable terms.[14] In addition, if a lawyer assists a client with non-recourse financing, the lawyer may wish to make clear that such assistance itself is not an endorsement of the financing company.[15]

With respect to benefits, a lawyer should advise the client to consider whether, absent funding, the client would be unable to cover litigation or living expenses, or prematurely could be forced into a relatively disadvantageous settlement, effectively limiting his or her access to seek redress through the legal system. Commercial claimants also may lack the resources to

pursue a claim absent funding, or may be able to deploy resources more effectively for their business needs by financing some or all of their litigation costs.

C. Conflicts of Interest

Within the parameters discussed above, a lawyer may refer a client to a litigating financing company. When making a referral, the lawyer is barred from accepting a referral fee from the company if the fee would impair the lawyer's exercise of professional judgment in determining whether a financing transaction is in the client's best interest and would compromise the lawyer's ethical obligation to provide candid advice regarding the arrangement; even where the fee is permitted, the lawyer may be required to remit the fee to the client.[16] A conflict also may arise in the event the lawyer is asked to advise the client about financing when the client cannot afford to commence or continue litigation absent a third party advance of the lawyer's fees. And the conflict rules may prohibit a lawyer, or possibly a company in which the lawyer has a substantial ownership interest, from extending financing to a client that the lawyer represents in litigation.[17] Lawyers should carefully evaluate these and other potential conflicts when initiating or continuing the representation of a client who contemplates the use of financing for the conduct of litigation.

D. Privilege and Confidentiality

Non-recourse financing arrangements also may result in waiver of the attorney-client privilege or other protection from disclosure. This risk arises from provisions requiring a claimant or his or her lawyer to disclose documents and information to financing companies to enable them to evaluate the strength of the claims in the litigation to be financed.[18] In addition, financing arrangements may require a lawyer to inform the financing company of developments in the case and/or allow periodic reviews of the case file.[19] And for very large claims, some financing companies reserve the right to share information regarding a matter with other companies that may participate in the financing.

This opinion does not address whether such communications between the client or lawyer and a financing company result in a waiver of the attorney-client privilege or other applicable protection. We note, however, that the argument has been made that the common interest privilege does not apply to such communications because the financing company's interest in the outcome of a litigation is commercial, rather than legal.[20]

With the foregoing in mind, a lawyer may not disclose privileged information to a financing company unless the lawyer first obtains the client's informed consent, including by explaining to the client the potential for waiver of privilege and the consequences that could have in discovery or other aspects of the case.[21] In making disclosures to the financing company, a lawyer should take care not to disclose any more information than is necessary in his or her judgment.[22]

E. Control Over the Legal Proceeding

Non-recourse financing agreements often require the claimant's lawyer to keep the financing company apprised of any developments in the litigation or to seek the company's consent when taking steps to pursue or resolve the lawsuit, such as making or responding to settlement offers. These notice provisions raise the specter that a financing company, armed with information regarding the progress of the case, may seek to direct or otherwise influence the course of the litigation.[23] For example, to protect its own interest in maximizing the fee it may earn, a financing company may object to steps calculated to advance the client's interests, such as pursuing a promising line of additional discovery at a cost the company would prefer to avoid, or accepting a settlement offer that does not meet the company's expectations regarding the return on its investment. While a client may agree to permit a financing company to direct the strategy or other aspects of a lawsuit, absent client consent, a lawyer may not permit the company to influence his or her professional judgment in determining the course or strategy of the litigation, including the decisions of whether to settle or the amount to accept in any settlement.[24]

III. Conclusion

Non-recourse litigation financing is on the rise, and provides to some claimants a valuable means for paying the costs of pursuing a legal claim, or even sustaining basic living expenses until a settlement or judgment is obtained. It is not unethical *per se* for a lawyer to advise on or be involved with such arrangements. However, they may raise various ethical issues for a lawyer, such as the potential waiver of privilege and interference in the lawsuit by a third party. A lawyer representing a client who is party, or considering becoming party, to a non-recourse funding arrangement should be aware of the potential ethical issues and should be prepared to address them as they arise.

June, 2011

[1]*See* Terry Carter, *Cash Up Front: New Funding Sources Ease Strains on Plaintiffs Lawyers*, ABA Journal 34-36 (Oct. 8, 2004), *available at* http://abajournal.com/magazine/article/cash_up_front/.

[2]*See* Binyamin Appelbaum, *Investors Put Money on Lawsuits to Get Payouts*, New York Times (Nov. 14, 2010), *available at* http://www.nytimes.com/2010/11/15/business/15lawsuit.html.

[3] *See* Holly E. Loiseau, Eric C. Lyttle, and Brianna N. Benfield, *Third-Party Financing of Commercial Litigation*, ABA In-House Litigator (2010), http://www.weil.com/files/Publication/17c770d9-514d-426d-aalf-bbc4c7547c0c/Presentation/PublicationAttachment/cacabd85-lea5-46ac-8657-40ffd9eac8be/IHL_2010_ThirdPartyFinance.pdf.

[4]*See* Louis M. Solomon, *Third-Party Litigation Financing: It's Time to Let Clients Choose*, N.Y.L.J. (Sept. 13, 2010).

[5] For articles (in addition to those cited elsewhere herein), *see, e.g.,* Steven Garber, Alternative Litigation Funding in the United States: Issues, Knowns and Unknowns (Rand Corp. 2010); Susan Lorde Martin, The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed, 10 Fordham J. Corp. & Fin. L. 55 (2004); Douglas R. Richmond, Other People's Money: The Ethics of Litigation Funding, 56 Mercer L. Rev. 649 (Winter 2005); Julie H. Mclaughlin, Litigation Funding: Charting a Legal and Ethical Course, Vermont Law Review, Vol. 31, No. 3 615-662 (Spring 2007). For ethics opinions, *see, e.g.,* N.Y. State 666 (1994); Utah State Bar Op. 97-11(1997); State Bar of Mich. Op. RI-321 (2000); FL. Bar Op. 00-3 (2002); Virginia Legal Ethics Op. 1764 (2002); N.Y. State 769 (2003); State Bar of Nevada Standing Comm. On Prof'l. Responsibility, Formal Op. 29 (2003).

[6]*See generally* Appelbaum, *supra* note 2; Garber, *supra,* note 3 at 10; *see also* Binyamin Appelbaum, *Lawsuit Loans Add New Risk for the Injured*, New York Times, (Jan. 16, 2011), *available at* http://www.nytimes.com/2011/01/17/business/17lawsuit.html?pagewanted=1&emc=eta1. Usury laws in New York set a maximum allowable rate of interest per annum. *See* N.Y. Banking Law § 14-a (McKinney 2008); *see also* N.Y. Gen. Oblig. Law § 5-501 (McKinney 2001 & Supp. 2011).

[7]*See, e.g.*, in the personal injury context, Frequently Asked Questions: What percentage of the proceeds do we purchase?, FastFunds, http://www.fastfunds4u.com/pages/faqs.html (last visited Apr. 19, 2011) ("We provide funds by purchasing a small portion of the anticipated proceeds. It is not a loan, so there is no interest, no matter how long it takes for the case to be resolved. Like the claimant and the attorney, we take the risk of a successful resolution. If the case is lost, we lose our money.").

[8]*See, e.g.*, *Echeverria v. Estate of Lindner*, 2005 N.Y. Slip Op. 50675(u), at 4-5 (Sup. Ct. Nassau County 2005) (finding non-recourse agreement was "loan" because recovery was certain under strict liability statute and interest rate was usurious); *Lawsuit Fin. v. Curry*, 683 N.W.2d 233, 236 (Mich. Ct. App. 2004) (finding same because judgment had already been entered in favor of plaintiff when she entered into financing agreement).

[9] Twenty-eight states reportedly no longer prohibit champerty. *See* Ashby Jones, *The Next National Investment Craze: Lawsuits*!, The Wall Street Journal Law Blog (June 4, 2010), *available at* http://blogs.wsj.com/law/2010/06/04/the-next-national-investment-craze-lawsuits/. The Court of Appeals of New York has recently clarified the law of champerty in New York. *SeeTrust for Certificate Holders of Merrill Lynch Mortgage Investors, Inc. v. Love Funding Corp.*, 13 N.Y.3d 190, 192 (2009).

[10]*See, e.g., Johnson v. Wright*, 682 N.W.2d 671 (Minn. Ct. App. 2004).

[11]*See* N.Y. State 666 (1994) (attorney may refer client to financing company for living expenses); *see also* Fla. Bar, Op. 00-3 (Mar. 15, 2002) (same). In addition to Rule 2.1's duty of candor, a lawyer may have other obligations. For example, several financing companies doing business in New York State have entered into a Stipulation with the Attorney General that requires the companies to follow certain guidelines, such as procuring an attorney certification that the lawyer has reviewed the financing agreement with the client. *See* American Legal Finance Association, ALFA Agreement (Feb. 17, 2005), *available at* http://www.americanlegalfin.com/alfasite2/documents/ALFAAgreementWithAttorneyGeneral.pdf. Signatories to the Agreement include Plaintiff Support Services, Pre-Settlement Finance, QuickCash, Magnolia Funding, BridgeFunds Limited, Plaintiff Funding Corp. d/b/a LawCash, Oasis Legal Finance, The Whitehaven Group, and New Amsterdam Capital Partners. *Id* at 9-18. The Stipulation is posted on the website of the American Legal Finance Association (AFLA). Currently,

21 companies belong to the Association nationwide. *See* American Legal Finance Association, *availableat* http://www.americanlegalfin.com/index.asp (last visited Apr. 19, 2011).

[12]*See* N.Y. State 769 (2003) (attorney should advise the client of costs and benefits of the transaction as well as alternative courses of action); *see also* Fla. Bar, Op. 00-3 (Mar. 15, 2002).

[13]*See* Garber, *supra* note 3, at 10; Appelbaum, *supra* note 2.

[14]*See* Nev. State Bar Standing Comm. On Ethics and Prof'l Responsibility, Formal Op. 29 (Aug. 7, 2003).

[15]*See* N.Y. State 769.

[16]*See* N.Y. Rules of Prof'l Conduct R. 1.7(a), 1.8(f), 5.4(c) (2010); N.Y. State 682 (1996) (lawyer must offer client any referral fee the lawyer receives for standard products and services); N.Y. State 671 (1994) (lawyer "absolutely forbidden" from receiving referral fee where amount of product or service purchased depends on attorney advice); ABA Formal Op. 331 (1972).

[17]*See* N.Y. Prof'l Conduct R. 1.8(e); N.Y. State 753 (2002) (reiterating that lawyer may not ethically represent a client in a real estate transaction if the lawyer acts as a principal in the title insurance agency that has been engaged for the transaction and that is performing non-ministerial tasks); *see also* N.Y. State 769; 666; Fla. Bar, Op. 00-3 (Mar. 15, 2002); Ohio Sup. Ct. Op. 2000-01 (2000) available at http://www.supremecourt.ohio.gov/Boards/BOC/Advisory_Opinions/2000/Op%2000-001.doc (last visited Apr. 20, 2011); Phila. Bar Ass'n Prof'l Guidance Comm., Ethics Op. 91-9 (May 1991); cf. S.C. Bar Ethics Advisory Op. 92-06 (1992) (an attorney may own interest in a non-recourse financing company that provides funding to non-clients).

[18]*See, e.g.,* Frequently Asked Questions: Will my case qualify for an advance?, LawMax Legal Finance, http://www.fundmycase.com/en/FAQ.php4 .") (last visited Apr. 19, 2011) ("LawMax considers each request for an advance on a case-by-case basis. We will thoroughly review your case, and our underwriters will make a decision within 48 hours of receiving the required documentation from your attorney."); Frequently Asked Questions: Do we get involved in the case?, FastFunds, http://www.fastfunds4u.com/pages/faqs.html (last visited Apr. 19, 2011) ("Our only involvement is to initially review the attorney's file so we can evaluate the claim."); Case Documents for Plaintiff Funding, LawLeaf, www.lawleaf.com/lawsuit-funding/case-documents-for-plaintiff-funding.html (requiring certain documents for evaluation of the claim).

[19]*See, e.g.*, The Funding Process, LawMax Legal Finance, http://www.litigationfinancing.com/FundingProcess.htm (last visited Apr. 19, 2011) ("We . . . ask . . . that we be kept aware of any developments in the case."); *see also* Del. State Bar Ass'n Comm. On Prof'l Ethics, Op. 2006-2 (Oct. 6, 2006) ("Th[e] information [requested] includes police/accident reports, medical records, witness statements, expert reports, and information relating to the defendant's insurance carrier and its policy limits."); Complaint, *S&T Oil Equip. & Mach. Ltd. v. Juridica Invests. Ltd.,* (S.D. Tex. Filed Feb. 14, 2011) (alleging that claimant's counsel "was required to place all information regarding the strategy, public profile, factual or legal developments regarding the [arbitration] on [the] internal website [of the law firm associated with the funding company]. This included key substantive pleadings, key documents, settlement documents and any scheduling orders.").

[20]*See, e.g.,Leader Techns., Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373 (D. Del. 2010) (compelling disclosure of documents shared with financing companies during discussions about potential financing); *see alsoAbrams v.First Tenn. Bank Nat'l Ass'n*, No. 3:03-cv-428, 2007 WL 320966, at *1 (E.D. Tenn. Jan. 30, 2007); *see also* Nate Raymond, *Litigation Funders Face Discovery Woes*, Nat'l L.J., Feb. 21, 2011 (reporting that in at least one case, the initial conversations between a funding company and the client were not protected from disclosure by the attorney client privilege).

[21]*See* N.Y. Prof'l Conduct R. 1.6(a) (2009).

[22]*See* N.Y. State 769.

[23]*See* Garber, *supra* note 3, at 18.

[24]*See* N.Y. Rules of Prof'l Conduct 1.7(a), 1.8(f), 5.4(c) (2010). After a settlement or judgment has been obtained, a lawyer may turn over to a funding company a portion of a client's recovery pursuant to the terms of that client's non-recourse financing agreement. *See* N.Y. State 666; Fla. Bar, Op. 00-3 (Mar. 15, 2002); S.C. Bar Ethics Advisory Op. 92-06 (1992);

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by the Committee on Professional Ethics of the New York City Bar Association.

Phila. Bar Ass'n Prof'l Guidance Comm., Ethics Op. 91-9 (May 1991). We do not reach the issue, but note the potential conflict, where a lawyer is a signatory to a financing agreement and is instructed by the client not to pay over to the financing company the contractually-specified portion of the settlement or judgment.

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TAB 4

Liar, Liar: Negotiation Ethics

LIAR, LIAR: NEGOTIATION ETHICS

Suzanne Burke Spencer, Panel Moderator **Laguna Beach, CA**

Suzanne Burke Spencer is the managing shareholder of Sall Spencer Callas & Krueger, a business litigation firm in Laguna Beach, California. She practices in the areas of professional malpractice and attorney ethics as well as complex business and real estate litigation. Ms. Burke Spencer has frequently lectured on attorney fees disputes, legal ethics and risk management in public and private seminars, and has authored or contributed to numerous articles on attorney ethics. Ms. Burke Spencer was appointed to the State Bar of California's Committee on Professional Responsibility and Conduct (COPRAC) for a three year term beginning October 2012, and is a former member of the Client Relations Committee of the Orange County Bar Association. A native of New Jersey, Ms. Burke Spencer relocated to California in 1995 and has lived and practiced here ever since.

Edward J. McIntyre **San Diego, CA**

Mr. McIntyre focuses his practice exclusively on issues professional responsibility, legal ethics and risk mitigation. He counsels and represents lawyers and their firms and serves as an expert witness. He lectures and writes about, and serves on professional committees devoted to, issues of professional responsibility. Mr. McIntyre was a trial lawyer for forty years. Most recently he was a litigation partner at Solomon Ward and the Firm's general counsel and professional responsibility partner. His practice emphasized complex business, securities and intellectual property litigation in federal and state courts and counseling publicly held and privately owned companies. Mr. McIntyre is recognized, as well, for his practice of First Amendment and journalism law. Admitted: United States Supreme Court; United States Courts of Appeal for the Third, Fifth, Ninth, Tenth and Federal Circuits; United States District Courts for the Eastern District of Pennsylvania, and Southern, Central and Northern Districts of California; state courts of California; state courts of Pennsylvania. He writes and lectures regularly on professional responsibility, including a monthly column in San Diego Lawyer Member, State Bar standing Committee on Professional Responsibility and Conduct (COPRAC) (2008-2011) Member, and former Chari, San Diego County Bar Association Legal Ethics Committee Lived in Geneva, Switzerland, in 1989 while following the GATT negotiations and writing a monthly column, Europe Today, for the San Diego Daily Transcript. Upon returning to San Diego, he continued the column through 1992.

David F. McGowan **San Diego, CA**

David McGowan is the Lyle L. Jones Professor of Competition and Innovation Law at the University of San Diego School of Law, where he teaches professional responsibility, among other courses. He is the author of *Developing Judgment About Practicing Law*, published by West. He also is a partner at Durie Tangri, LLP, in San Francisco, where his practice includes representing lawyers.

Hon. John Leo Wagner, Ret. **Los Angeles, CA**

Judge Wagner is a full-time Mediator and Arbitrator with Judicate West. He is a former United States Magistrate Judge, and served for 8 years as the head of the ADR practice group for Irell & Manella LLP. He has over 30 years of experience in settling complex, multi-party, difficult and emotional disputes, and has conducted thousands of mediations and arbitrations. He was a member of the CPR/Georgetown Commission on Ethics and Standards in ADR, which produced the CPR Model Rule for the Lawyer as Third-Party Neutral. As a member of the Court Administration and Case Management Committee of the United States Judicial Conference, he was active in formulating court rules and Judicial Conference policy regarding the standards to be applied in court-annexed mediation programs. The Daily Journal has selected Judge Wagner as one of the Top Neutrals in California every year since 2008, culminating with being selected as one of 22 "Master ADR Neutrals." He was also selected as one of 42 Power Neutrals by The Hollywood Reporter, Esq. in 2007. He has been listed as a Southern California Super Lawyer in the field of Alternative Dispute Resolution every year since 2007, and has been listed in The Best Lawyers in America from 2007 to the present in the specialty of Alternative Dispute Resolution. He was named the Best Lawyers' 2014 Orange County Arbitration "Lawyer of the Year." Judge Wagner is a past President and a Distinguished Fellow of the International Academy of Mediators. He is a Fellow of the American College of Civil Trial Mediators and is listed on the CPR International Institute for Conflict Prevention and Resolution National Panel of Distinguished Neutrals. He was designated a Master at the Founding of the Paul R. Michel Intellectual Property American Inn of Court (Los Angeles). He is a Diplomat Member of the California Panel of Distinguished Neutrals and of the National Panel of Distinguished Neutrals.

LIAR, LIAR: NEGOTIATION ETHICS

LIST OF WRITTEN MATERIALS

1. Panel Outline

2. *Cooking the Settlement*, Richard Hendlin and Luis Ventura, San Diego Lawyer, November/December 2008

Written materials can be downloaded at:
http://www.calbar.org/ethics-symposium/2015_materials.html

The State Bar of California
Ethics Symposium
Thomas Jefferson Law School
April 25, 2015

Liar, Liar: Negotiation Ethics

Panelists:

David McGowen, Esq.
Ed McIntyre, Esq.
Hon. John Leo Wagner
Suzanne Burke Spencer (Moderator)

Sources of an Attorney's Ethical Duties in Negotiation

California

- Bus. & Prof. Code § 6106: "The commission of any act involving moral turpitude, dishonesty or corruption, whether the act is committed in the course of his relations as an attorney or otherwise, and whether the act is a felony or misdemeanor or not, constitutes a cause for disbarment or suspension."

- Bus. & Prof. Code § 6068(d): An attorney must "employ, for the purpose of maintaining the causes confided to him or her those means only as are consistent with truth, and never to seek to mislead the judge or any judicial officer by an artifice or false statement of fact or law")

- Rule 5-220: A lawyer "shall not suppress any evidence that the member or the member's client has a legal obligation to reveal or to produce."

- Rule 5-200: In presenting a matter to a tribunal, a lawyer "(A) Shall employ, for the purpose of maintaining the causes confided to the member such means only as are consistent with truth; (B) Shall not seek to mislead the judge, judicial officer, or jury by an artifice or false statement of fact or law")

- Do the Rules applicable to representations made to a tribunal apply if a judicial officer presides over a mediation or settlement conference? ABA Standing Committee on Ethics and Professional Responsibility says yes (ABA Formal Opinion 93-370 (Judicial Participation in Pretrial Settlement Negotiations))

Model Rules

- Rule 4.1: "In the course of representing a client a lawyer shall not knowingly: (a) make a false statement of material fact or law to a third person; or

(b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6 [duty of confidentiality]"

- Rule 8.4(c): "It is professional misconduct for a lawyer to: . . . engage in conduct involving dishonesty, fraud, deceit or misrepresentation"

- The more specific Rule 4.1 applies to negotiations versus the more general duty of honesty in Rule 8.4(c). ABA Formal Opinion 06-439 (Lawyer's Obligation of Truthfulness When Representing a Client in Negotiation: Application to Caucused Mediation)

<u>Does the Negotiation Environment Change or Influence Ethical Obligations</u>

- Are lawyers expected to lie in negotiations?

  - "If it is true that lawyers succeed in the degree to which they are effective in negotiations, it is equally true that one's effectiveness in negotiations depends in part upon one's willingness to lie." Gerald B. Wetlaufer, *The Ethics of Lying in Negotiation*, 75 Iowa L. Rev. 1219, 1220 (1990).

  - Does this expectation implicate the duty of competence? Rule 3-110

- "Puffing" or Posturing

  - COPRAC Interim Opinion 12-0007

  - ABA Formal Opinion 06-439 (Lawyer's Obligation of Truthfulness When Representing a Client in Negotiation: Application to Caucused Mediation)

  - PROSSER ON TORTS, 739 (3d ed. 1964) (discussing the permissible practice of "puffing" as the bargainer's "privilege to lie his head off, so long as he says nothing specific, on the theory that no reasonable man would believe him, or that no reasonable man would be influenced by such talk!")

- Concealment

  - Duty of honesty may prohibit concealment as well as affirmative statements. *In the Matter of Loftus* (Review Dep't 2007) 5 Cal. State Bar Ct. Rptr. 80, 86 (Acts of moral turpitude, which are prohibited by Business and Professions Code § 6106, "include concealment as well as affirmative misrepresentations."); *In the Matter of Dale* (Review Dep't 2005) 4 Cal. State Bar Ct. Rptr. 798, 808 ("'[N]o distinction can . . . be drawn among concealment, half-truth, and false statement of

fact.'" (quoting *In the Matter of Chestnut* (Review Dep't 2000) 4 Cal. State Bar Ct. Rptr. 166, 174)).

- Is a misrepresentation of a party's "actual bottom line" an ethical violation?

  - *See* ABA Formal Opinion 93-370 (Judicial Participation in Pretrial Settlement Negotiations)

- Interplay between duty of honesty and Rule 3-100 (Confidential Information of a Client) and Bus. & Prof. Code § 6068(e)

- Duty to correct opponent's mistake

  - COPRAC Formal Opinion No. 2013-189

- As a matter of civil law, lawyers cannot make fraudulent representations in negotiations with third parties

  - *Vega v. Jones, Day, Reavis & Pogue* (2004) 121 Cal.App.4th 282, 291 ("a lawyer communicating on behalf of a client with a nonclient may not knowingly make a false statement of material fact to the nonclient [citation], and may be liable to a nonclient for fraudulent statements made during business negotiations"); see also *Goodman v. Kennedy* (1976) 18 Cal.3d 335, 346; *Cicone v. URS Corp.* (1986) 183 Cal.App.3d 194, 202 ("the case law is clear that a duty is owed by an attorney not to defraud another, even if that other is an attorney negotiating at arm's length"); see also COPRAC Form. Opn. No. 2013-189, FN 11 and 12.

<u>Are there any real consequences to lying during settlement negotiations?</u>

- Mediation confidentiality may bar claims

  - *Cassel v. Superior Court* (2011) 51 Cal.4th 113 (no claims can be brought by client against former attorney based on attorney-client communications that occurred during mediation)

  - *Amis v. Greenberg Traurig LLP*, No. B248447, 2015 Cal. App. LEXIS 247 (March 18, 2015)

- Release language in settlement agreement may bar claims based on fraud in the settlement process

- Likelihood of discipline is low

  - But see *In re Attorney Lynn Hubbard III*, Case No. 12-cv-1975 L (WMc) (lawyer suspended for one year from practice before the

Southern District of California under the local rules of that Court for signing settlement agreement on behalf of deceased client without revealing fact of client's death)

Should California have 4.1 or something similar?

- Criticism:

  - Rule 4.1 does not go far enough; lawyers are already prohibited from committing fraud

  - Rule 4.1 "imposes limits on the deception lawyers can use in their statements to others" Hinshaw & Alberts, *"Attorney Negotiation Ethics: An Empirical Assessment,"* p. 8. For example, there is no prohibition on making false statements concerning immaterial facts.

Other Resources:

ABA Formal Opinion 93-370 (Judicial Participation in Pretrial Settlement Negotiations)

http://www.americanbar.org/content/dam/aba/publications/YourABA/93_370.authcheckdam.pdf

ABA Formal Opinion 06-439 (Lawyer's Obligation of Truthfulness When Representing a Client in Negotiation: Application to Caucused Mediation)

Barry R. Temkin, "Misrepresentation by Omission in Settlement Negotiations: Should There Be A Silent Safe Harbor?" *The Georgetown Journal of Legal Ethics*, Vol. 18, Fall 2004

Richmond, Douglas R., "Lawyers' Professional Responsibilities and Liabilities in Negotiations," *The Georgetown Journal of Legal Ethics*, Vol. 22, 2009

"Ethical Guidelines for Settlement Negotiations," American Bar Association, Section of Litigation (August 2002)

THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION NO. 2013-189

ISSUE: Has an attorney engaged in deceitful conduct by not alerting opposing counsel of: (A) an apparent material error made by opposing counsel in contract language; or (B) a material change made by the attorney in contract language?

DIGEST: Where an attorney has engaged in no conduct or activity that induced an apparent material error by opposing counsel, the attorney has no obligation to alert the opposing counsel of the apparent error. However, where the attorney has made a material change in contract language in such a manner that his conduct constitutes deceit, active concealment or fraud, the failure of the attorney to alert opposing counsel of the change would be a violation of his ethical obligations.

AUTHORITIES INTERPRETED: Rule 3-700(B)(2) of the Rules of Professional Conduct of the State Bar of California.[1/]

Business and Professions Code section 6106.

Business and Professions Code section 6128(a).

STATEMENT OF FACTS

Buyer and Seller have been in discussions regarding the sale of the Company from Seller to Buyer, and have agreed in concept to some of the material terms, including total consideration of $5 million to be paid by Buyer and Buyer's requirement that Seller enter into a covenant not to compete with the Company following the sale. Buyer's Attorney and Seller's Attorney are tasked with preparing a Purchase and Sale Agreement to reflect the agreement of the parties.

Buyer's Attorney prepares an initial draft of the Purchase and Sale Agreement. One section towards the back of the 50-page draft agreement contains the terms of an enforceable covenant not to compete, and includes a provision that Buyer's sole and exclusive remedy for a breach by Seller of its covenant not to compete is the return of that portion of the total consideration which has been allocated in the Purchase and Sale Agreement for the covenant not to compete. Another section in the front of the draft agreement provides that, of the $5 million to be paid by Buyer, $3 million is to be allocated to the purchase price for the Company and $2 million is to be allocated as consideration for the covenant not to compete.

Scenario A

After soliciting input on the initial draft from Seller and Seller's tax advisor, Seller's Attorney provides Buyer's Attorney with comments on the initial draft, including the observation from Seller's tax advisor that payments received by Seller with respect to the covenant not to compete are not as favorable, from a tax perspective, as payments with respect to the purchase price for the Company.

Buyer's Attorney then prepares a revised version of the Purchase and Sale Agreement which, apparently in response to the comments of Seller's Attorney, provides for an allocation of only $1 as consideration for

[1/] Unless otherwise indicated, all future references to rules in this opinion will be to the Rules of Professional Conduct of the State Bar of California.

the covenant not to compete with $4,999,999 allocated to the purchase price for the Company. In reviewing the changes made in the revised version, Seller's Attorney recognizes that the allocation of only $1 as consideration for the covenant not to compete essentially renders the covenant meaningless, because Buyer's sole and exclusive remedy for breach by Seller of the covenant would be the return by Seller of $1 of the total consideration. Seller's Attorney notifies Seller about the apparent error with respect to the consequences of the change made by Buyer's Attorney. Seller instructs Seller's Attorney to not inform Buyer's Attorney of this apparent error. Seller's Attorney says nothing to Buyer's Attorney and allows the Purchase and Sale Agreement to be entered into by the parties in that form.

Scenario B

After receiving the initial draft from Buyer's Attorney, Seller's Attorney prepares a revised version of the Purchase and Sale Agreement which provides for an allocation of only $1 as consideration for the covenant not to compete, with the intent of essentially rendering the covenant not to compete meaningless. Although Seller's Attorney had no intention of keeping this change secret from Buyer's Attorney, Seller's Attorney generates a "redline" of the draft that unintentionally failed to highlight the change, and then tenders the revised version to Buyer's Attorney. Subsequently, Seller's Attorney discovers the unintended defect in the "redline" and notifies Seller about the change, including the failure to highlight the change, in the revised version. Seller instructs Seller's Attorney to not inform Buyer's Attorney of the change. Seller's Attorney says nothing to Buyer's Attorney and allows the Purchase and Sale Agreement to be entered into by the parties in that form.

Under either Scenario, has Seller's Attorney violated any ethical duties?[2/]

DISCUSSION

Following Client's Instruction to Not Disclose

Attorneys generally must follow the instructions of their clients. See ABA Model Rule 1.2(a) ("a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by [ABA Model] Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation …").[3/] However, if the client insists on certain unethical conduct, the attorney may have an obligation to withdraw from the representation. Rule 3-700(B)(2) provides "[a] member representing a client . . . shall withdraw from employment, if: . . . [t]he member knows or should know that continued employment will result in violation of these rules or of the State Bar Act." Such an obligation, for example, may arise if the unethical conduct in question involves a fraudulent failure to make a disclosure. As the Los Angeles County Bar Association has opined, upon discovering that an adverse party made an overpayment under a settlement agreement, "[c]ounsel is obligated to inform his/her client of the overpayment under [rule] 3-500. Under [Bus. & Prof. Code,] § 6068(e) . . ., where the client has requested the information be held in confidence, the attorney is obligated to preserve the secret. The attorney should counsel the client to disclose and return

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[2/] This opinion addresses a situation arising out of a transaction setting only, and because the matter is not pending before a tribunal, a lawyer's duty of candor to the court found in rule 5-200 and Business and Professions Code section 6068(d) are not being addressed in this opinion. See *Datig v. Dove Books, Inc.* (1999) 73 Cal.App.4th 964, 980-981 [87 Cal.Rptr.2d 719].

[3/] The ABA Model Rules are not binding in California but may be used for guidance by lawyers where there is no direct California authority and the ABA Model Rules do not conflict with California policy. *City & County of San Francisco v. Cobra Solutions, Inc.* (2006) 38 Cal.4th 839, 852 [43 Cal.Rptr.3d 771]. Thus, in the absence of related California authority, we may look to the ABA Model Rules, and the ABA Opinions interpreting them, as well as the ethics opinions of other jurisdictions or bar associations for guidance. (Rule 1-100(A) (ethics opinions and rules and standards promulgated by other jurisdictions and bar associations may also be considered); *State Comp. Ins. Fund v. WPS, Inc.* (1999) 70 Cal.App.4th 644, 656 [82 Cal.Rptr.2d 799]).

the overpayment. If the client refuses, however, the attorney must consider whether the failure to disclose constitutes fraud. The attorney must then determine whether he/she may or must withdraw from the representation pursuant to [rule] 3-700." Los Angeles County Bar Assn. Formal Opn. No. 520.

Under either Scenario A or Scenario B of our Statement of Facts, once Seller's Attorney has informed Seller of the development,[4/] Seller's Attorney must abide by the instruction of Seller to not disclose. If, however, failure to make such disclosure constitutes an ethical violation by Seller's Attorney, then Seller's Attorney may have an obligation to withdraw from the representation under such circumstances. See Cal. State Bar Formal Opn. No. 1996-146.

Failure to Alert Opposing Counsel

Attorneys are held to a high standard, and may be subject to general obligations of professionalism. For example, attorneys have been held to have a duty to respect the legitimate interests of opposing counsel. "An attorney has an obligation not only to protect his client's interests but also to respect the legitimate interests of fellow members of the bar, the judiciary, and the administration of justice." *Kirsch v. Duryea* (1978) 21 Cal.3d 303, 309 [146 Cal.Rptr. 218] (overturning a malpractice judgment against an attorney for withdrawing from a case he believed lacked merit). Further, this Committee has previously concluded that attorneys should treat opposing counsel with candor and fairness. (See Cal. State Bar Formal Opn. No. 1967-11 ["It is true that, under [former] canon 15 of the Canons of Ethics of the American Bar Association, an attorney must zealously advance the interests of his client, but not by using 'any manner of fraud or chicane. He must obey his own conscience and not that of his client.' One of the obligations of conscience to which the lawyer must conform is stated in [former] canon 22: his conduct with other lawyers 'should be characterized by candor and fairness.' [Former] canon 29 states that a lawyer 'should strive at all times to uphold the honor and to maintain the dignity of the profession . . .' All of the canons are commended to the members of the State Bar by rule *[former]* 1 of the Rules of Professional Conduct of the State Bar."]). [5/] See also ABA Model Rule 3.4.[6/]

[4/] Attorneys have an obligation to keep their clients reasonably informed about significant developments relating to the matter for which they have been employed. Rule 3-500 and Bus. & Prof. Code, § 6068(m). See also rule 3-510. Both the apparent error made by Buyer's Attorney in Scenario A and the intentional change made by Seller's Attorney in Scenario B would constitute a "significant development," which would require that Seller be informed of the potential for added costs and burdens of enforcement, including litigation and the likelihood that Buyer may seek reformation of the Purchase and Sale Agreement. See Civ. Code, §§ 3399, 1689. See also *Dyke v. Zaiser* (1947) 80 Cal.App.2d 639 [182 P.2d 344] and *Stare v. Tate* (1971) 21 Cal.App.3d 432 [98 Cal.Rptr. 264]. On the other hand, if Seller's Attorney intends to inform Buyer's Attorney of the apparent error, Seller's Attorney need not inform Seller of the apparent error. Where a client has already agreed to a contract provision which is inadequately reflected in the draft contract prepared by opposing counsel, the inadvertent error by opposing counsel by itself (i.e., unless left uncorrected in the final executed version) does not constitute a significant development, and the client's attorney may correct the drafting error and need not inform the client. See ABA Informal Opn. No. 86-1518 (attorney has no obligation to inform his client of the error because "the decision on the contract ha[d] already been made by the client.").

[5/] An insertion added by the Committee is placed in brackets and italicized to distinguish it from bracketed insertions appearing in the original material.

[6/] See also, the California State Bar's *California Attorney Guidelines of Civility and Professionalism*, (posted online at http://ethics.calbar.ca.gov/LinkClick.aspx?fileticket=mPBEL3nGaFs%3d&tabid=455 (as of May 20, 2013)) which, among other things, encourages attorneys "to be professional with . . . other parties and counsel . . . ." We note, however, that such guidelines are nonbinding: "[T]he Guidelines are [voluntary and] not mandatory rules of professional conduct, nor rules of practice, nor standards of care, [and] they are not to be used as an independent basis for disciplinary charges by the State Bar or claims of professional negligence." *California Attorney Guidelines of Civility and Professionalism*, adopted by the Board of Trustees July 20, 2007, long version at page 3. A copy is on file with the State Bar.

Any duty of professionalism, however, is secondary to the duties owed by attorneys to their own clients. There is no general duty to protect the interests of nonclients. *Fox v. Pollack* (1986) 181 Cal.App.3d 954, 961 [226 Cal.Rptr. 532] ("an attorney has no duty to protect the interests of an adverse party [citations] for the obvious reasons that the adverse party is not the intended beneficiary of the attorney's services, and that the attorney's undivided loyalty belongs to the client."). See also *Skarbrevik v. Cohen, England & Whitfield* (1991) 231 Cal.App.3d 692, 702 [282 Cal.Rptr. 627] ("no [attorney] duty has been found when the third party is someone with whom the client is dealing at arm's length, rather than someone intended to be benefited by the attorney-client transaction."). Furthermore, a duty to nonclients would damage the attorney-client relationship. *Fox, supra,* 181 Cal.App.3d at p. 962 ("The effect of such a duty on respondent would be the eradication of confidentiality (Bus. & Prof. Code, § 6068 subd. (e); Evid. Code, § 950 et seq.), the creation of a conflict of interest ([former] rules 4-101, 5-101, 5-102, Rules Prof. Conduct) and the consequent destruction of the attorney-client relationship between respondent and his clients.").

Attorneys generally owe no duties to opposing counsel nor do they have any obligation to correct the mistakes of opposing counsel. There is no liability for conscious nondisclosure absent a duty of disclosure. *Goodman v. Kennedy* (1976) 18 Cal.3d 335, 342, 346 [134 Cal.Rptr. 375]. There is also no duty to correct erroneous assumptions of opposing counsel. See ABA Formal Opn. No. 94-387 (no duty to disclose to opposing party that statute of limitations has run). See also *Ethical Guidelines for Settlement Negotiations* (August 2002), ABA Section of Litigation, at page 56,[7/] ("there is no general ethics obligation, in the settlement context or elsewhere, to correct the erroneous assumptions of the opposing party or opposing counsel . . .").[8/]

On the other hand, it is unlawful (and a violation of an attorney's ethical obligations) for an attorney to commit any act of moral turpitude, dishonesty, or corruption. Business and Professions Code section 6106 provides that: "The commission of any act involving moral turpitude, dishonesty or corruption, whether the act is committed in the course of his relations as an attorney or otherwise, and whether the act is a felony or misdemeanor or not, constitutes a cause for disbarment or suspension." It is similarly inappropriate for an attorney to engage in deceit or active concealment, or make a false statement of a material fact to a nonclient. Business and Professions Code section 6128(a) provides that: "Every attorney is guilty of a misdemeanor who . . . [i]s guilty of any deceit or collusion, or consents to any deceit or collusion, with intent to deceive the court or any party." Also, an attorney may not knowingly assist his or her client in any criminal or fraudulent conduct. See: rule 3-210 ("A member shall not advise the violation of any law, rule, or ruling of a tribunal unless the member believes in good faith that such law, rule, or ruling is invalid."); Business and Professions Code section 6068(a) (it is the duty of an attorney to "support the Constitution and laws of the United States and of this state."); and ABA Model Rule 1.2(d) ("A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent.").[9/]

[7/] Posted online at: http://www.americanbar.org/content/dam/aba/migrated/2011_build/dispute_resolution/settlementnegotiations.pdf (as of May 20, 2013). A copy is on file with the State Bar.

[8/] This opinion does not address a scrivener's error. See ABA Informal Opn. No. 86-1518: interpreting Model Rule 1.2(d) to conclude that where a transcription of an agreement contains a scrivener's error, an attorney cannot allow his or her client to benefit from the mistake and must notify the other party's attorney ("Where the lawyer for A has received for signature from the lawyer for B the final transcription of a contract from which an important provision previously agreed upon has been inadvertently omitted by the lawyer for B, the lawyer for A, unintentionally advantaged, should contact the lawyer for B to correct the error and need not consult A about the error."). See also *In re Conduct of Gallagher* (Or. 2001) 332 Or. 173 [26 P.3d 131] (attorney who was aware of opposing counsel's mistake regarding settlement checks – settlement amount had been wrongly calculated – had a duty to correct such mistake). But see Md. State Bar Ass'n, Comm. on Ethics Opn. No. 89-44 (1989) (opining that there is no obligation to reveal the omission of a material term in a contract).

[9/] See also ABA Model Rule 8.4(c) ("It is professional misconduct for a lawyer to . . . engage in conduct involving dishonesty, fraud, deceit or misrepresentation"); ABA Model Rule 4.1 [Truthfulness In Statements To Others] ("In the course of representing a client a lawyer shall not knowingly: (a) make a

As a result, an attorney may have an obligation to inform opposing counsel of his or her error if and to the extent that failure to do so would constitute fraud, a material misstatement, or engaging in misleading or deceitful conduct.[10/] "While an attorney's professional duty of care extends only to his own client and intended beneficiaries of his legal work, the limitations on liability for negligence do not apply to liability for fraud. [Citation.] Accordingly, a lawyer communicating on behalf of a client with a nonclient may not knowingly make a false statement of material fact to the nonclient [citation] . . . ." *Vega v. Jones, Day, Reavis & Pogue* (2004) 121 Cal.App.4th 282, 291 [17 Cal.Rptr.3d 26].[11/] Even when no duty of disclosure would otherwise exist, "where one does speak he must speak the whole truth to the end that he does not conceal any facts which materially qualify those stated. [Citation.] One who is asked for or volunteers information must be truthful, and the telling of a half-truth calculated to deceive is fraud." *Cicone v. URS Corp.* (1986) 183 Cal.App.3d 194, 201. See *Goodman, supra,* 18 Cal.3d at pp. 346-347 and *Shafer v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2003) 107 Cal.App.4th 54, 72 [131 Cal.Rptr.2d 777].[12/]

<u>*Scenario A*</u>

In Scenario A of our Statement of Facts, although the Purchase and Sale Agreement contains a covenant not to compete, the apparent error of Buyer's Attorney limits the effectiveness of the covenant because the penalty for breach results in payment by Seller of only $1. However, Seller's Attorney has engaged in no conduct or activity that induced the apparent error. Further, under our Statement of Facts, there had been no agreement on the allocation of the purchase price to the covenant, and the Purchase and Sale Agreement does in fact contain a covenant not to compete the terms of which are consistent with the parties' mutual understanding. Under these circumstances, where Seller's Attorney has not engaged in deceit, active

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[footnote continued…]

false statement of material fact or law to a third person; or (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6."); *Ethical Guidelines for Settlement Negotiations* (August 2002), ABA Section of Litigation, at pages 56–57, ("the duty to avoid misrepresentations and misleading conduct implies a professional responsibility to correct mistakes induced by the lawyer or the lawyer's client and not to exploit such mistakes."); and *In Re Martinez* (Bankr. D. Nev. 2008) 393 B.R. 27, 35 (attorneys sanctioned for "advocating the propriety of [a] mistaken stipulation when they knew, or should have known, that the continued assertion of the validity of the stipulation, and the order entered on it, was not 'warranted by existing law.'").

[10/] "Active concealment or suppression of facts by a nonfiduciary 'is the equivalent of a false representation, i.e., actual fraud. [Citation.]'" *Vega v. Jones, Day, Reavis & Pogue* (2004) 121 Cal.App.4th 282, 291 [17 Cal.Rptr.3d 26]. See *Fox, supra,* 181 Cal.App.3d at p. 962 and 5 Witkin, Cal. Procedure (4th ed. 1997) Pleading, 678, p. 136.

[11/] If a person commits actual fraud, the fact that such person does so in the capacity of attorney does not relieve the person of liability. See: *Goodman, supra*, 18 Cal.3d at p. 346; and *Vega, supra,* 121 Cal.App.4th at p. 291 ("A fraud claim against a lawyer is no different from a fraud claim against anyone else."). Also, the fact that the other person is also an attorney makes no difference. *Cicone v. URS Corp.* (1986) 183 Cal.App.3d 194, 202 [227 Cal.Rptr. 887] ("the case law is clear that a duty is owed by an attorney not to defraud another, even if that other is an attorney negotiating at arm's length.").

[12/] See also *Vega, supra,* 121 Cal.App.4th at p. 294 ("it is established by statute 'that intentional concealment of a material fact is an alternative form of fraud and deceit equivalent to direct affirmative misrepresentation' [citations omitted] . . . . In some but not all circumstances, an independent duty to disclose is required; active concealment may exist where a party '[w]hile under no duty to speak, nevertheless does so, but does not speak honestly or makes misleading statements or suppresses facts which materially qualify those stated.'" [Fn. omitted.]); *Lovejoy v. AT&T Corp.* (2001) 92 Cal.App.4th 85, 97 [111 Cal.Rptr.2d 711]; *Stevens v. Superior Court* (1986) 180 Cal.App.3d 605, 608 [225 Cal.Rptr. 624].

concealment or fraud, we conclude that Seller's Attorney does not have an affirmative duty to disclose the apparent error to Buyer's Attorney.[13/]

Scenario B

Had Seller's Attorney intentionally created a defective "redline" to surreptitiously conceal the change to the covenant not to compete, his conduct would constitute deceit, active concealment and possibly fraud, in violation of Seller's Attorney's ethical obligations. However, in Scenario B of our Statement of Facts, Seller's Attorney *intentionally* made the change which essentially renders the covenant not to compete meaningless, but *unintentionally* provided a defective "redline" that failed to highlight for Buyer's Attorney that the change had been made. Under these circumstances, and prior to discovery of the unintentional defect, Seller's Attorney has engaged in no such unethical conduct. But once Seller's Attorney realizes his own error, we conclude that the failure to correct that error and advise Buyer's Attorney of the change might be conduct that constitutes deceit, active concealment and/or fraud, with any such determination to be based on the relevant facts and circumstances.[14/] If Seller instructs Seller's Attorney to not advise Buyer's Attorney of the change, where failure to do so would be a violation of his ethical obligations, Seller's Attorney may have to consider withdrawing.[15/]

CONCLUSION

Where an attorney has engaged in no conduct or activity that induced an apparent material error by opposing counsel, the attorney has no obligation to alert the opposing counsel of the apparent error. However, where the attorney has made a material change in contract language in such a manner that his conduct constitutes deceit, active concealment, or fraud, the failure of the attorney to alert opposing counsel of the change would be a violation of his ethical obligations.

This opinion is issued by the Standing Committee on Professional Responsibility and Conduct of the State Bar of California. It is advisory only. It is not binding upon the courts, the State Bar of California, its Board of Trustees, any persons, or tribunals charged with regulatory responsibilities, or any member of the State Bar.

[13/] We do not address whether such conduct is offensive or unprofessional – only that such conduct does not violate Seller's Attorney's ethical obligations.

[14/] Any such determination – which may depend, for example, on whether the changed provision is further negotiated and revised (thereby effectively calling Buyer's Attorney's attention to the changed language) – is beyond the scope of this opinion. See, e.g., Cal. State Bar Formal Opn. No. 1996-146 ("A lawyer acts unethically where she assists in the commission of a fraud by implying facts and circumstances that are not true in a context likely to be misleading."); cf. *Datig, supra*, 73 Cal.App.4th at pp. 980-981 (once attorney realized he had negligently misled the court, the attorney had an affirmative duty to immediately notify the court).

[15/] Subject to any ethical obligations regarding withdrawal from representation. See, e.g., rule 3-700.

THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 12-0007

ISSUE: When an attorney is engaged in negotiations on behalf of a client, what conduct constitutes permissible "puffing" and what conduct constitutes improper false statements of material fact?

DIGEST: Statements made by counsel during the course of negotiations are, generally, subject to those rules prohibiting an attorney from engaging in deceit or collusion. (See Business and Professions Code sections 6068(d) and 6128(a)). Thus, it is improper for an attorney to make false statements of material fact during the course of a negotiation. However, statements about a party's negotiating goals or willingness to compromise may include allowable "puffery" provided those statements do not contain false statements of material fact.

AUTHORITIES INTERPRETED: Rules 3-100 and 3-700(B)(2) of the Rules of Professional Conduct of the State Bar of California.[1/]

Business and Professions Code section 6068(b), (c), (d) and (e).

Business and Professions Code section 6106.

Business and Professions Code section 6128.

STATEMENT OF FACTS

Plaintiff is injured in an automobile accident and retains Attorney to sue the other driver (Defendant). As a result of the accident, Plaintiff incurs $50,000 in medical expenses and Plaintiff is no longer able to work. Prior to the accident Plaintiff was earning $50,000 per year.

Attorney files a lawsuit on Plaintiff's behalf. The parties agree to participate in a court-sponsored settlement conference that will be presided over by a local attorney volunteer. Leading up to and during the settlement conference, the following occurs:

1. In the settlement conference brief submitted on Plaintiff's behalf, Attorney asserts that he will have no difficulty proving that Defendant was texting while driving immediately prior to the accident. In that brief, Attorney references the existence of an eyewitness to the accident, asserts that the eyewitness's account is undisputed, asserts that the eyewitness specifically saw the driver texting while driving immediately prior to the accident, and asserts that the eyewitnesses' credibility is excellent. In fact, Attorney has been unable to locate any eyewitness to the accident.

2. While the attorney presiding over the settlement conference (settlement officer) is talking privately with Attorney and Plaintiff, the settlement officer asks Attorney and Plaintiff about Plaintiff's wage loss claim. Attorney tells the settlement officer that Plaintiff was earning $75,000 per year, which is $25,000 more than Plaintiff was actually earning; Attorney is aware that the settlement officer will convey this figure to Defendant, which the settlement officer does.

[1/] Unless otherwise indicated, all future references to rules in this opinion will be to the Rules of Professional Conduct of the State Bar of California.

3. While talking privately outside the presence of the settlement officer, Attorney and Plaintiff discuss Plaintiff's "bottom line" settlement number. Plaintiff advises Attorney that Plaintiff's "bottom line" settlement number is $175,000. When the settlement officer asks Attorney for Plaintiff's demand, Attorney tells the settlement officer, "Plaintiff will never settle for less than $375,000. Our demand is $1 million."

4. In response to Plaintiff's $1 million demand, Defendant's lawyer informs the settlement officer that Defendant's insurance policy limit is $50,000.

5. Defendant's lawyer also states that Defendant is prepared to litigate the matter and might simply file for bankruptcy if Defendant does not get a defense verdict. In fact, Defendant has a $500,000 insurance policy. Further, Defendant has no plans to file for bankruptcy and has never discussed doing so with his lawyer.

6. The matter does not resolve at the settlement conference, but the parties agree to participate in a follow-up settlement conference one month later, pending the exchange of additional information regarding Plaintiff's medical expenses and wage-loss claim. During that month, Attorney learns that Plaintiff has accepted an offer of employment in a new field and that Plaintiff's starting salary will be $75,000.00. Recognizing that accepting this position negatively impacts her wage loss claim, Plaintiff instructs Attorney to conceal Plaintiff's new employment at the upcoming mediation. Attorney pushes to have the follow-up settlement conference occur the day before Plaintiff starts her new job so that, "technically," Plaintiff is not working at the time of the follow-up settlement conference.

DISCUSSION

Although attorneys must advocate zealously for their clients (See *Davis v. State Bar* (1983) 33 Cal.3d 231, 238 [188 Cal.Rptr. 441]), there are limits to an attorney's conduct, as set forth in the Rules of Professional Conduct and the Business and Professions Code. With respect to the limits on an attorney's conduct while negotiating on behalf of a client, Business and Professions Code section 6068 requires, among other things, that an attorney "maintain the respect due to the courts of justice and judicial officers," "counsel or maintain those actions, proceedings, or defenses only as appear to him or her legal or just, except the defense of a person charged with a public offense," and "employ, for the purpose of maintaining the causes confided to him or her those means only as are consistent with truth, and never to seek to mislead the judge or any judicial officer by an artifice or false statement of fact or law." Business and Professions Code sections 6068(b), (c), and (d).

Furthermore, Business and Professions Code section 6128 provides that "[e]very attorney is guilty of a misdemeanor who…[i]s guilty of any deceit or collusion, or consents to any deceit or collusion, with intent to deceive the court or any party." Business and Professions Code section 6128(a).

In addition to the Business and Professions Code, the State Bar's *California Attorney Guidelines of Civility and Professionalism*[2/] specifically address an attorney's conduct when negotiating a written agreement on behalf of a client. Specifically, section 18, "Negotiation of Written Agreements" provides:

> An attorney should negotiate and conclude written agreements in a cooperative manner and with informed authority of the client.

[2/] The State Bar of California's *Attorney Guidelines of Civility and Professionalism* <http://ethics.calbar.ca.gov/LinkClick.aspx?fileticket=mPBEL3nGaFs%3d&tabid=455> are non-binding. "[T]he Guidelines are not mandatory rules of professional conduct, nor rules of practice, nor standards of care, [and] they are not to be used as an independent basis for disciplinary charges by the State Bar or claims of professional negligence."

For example:

. . .

c. An attorney should avoid negotiating tactics that are abusive; that are not made in good faith; that threaten inappropriate legal action; that are not true; that set arbitrary deadlines; that are intended solely to gain an unfair advantage or take unfair advantage of a superior bargaining position; or that do not accurately reflect the client's wishes or previous oral agreements.

d. An attorney should not participate in an action or the preparation of a document that is intended to circumvent or violate applicable laws or rules.

In addition to other applicable Sections of these Guidelines, attorneys engaged in a transactional practice have unique responsibilities because much of the practice is conducted without judicial supervision.

For example:

a. Attorneys should be mindful that their primary goals are to negotiate in a manner that accurately represents their client and the purpose for which they were retained.

b. Attorneys should successfully and timely conclude a transaction in a manner that accurately represents the parties' intentions and has the least likely potential for litigation.

See also *Coviello v. State Bar* (1955) 45 Cal.2d 57 [286 P.2d 357] (upholding a six-month suspension based on lawyer's intentional deceit of opposing counsel); *Stare v. Tate* (1971) 21 Cal.App.3d 432 [98 Cal.Rptr. 264] (the appellate court "granted reformation of the agreement to plaintiff ex-wife in conformance with her understanding of the agreement. Defendant ex-husband's attorney was aware of the mistake made by plaintiff's attorney and attempted to prevent him from discovering the mistake; therefore, under statute plaintiff was entitled to reformation"); *Monroe v. State Bar* (1961) 55 Cal.2d 145, 152 [10 Cal.Rptr. 257] (upholding a nine-month suspension because "intentionally deceiving opposing counsel is ground for disciplinary action"); *Hallinan v. State Bar* (1948) 33 Cal.2d 246 (attorney suspended for three months after "attorney admitted that he simulated a client's name on a settlement release even though he knew that the opposing counsel wanted the attorney's client to personally sign the settlement papers"). But see *Estate of Falco v. Decker* (1987) 188 Cal.App.3d 1004, 1015, fn. 11 [233 Cal.Rptr. 807] ("We refrain from determining the corollary issue of whether an attorney who is ethically prohibited from proceeding to trial in a case the attorney believes lacks merit is similarly prohibited from settling the case.").

Finally, Standard 2.7 of Title IV of the Rules of Procedure of the State Bar of California (under Title 5 Discipline of the Rules of the State Bar), relating to Standards for Attorney Sanctions for Professional Misconduct, provides that "[d]isbarment or actual suspension is appropriate for an act of moral turpitude, dishonesty, fraud, corruption or concealment of a material fact. The degree of sanction depends on the magnitude of the misconduct and the extent to which the misconduct harmed or misled the victim and related to the member's practice of law."

In addition to the applicable California authority, in 2006, the American Bar Association published ABA Formal Opn. No. 06-439, specifically addressing this issue. According to ABA Formal Opn. No. 06-439:

> Under Model Rule 4.1, in the context of a negotiation, including a caucused mediation, a lawyer representing a client may not make a false statement of material fact to a third person. However, statements regarding a party's negotiating goals or its willingness to compromise, as well as statements that can fairly be characterized as negotiation "puffing," ordinarily are not considered "false statements of material fact" within the meaning of the Model Rules.

ABA Formal Opn. No. 06-439 is based largely on ABA Model Rules of Professional Conduct, Rule 4.1,[3/] which prohibits an attorney from making "a false statement of material fact or law to a third person" and failing to "disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6."

The California Rules of Professional Conduct do not contain a corresponding rule. However, various California courts have addressed the issue in the context of intentional torts rather than attorney ethics. For example, see Cal. State Bar Formal Opn. No. 2013-189:

> [10] "Active concealment or suppression of facts by a nonfiduciary 'is the equivalent of a false representation, i.e., actual fraud. [Citation.]'" *Vega v. Jones Day, Reavis & Pogue* (2004) 121 Cal.App.4th 282, 291 [17 Cal.Rptr.3d 26]. See *Fox* [*v. Pollack*] 181 Cal.App.3d [954] at p. 962 and 5 Witkin, Cal. Procedure (4th ed. 1997) Pleading, 678, p.136.
>
> [11] If a person commits actual fraud, the fact that such person does so in the capacity of attorney does not relieve the person of liability. See: *Goodman* [*v. Kennedy* (1976)] 18 Cal.3d [335] at p. 346; *Vega, supra,* 121 Cal.App.4th at p. 291 ("A fraud claim against a lawyer is no different from a fraud claim against anyone else."). Also, the fact that the other person is also an attorney makes no difference. *Cicone v. URS Corp.* (1986) 183 Cal.App.3d 194, 202 [227 Cal.Rptr. 887] ("the case law is clear that a duty is owed by an attorney not to defraud another, even if that other is an attorney negotiating at arm's length.").
>
> [12] See also *Vega, supra,* 121 Cal.App.4th at p. 294 ("it is established by statute 'that intentional concealment of a material fact is an alternative form of fraud and deceit equivalent to direct affirmative misrepresentation' [citations omitted] . . . . In some but not all circumstances, an independent duty to disclose is required; active concealment may exist where a party '[w]hile under no duty to speak, nevertheless does so, but does not speak honestly or makes misleading statements or suppresses facts which materially qualify those stated.'" [Fn. Omitted.]); *Lovejoy v. AT&T Corp.* (2001) 92 Cal.App.4th 85, 97 [111 Cal.Rptr.2d 711]; *Stevens v. Superior Court* (1986) 180 Cal.App.3d 605, 608 [225 Cal.Rptr. 624].

In our scenario, Attorney makes two types of representations worthy of discussion here: (1) statements that constitute impermissible misrepresentations of material fact, i.e. conduct constituting fraud and deceit, upon which Attorney intends for the listener to rely; and (2) statements that constitute acceptable exaggeration or "puffing" in negotiations.

<u>Specific Examples</u>

Consider the following examples of Attorney's conduct during negotiations:

Example 1: Attorney's misrepresentations about the existence of a favorable eyewitness.

Attorney's misrepresentations about the existence of a favorable eyewitness is an improper false statement of material fact, intended to mislead Defendant and his lawyer. Attorney is making representations regarding the existence of favorable evidence for the express purpose of having Defendant rely on it.

[3/] The ABA Model Rules are not binding in California but may be used for guidance by lawyers where there is no direct California authority and the ABA Model Rules do not conflict with California policy. *City & County of San Francisco v. Cobra Solutions, Inc.* (2006) 38 Cal.4th 839, 852 [43 Cal.Rptr.3d 771]. Thus, in the absence of related California authority, we may look to the ABA Model Rules, and the ABA Opinions interpreting them, as well as the ethics opinions of other jurisdictions or bar associations for guidance. (Rule 1-100(A) ("Ethics opinions and rules and standards promulgated by other jurisdictions and bar associations may also be considered."); *State Comp. Ins. Fund v. WPS, Inc.* (1999) 70 Cal.App.4th 644, 656 [70 Cal.App.4th 644]).

Attorney's misrepresentation is not an expression of opinion, but a material representation that "a reasonable [person] would attach importance to . . . in determining his choice of action in the transaction in question . . . ." (*Charpentier v. Los Angeles Rams Football Co., Inc.* (1999) 75 Cal.App.4th 301, 312-13 [89 Cal.Rptr.2d 115], quoting section 538 of the Restatement Second of Torts).

This is consistent with Business and Professions Code section 6128(a) and Business and Professions Code section 6106, which makes any act involving moral turpitude, dishonesty or corruption a cause for disbarment or suspension.

Thus, Attorney's misrepresentations regarding the existence of a favorable eyewitness constitutes an improper false statement of a material fact and is not permissible.

Example 2: Attorney's inaccurate representations to the settlement officer (which Attorney intended be conveyed to Defendant and Defendant's lawyer) regarding Plaintiff's wage-loss claim.

Attorney's statement that the Plaintiff was earning $75,000 per year, when Plaintiff was actually earning $50,000, is an intentional misstatement of a verifiable fact. Attorney is not expressing his opinion, nor his state of mind, but rather a fact that is material to the negotiations. As with Example 1, Attorney's statement constitutes an improper false statement of a material fact and is not permissible.

Example 3: Attorney's inaccurate representation regarding Plaintiff's "bottom line" settlement number.

As explained in ABA Formal Opn. No. 06-439, statements regarding a party's negotiating goals or willingness to compromise, as well as statements that constitute mere "puffery," are not false statements of material fact and thus, do not constitute an ethical violation and are not fraudulent or deceitful. In fact, a party negotiating at arm's length should realistically expect that an adversary will not reveal its true negotiating goals or willingness to compromise.

Here, Attorney's inaccurate representation regarding the Plaintiff's "bottom line" settlement number is allowable "puffery" rather than a misrepresentation of a material fact. Attorney has not committed an ethical violation by overstating Plaintiff's "bottom line" settlement number. Moreover, Attorney revealing actual "bottom line" could be a violation of Business and Professions code section 6068(e).

Example 4: Defendant's lawyer's representation that Defendant's insurance policy is for $50,000 although it is really $500,000.

Defendant's lawyer's inaccurate representations regarding Defendant's policy limits is an intentional misrepresentation of a material fact intended to mislead Plaintiff and Attorney. See *Shafer v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2003) 107 Cal.App.4th 54, 76 [131 Cal.Rptr.2d 777] (holding that the plaintiffs "reasonably relied on the coverage representations made by counsel for an insurance company"). As with Example 1, Defendant's lawyer's intentional misrepresentation about the available policy limits is improper.

Example 5: Defendant's lawyer's representation that Defendant will litigate the matter and file for bankruptcy if there is not a defense verdict.

Whether Defendant's lawyer's representation regarding Defendant's plans to file for bankruptcy constitutes a permissible negotiating tactic will depend on the specific facts at hand. For example, if Defendant's lawyer knows that Defendant does not qualify for bankruptcy protection, threatening that Defendant intends to file in order to gain a negotiating advantage would constitute an impermissible intentional misrepresentation of a material fact intended to mislead Plaintiff and Attorney regarding Defendant's financial ability to pay. However, if Defendant's lawyer believes in good faith that bankruptcy is an available option for Defendant, even if unlikely, a statement by Defendant's lawyer that Defendant could or might consider filing for bankruptcy protection would likely be a permissible negotiating tactic, rather than a false statement of material fact.

Example 6: Plaintiff's instruction to Attorney to conceal material facts from Defendant and Defendant's lawyer prior to the follow-up settlement conference.

This example raises two issues - the failure to disclose the new employment, and Plaintiff's instruction to Attorney to not disclose the information. First, as to the underlying fact of employment itself, the failure to disclose the new employment would be a suppression of material fact that is the equivalent of a material misrepresentation, and would be improper. (*Vega v. Jones* (2004) 121 Cal.App.4th 282, 291 [17 Cal.Rptr.3d 26].) The parties specifically agreed to participate in a follow-up settlement conference pending exchange of specific information, including that involving the wage-loss claim. Unquestionably, the wage loss claim is at the heart of the follow up negotiations, and is therefore material. Even if Plaintiff is technically not employed on the date of the mediation, the wage-loss claim is one that assumes wage losses going forward, and any representation of such a loss that does not disclose the $75,000 new employment would be a false representation regarding the extent of the losses.

Second, Attorney was specifically instructed by Plaintiff, his client, not to make the disclosure. That instruction, conveyed by a client to his attorney, is a confidential communication that Attorney is obligated to protect under rule 3-100 and Business and Professions Code section 6068(e). See also Cal. Evidence Code sections 952, 954, 955. While Attorney is generally required to follow his client's instructions, Attorney must counsel his client that Attorney cannot take part in a misrepresentation and/or suppression of evidence. (Cal. State Bar Formal Opn. No. 2013-189,[4/] see also Los Angeles County Bar Assn. Formal Opn. 520).

CONCLUSION

Attorneys are prohibited from making false statements of material fact, including during the course of negotiating with a third-party. However, attorneys may engage in permissible "puffery" during negotiations; "puffery" may include statements regarding a client's negotiation goals or willingness to compromise. Engaging in "puffery" during negotiations does not constitute making a false statement of material fact.

*[**Publisher's Note:** Internet resources cited in this opinion were last accessed by staff on February 14, 2014. A copy of these resources are on file with the State Bar's Office of Professional Competence.]*

[4/] Cal. State Bar Formal Opn. No. 2013-189 contains a full discussion regarding an attorney's ethical obligations when a client instructs his or her attorney to conceal material facts from the opposing party and/or opposing counsel. As addressed more fully in that opinion, an attorney should first counsel his or her client regarding the client's request and, if the client refuses to reconsider, the attorney may be obligated to withdraw his or her representation, pursuant to rule 3-700(B)(2).

Cooking the Settlement

BY RICHARD D. HENDLIN AND LUIS E. VENTURA

Straying Outside the Recipe for Permissible Negotiation Strategies

Attracted by the For Sale sign, Tom J. Efferson walks into the Cajun restaurant, Louisiana, to discuss its purchase from Nap O. Leon. Leon invites Efferson to inspect the restaurant. In moving an old stove, Efferson discovers what appears to be a trove of amazing Cajun recipes, which he concludes will make for a fantastic cookbook. He makes no mention of them to Leon, returns the recipes to their location and moves the stove back into place.

A few days later, Efferson has his lawyer, John Adams, communicate a $200,000 offer to Leon. Leon asks his attorney, John Hancock, to handle negotiations and to make a counteroffer of $500,000, which he does in inordinately large penmanship. Adams makes a counteroffer of $275,000, stating that this is the maximum Efferson will pay. Unbeknownst to Hancock, Efferson had authorized Adams to agree to as much as $400,000 for Louisiana because of the anticipated profit from publishing the recipes, the existence of which neither has disclosed.

Leon is incensed by the $275,000 offer and instructs Hancock to inform Adams that the king of Spain has offered $325,000, even though there have been no discussions with the king (other than the normal Friday evening takeout order of jambalaya). Induced by this

Unbeknownst to Hancock, Efferson had authorized Adams to agree to as much as $400,000 for Louisiana because of the anticipated profit from publishing the recipes, the existence of which neither has disclosed.

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false outside offer, Efferson instructs Adams to make a $315,000 counteroffer, which Leon accepts.

Adams drafts the purchase agreement but mistakenly types in $325,000 instead of $315,000. Hancock and Leon notice the error but say nothing. When Adams receives the fully signed agreement, he notices the mistake and calls Hancock. Hancock states that the agreed price was $325,000 and that "a written deal is a written deal." Efferson sues for reformation of the agreement.

Judge Ben Franklin hears a settlement conference during which Hancock states to the judge that the agreed price was $325,000. He nonetheless offers to settle at $320,000. Adams responds that he only has authority for the agreed price of $315,000. After further talks, the case settles at $317,000.

With the use of his special bifocal ethics glasses, which he invented, Judge Franklin looks into the past and sees the events and posturing that has taken place. He holds a special meeting with the two attorneys. "The both of you have committed some potentially serious ethics violations during negotiation," he says. The attorneys are shocked. "Mr. Adams, you made some potentially material misrepresentations and omissions during purchase negotiations. Not only did you fail to mention the Cajun recipes, you also stated to Hancock that $275,000 was the most Efferson would pay. Then in the judicial settlement conference, you stated to me that your settlement authority was $315,000. However, you had been given authority for up to $400,000."

"Wait a minute," responds Adams. "These comments are fair play in negotiations."

"Do not be so certain," says Franklin. "ABA Model Rule 4.1(a) prohibits lawyers from knowingly making false statements of material fact or law to third persons. The rule acknowledges that certain types of statements, such as estimates of price or a party's intentions as to an acceptable settlement, are ordinarily not considered statements of material fact." (See ABA Formal Op. 06-439, "Lawyer's Obligation of Truthfulness When Representing a Client in Negotiation: Application to Caucused Mediation," pp. 1, 6.)

"However, a party's actual bottom line or the lawyer's settlement authority are consider material facts and certainly cannot be misrepresented to a judge," he added. (Id. at p. 4; Calif. Rule of Prof. Conduct 5-200(B) [prohibition against misleading judge and making false statements of fact].) "You can, of course, respectfully decline to disclose such information.

"You, Mr. Hancock, fare no better. Despite knowing that the agreement contained a mistake and that the agreed price was $315,000, you repeatedly stated that it was $325,000. Such an error is certainly grounds for reformation," says Franklin, (Stare v. Tate (1971) 21 Cal.App.3d 432), "and your statements are misrepresentations of fact and not permissible settlement posturing. You also fabricated the offer from the king of Spain, and such false negotiation tactics may be grounds for actionable fraud" (Beavers v. Lamplighters Realty Inc. (Okla.Ct.App. 1976) 556 P.2d 1328).

"But the ABA Model Rules are not binding in California," Hancock interjects.

"This is true," says Franklin. "However, the rules of ethics in California are found not only in the Rules of Professional Conduct and the Business and Professions Code, but they are also adopted as common law rules developed through case law. Our courts often look to the ABA Model Rules as appropriate sources to fashion rules of ethics." (See, e.g., City and County of San Francisco v. Cobra Solutions Inc. (2006) 38 Cal.4th 839, 852.) "Consequently, one cannot consider the ABA Model Rules and ABA Formal Opinions as irrelevant. I strongly suggest you do not ignore them." ■

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The rules of ethics in California are found not only in the Rules of Professional Conduct and the Business and Professions Code, but they are also adopted as common law rules developed through case law.

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TAB 5

California Rules of Professional Conduct

CALIFORNIA RULES OF PROFESSIONAL CONDUCT

(Current rules as of January 1, 2015. The operative dates of select rule amendments are shown at the end of relevant rules.)

CHAPTER 1.
PROFESSIONAL INTEGRITY IN GENERAL

Rule 1-100 Rules of Professional Conduct, in General

(A) Purpose and Function.

The following rules are intended to regulate professional conduct of members of the State Bar through discipline. They have been adopted by the Board of Governors of the State Bar of California and approved by the Supreme Court of California pursuant to Business and Professions Code sections 6076 and 6077 to protect the public and to promote respect and confidence in the legal profession. These rules together with any standards adopted by the Board of Governors pursuant to these rules shall be binding upon all members of the State Bar.

For a willful breach of any of these rules, the Board of Governors has the power to discipline members as provided by law.

The prohibition of certain conduct in these rules is not exclusive. Members are also bound by applicable law including the State Bar Act (Bus. & Prof. Code, §6000 et seq.) and opinions of California courts. Although not binding, opinions of ethics committees in California should be consulted by members for guidance on proper professional conduct. Ethics opinions and rules and standards promulgated by other jurisdictions and bar associations may also be considered.

These rules are not intended to create new civil causes of action. Nothing in these rules shall be deemed to create, augment, diminish, or eliminate any substantive legal duty of lawyers or the non-disciplinary consequences of violating such a duty.

(B) Definitions.

(1) "Law Firm" means:

(a) two or more lawyers whose activities constitute the practice of law, and who share its profits, expenses, and liabilities; or

(b) a law corporation which employs more than one lawyer; or

(c) a division, department, office, or group within a business entity, which includes more than one lawyer who performs legal services for the business entity; or

(d) a publicly funded entity which employs more than one lawyer to perform legal services.

(2) "Member" means a member of the State Bar of California.

(3) "Lawyer" means a member of the State Bar of California or a person who is admitted in good standing of and eligible to practice before the bar of any United States court or the highest court of the District of Columbia or any state, territory, or insular possession of the United States, or is licensed to practice law in, or is admitted in good standing and eligible to practice before the bar of the highest court of, a foreign country or any political subdivision thereof.

(4) "Associate" means an employee or fellow employee who is employed as a lawyer.

(5) "Shareholder" means a shareholder in a professional corporation pursuant to Business and Professions Code section 6160 et seq.

(C) Purpose of Discussions.

Because it is a practical impossibility to convey in black letter form all of the nuances of these disciplinary rules, the comments contained in the Discussions of the rules, while they do not add independent basis for imposing discipline, are intended to provide guidance for interpreting the rules and practicing in compliance with them.

(D) Geographic Scope of Rules.

(1) As to members:

These rules shall govern the activities of members in and outside this state, except as members lawfully practicing outside this state may be specifically required by a jurisdiction in which they are practicing to follow rules of professional conduct different from these rules.

(2) As to lawyers from other jurisdictions who are not members:

These rules shall also govern the activities of lawyers while engaged in the performance of lawyer functions in this state; but nothing contained in these rules shall be deemed to authorize the performance of such functions by such persons in this state except as otherwise permitted by law.

(E) These rules may be cited and referred to as "Rules of Professional Conduct of the State Bar of California."

Discussion:

The Rules of Professional Conduct are intended to establish the standards for members for purposes of discipline. (See *Ames v. State Bar* (1973) 8 Cal.3d 910 [106 Cal.Rptr. 489].) The fact that a member has engaged in conduct that may be contrary to these rules does not automatically give rise to a civil cause of action. (See *Noble v. Sears, Roebuck & Co.* (1973) 33 Cal.App.3d 654 [109 Cal.Rptr. 269]; *Wilhelm v. Pray, Price, Williams & Russell* (1986) 186 Cal.App.3d 1324 [231 Cal.Rptr. 355].) These rules are not intended to supercede existing law relating to members in non-disciplinary contexts. (See, e.g., *Klemm v. Superior Court* (1977) 75 Cal.App.3d 893 [142 Cal.Rptr. 509] (motion for disqualification of counsel due to a conflict of interest); *Academy of California Optometrists, Inc. v. Superior Court* (1975) 51 Cal.App.3d 999 [124 Cal.Rptr. 668] (duty to return client files); *Chronometrics, Inc. v. Sysgen, Inc.* (1980) 110 Cal.App.3d 597 [168 Cal.Rptr. 196] (disqualification of member appropriate remedy for improper communication with adverse party).)

Law firm, as defined by subparagraph (B)(1), is not intended to include an association of lawyers who do not share profits, expenses, and liabilities. The subparagraph is not intended to imply that a law firm may include a person who is not a member in violation of the law governing the unauthorized practice of law. (Amended by order of the Supreme Court, operative September 14, 1992.)

[***Publisher's Note re Rule 1-100(A):*** *Operative January 1, 2012, Business and Professions Code section 6010, in part, provides that the State Bar is governed by a board known as the board of trustees of the State Bar and that any provision of law referring to the "board of governors" shall be deemed to refer to the "board of trustees." In accordance with this law, references to the "board of governors" included in the current Rules of Professional Conduct are deemed to refer to the "board of trustees."*]

Rule 1-110 Disciplinary Authority of the State Bar

A member shall comply with conditions attached to public or private reprovals or other discipline administered by the State Bar pursuant to Business and Professions Code sections 6077 and 6078 and rule 9.19, California Rules of Court. (Amended by order of the Supreme Court, operative July 11, 2008.)

Rule 1-120 Assisting, Soliciting, or Inducing Violations

A member shall not knowingly assist in, solicit, or induce any violation of these rules or the State Bar Act.

Rule 1-200 False Statement Regarding Admission to the State Bar

(A) A member shall not knowingly make a false statement regarding a material fact or knowingly fail to disclose a material fact in connection with an application for admission to the State Bar.

(B) A member shall not further an application for admission to the State Bar of a person whom the member knows to be unqualified in respect to character, education, or other relevant attributes.

(C) This rule shall not prevent a member from serving as counsel of record for an applicant for admission to practice in proceedings related to such admission.

Discussion:

For purposes of rule 1-200 "admission" includes readmission.

Rule 1-300 Unauthorized Practice of Law

(A) A member shall not aid any person or entity in the unauthorized practice of law.

(B) A member shall not practice law in a jurisdiction where to do so would be in violation of regulations of the profession in that jurisdiction.

Rule 1-310 Forming a Partnership With a Non-Lawyer

A member shall not form a partnership with a person who is not a lawyer if any of the activities of that partnership consist of the practice of law.

Discussion:

Rule 1-310 is not intended to govern members' activities which cannot be considered to constitute the practice of law. It is intended solely to preclude a member from being involved in the practice of law with a person who is not a lawyer. (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 1-311 Employment of Disbarred, Suspended, Resigned, or Involuntarily Inactive Member

(A) For purposes of this rule:

(1) "Employ" means to engage the services of another, including employees, agents, independent contractors and consultants, regardless of whether any compensation is paid;

(2) "Involuntarily inactive member" means a member who is ineligible to practice law as a result of action taken pursuant to Business and Professions Code sections 6007, 6203(c), or California Rule of Court 9.31; and

(3) "Resigned member" means a member who has resigned from the State Bar while disciplinary charges are pending.

(B) A member shall not employ, associate professionally with, or aid a person the member knows or reasonably should know is a disbarred, suspended, resigned, or involuntarily inactive member to perform the following on behalf of the member's client:

(1) Render legal consultation or advice to the client;

(2) Appear on behalf of a client in any hearing or proceeding or before any judicial officer, arbitrator, mediator, court, public agency, referee, magistrate, commissioner, or hearing officer;

(3) Appear as a representative of the client at a deposition or other discovery matter;

(4) Negotiate or transact any matter for or on behalf of the client with third parties;

(5) Receive, disburse or otherwise handle the client's funds; or

(6) Engage in activities which constitute the practice of law.

(C) A member may employ, associate professionally with, or aid a disbarred, suspended, resigned, or involuntarily inactive member to perform research, drafting or clerical activities, including but not limited to:

(1) Legal work of a preparatory nature, such as legal research, the assemblage of data and other necessary information, drafting of pleadings, briefs, and other similar documents;

(2) Direct communication with the client or third parties regarding matters such as scheduling, billing, updates, confirmation of receipt or sending of correspondence and messages; or

(3) Accompanying an active member in attending a deposition or other discovery matter for the limited purpose of providing clerical assistance to the active member who will appear as the representative of the client.

(D) Prior to or at the time of employing a person the member knows or reasonably should know is a disbarred, suspended, resigned, or involuntarily inactive member, the member shall serve upon the State Bar written notice of the employment, including a full description of such person's current bar status. The written notice shall also list the activities prohibited in paragraph (B) and state that the disbarred, suspended, resigned, or involuntarily inactive member will not perform such activities. The member shall serve similar written notice upon each client on whose specific matter such person will work, prior to or at the time of employing such person to work on the client's specific matter. The

member shall obtain proof of service of the client's written notice and shall retain such proof and a true and correct copy of the client's written notice for two years following termination of the member's employment with the client.

(E) A member may, without client or State Bar notification, employ a disbarred, suspended, resigned, or involuntarily inactive member whose sole function is to perform office physical plant or equipment maintenance, courier or delivery services, catering, reception, typing or transcription, or other similar support activities.

(F) Upon termination of the disbarred, suspended, resigned, or involuntarily inactive member, the member shall promptly serve upon the State Bar written notice of the termination.

Discussion:

For discussion of the activities that constitute the practice of law, see *Farnham v. State Bar* (1976) 17 Cal.3d 605 [131 Cal.Rptr. 611]; *Bluestein v. State Bar* (1974) 13 Cal.3d 162 [118 Cal.Rptr. 175]; *Baron v. City of Los Angeles* (1970) 2 Cal.3d 535 [86 Cal.Rptr. 673]; *Crawford v. State Bar* (1960) 54 Cal.2d 659 [7 Cal.Rptr. 746]; *People v. Merchants Protective Corporation* (1922) 189 Cal. 531, 535 [209 P. 363]; *People v. Landlords Professional Services* (1989) 215 Cal.App.3d 1599 [264 Cal.Rptr. 548]; and *People v. Sipper* (1943) 61 Cal.App.2d Supp. 844 [142 P.2d 960].)

Paragraph (D) is not intended to prevent or discourage a member from fully discussing with the client the activities that will be performed by the disbarred, suspended, resigned, or involuntarily inactive member on the client's matter. If a member's client is an organization, then the written notice required by paragraph (D) shall be served upon the highest authorized officer, employee, or constituent overseeing the particular engagement. (See rule 3-600.)

Nothing in rule 1-311 shall be deemed to limit or preclude any activity engaged in pursuant to rules 9.40, 9.41, 9.42, and 9.44 of the California Rules of Court, or any local rule of a federal district court concerning admission *pro hac vice*. (Added by Order of Supreme Court, operative August 1, 1996. Amended by order of the Supreme Court, operative July 11, 2008.)

Rule 1-320 Financial Arrangements With Non-Lawyers

(A) Neither a member nor a law firm shall directly or indirectly share legal fees with a person who is not a lawyer, except that:

(1) An agreement between a member and a law firm, partner, or associate may provide for the payment of money after the member's death to the member's estate or to one or more specified persons over a reasonable period of time; or

(2) A member or law firm undertaking to complete unfinished legal business of a deceased member may pay to the estate of the deceased member or other person legally entitled thereto that proportion of the total compensation which fairly represents the services rendered by the deceased member; or

(3) A member or law firm may include non-member employees in a compensation, profit-sharing, or retirement plan even though the plan is based in whole or in part on a profit-sharing arrangement, if such plan does not circumvent these rules or Business and Professions Code section 6000 et seq.; or

(4) A member may pay a prescribed registration, referral, or participation fee to a lawyer referral service established, sponsored, and operated in accordance with the State Bar of California's Minimum Standards for a Lawyer Referral Service in California.

(B) A member shall not compensate, give, or promise anything of value to any person or entity for the purpose of recommending or securing employment of the member or the member's law firm by a client, or as a reward for having made a recommendation resulting in employment of the member or the member's law firm by a client. A member's offering of or giving a gift or gratuity to any person or entity having made a recommendation resulting in the employment of the member or the member's law firm shall not of itself violate this rule, provided that the gift or gratuity was not offered or given in consideration of any promise, agreement, or understanding that such a gift or gratuity would be forthcoming or that referrals would be made or encouraged in the future.

(C) A member shall not compensate, give, or promise anything of value to any representative of the press, radio, television, or other communication medium in anticipation of or in return for publicity of the member, the law firm, or any other member as such in a news item, but the incidental provision of food or beverage shall not of itself violate this rule.

Discussion:

Rule 1-320(C) is not intended to preclude compensation to the communications media in exchange for advertising the member's or law firm's availability for professional employment. (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 1-400 Advertising and Solicitation

(A) For purposes of this rule, "communication" means any message or offer made by or on behalf of a member concerning the availability for professional employment of a member or a law firm directed to any former, present, or prospective client, including but not limited to the following:

(1) Any use of firm name, trade name, fictitious name, or other professional designation of such member or law firm; or

(2) Any stationery, letterhead, business card, sign, brochure, or other comparable written material describing such member, law firm, or lawyers; or

(3) Any advertisement (regardless of medium) of such member or law firm directed to the general public or any substantial portion thereof; or

(4) Any unsolicited correspondence from a member or law firm directed to any person or entity.

(B) For purposes of this rule, a "solicitation" means any communication:

(1) Concerning the availability for professional employment of a member or a law firm in which a significant motive is pecuniary gain; and

(2) Which is:

(a) delivered in person or by telephone, or

(b) directed by any means to a person known to the sender to be represented by counsel in a matter which is a subject of the communication.

(C) A solicitation shall not be made by or on behalf of a member or law firm to a prospective client with whom the member or law firm has no family or prior professional relationship, unless the solicitation is protected from abridgment by the Constitution of the United States or by the Constitution of the State of California. A solicitation to a former or present client in the discharge of a member's or law firm's professional duties is not prohibited.

(D) A communication or a solicitation (as defined herein) shall not:

(1) Contain any untrue statement; or

(2) Contain any matter, or present or arrange any matter in a manner or format which is false, deceptive, or which tends to confuse, deceive, or mislead the public; or

(3) Omit to state any fact necessary to make the statements made, in the light of circumstances under which they are made, not misleading to the public; or

(4) Fail to indicate clearly, expressly, or by context, that it is a communication or solicitation, as the case may be; or

(5) Be transmitted in any manner which involves intrusion, coercion, duress, compulsion, intimidation, threats, or vexatious or harassing conduct.

(6) State that a member is a "certified specialist" unless the member holds a current certificate as a specialist issued by the Board of Legal Specialization, or any other entity accredited by the State Bar to designate specialists pursuant to standards adopted by the Board of Governors, and states the complete name of the entity which granted certification.

(E) The Board of Governors of the State Bar shall formulate and adopt standards as to communications which will be presumed to violate this rule 1-400. The standards shall only be used as presumptions affecting the burden of proof in disciplinary proceedings involving alleged violations of these rules. "Presumption affecting the burden of proof"

means that presumption defined in Evidence Code sections 605 and 606. Such standards formulated and adopted by the Board, as from time to time amended, shall be effective and binding on all members.

(F) A member shall retain for two years a true and correct copy or recording of any communication made by written or electronic media. Upon written request, the member shall make any such copy or recording available to the State Bar, and, if requested, shall provide to the State Bar evidence to support any factual or objective claim contained in the communication.

[***Publisher's Note****: Former rule 1-400(D)(6) repealed by order of the Supreme Court effective November 30, 1992. New rule 1-400(D)(6) added by order of the Supreme Court effective June 1, 1997.*]

Standards:

Pursuant to rule 1-400(E) the Board has adopted the following standards, effective May 27, 1989, unless noted otherwise, as forms of "communication" defined in rule 1-400(A) which are presumed to be in violation of rule 1-400:

(1) A "communication" which contains guarantees, warranties, or predictions regarding the result of the representation.

(2) A "communication" which contains testimonials about or endorsements of a member unless such communication also contains an express disclaimer such as "this testimonial or endorsement does not constitute a guarantee, warranty, or prediction regarding the outcome of your legal matter."

(3) A "communication" which is delivered to a potential client whom the member knows or should reasonably know is in such a physical, emotional, or mental state that he or she would not be expected to exercise reasonable judgment as to the retention of counsel.

(4) A "communication" which is transmitted at the scene of an accident or at or en route to a hospital, emergency care center, or other health care facility.

(5) A "communication," except professional announcements, seeking professional employment for pecuniary gain, which is transmitted by mail or equivalent means which does not bear the word "Advertisement," "Newsletter" or words of similar import in 12 point print on the first page. If such communication, including firm brochures, newsletters, recent legal development advisories, and similar materials, is transmitted in an envelope, the envelope shall bear the word "Advertisement," "Newsletter" or words of similar import on the outside thereof.

(6) A "communication" in the form of a firm name, trade name, fictitious name, or other professional designation which states or implies a relationship between any member in private practice and a government agency or instrumentality or a public or non-profit legal services organization.

(7) A "communication" in the form of a firm name, trade name, fictitious name, or other professional designation which states or implies that a member has a relationship to any other lawyer or a law firm as a partner or associate, or officer or shareholder pursuant to Business and Professions Code sections 6160-6172 unless such relationship in fact exists.

(8) A "communication" which states or implies that a member or law firm is "of counsel" to another lawyer or a law firm unless the former has a relationship with the latter (other than as a partner or associate, or officer or shareholder pursuant to Business and Professions Code sections 6160-6172) which is close, personal, continuous, and regular.

(9) A "communication" in the form of a firm name, trade name, fictitious name, or other professional designation used by a member or law firm in private practice which differs materially from any other such designation used by such member or law firm at the same time in the same community.

(10) A "communication" which implies that the member or law firm is participating in a lawyer referral service which has been certified by the State Bar of California or as having satisfied the Minimum Standards for Lawyer Referral Services in California, when that is not the case.

(11) (Repealed. See rule 1-400(D)(6) for the operative language on this subject.)

(12) A "communication," except professional announcements, in the form of an advertisement primarily directed to seeking professional employment primarily for pecuniary gain transmitted to the general public or any substantial portion thereof by mail or equivalent means or by means of television, radio, newspaper, magazine or other form of commercial mass media which does not state the name of the member responsible for the communication. When the communication is made on behalf of a law firm, the communication shall state the name of at least one member responsible for it.

(13) A "communication" which contains a dramatization unless such communication contains a disclaimer which states "this is a dramatization" or words of similar import.

(14) A "communication" which states or implies "no fee without recovery" unless such communication also expressly discloses whether or not the client will be liable for costs.

(15) A "communication" which states or implies that a member is able to provide legal services in a language other than English unless the member can actually provide legal services in such language or the communication also states in the language of the communication (a) the employment title of the person who speaks such language and (b) that the person is not a member of the State Bar of California, if that is the case.

(16) An unsolicited "communication" transmitted to the general public or any substantial portion thereof primarily directed to seeking professional employment primarily for pecuniary gain which sets forth a specific fee or range of fees for a particular service where, in fact, the member charges a greater fee than advertised in such communication within a period of 90 days following dissemination of such communication, unless such communication expressly specifies a shorter period of time regarding the advertised fee. Where the communication is published in the classified or "yellow pages" section of telephone, business or legal directories or in other media not published more frequently than once a year, the member shall conform to the advertised fee for a period of one year from initial publication, unless such communication expressly specifies a shorter period of time regarding the advertised fee. (Amended by order of Supreme Court, operative September 14, 1992. Standard (5) amended by the Board, effective May 11, 1994. Standards (12) - (16) added by the Board, effective May 11, 1994. Standard (11) repealed June 1, 1997)

[***Publisher's Note re Rule 1-400(D)(6) and (E):*** *Operative January 1, 2012, Business and Professions Code section 6010, in part, provides that the State Bar is governed by a board known as the board of trustees of the State Bar and that any provision of law referring to the "board of governors" shall be deemed to refer to the "board of trustees." In accordance with this law, references to the "board of governors" included in the current Rules of Professional Conduct are deemed to refer to the "board of trustees."*]

Rule 1-500 Agreements Restricting a Member's Practice

(A) A member shall not be a party to or participate in offering or making an agreement, whether in connection with the settlement of a lawsuit or otherwise, if the agreement restricts the right of a member to practice law, except that this rule shall not prohibit such an agreement which:

(1) Is a part of an employment, shareholders', or partnership agreement among members provided the restrictive agreement does not survive the termination of the employment, shareholder, or partnership relationship; or

(2) Requires payments to a member upon the member's retirement from the practice of law; or

(3) Is authorized by Business and Professions Code sections 6092.5 subdivision (i), or 6093.

(B) A member shall not be a party to or participate in offering or making an agreement which precludes the reporting of a violation of these rules.

Discussion:

Paragraph (A) makes it clear that the practice, in connection with settlement agreements, of proposing that a member refrain from representing other clients in similar litigation, is prohibited. Neither counsel may demand or suggest such provisions nor may opposing counsel accede or agree to such provisions.

Paragraph (A) permits a restrictive covenant in a law corporation, partnership, or employment agreement. The law corporation shareholder, partner, or associate may agree not to have a separate practice during the existence of the relationship; however, upon termination of the relationship (whether voluntary or involuntary), the member is free to practice law without any contractual restriction except in the case of retirement from the active practice of law. (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 1-600 Legal Service Programs

(A) A member shall not participate in a nongovernmental program, activity, or organization furnishing, recommending, or paying for legal services, which allows any third person or organization to interfere with the member's independence of professional judgment, or with the client-lawyer relationship, or allows unlicensed persons to practice law, or allows any third person or organization to receive directly or indirectly any part of the consideration paid to the member except as permitted by these rules, or otherwise violates the State Bar Act or these rules.

(B) The Board of Governors of the State Bar shall formulate and adopt Minimum Standards for Lawyer Referral Services, which, as from time to time amended, shall be binding on members.

Discussion:

The participation of a member in a lawyer referral service established, sponsored, supervised, and operated in conformity with the Minimum Standards for a Lawyer Referral Service in California is encouraged and is not, of itself, a violation of these rules.

Rule 1-600 is not intended to override any contractual agreement or relationship between insurers and insureds regarding the provision of legal services.

Rule 1-600 is not intended to apply to the activities of a public agency responsible for providing legal services to a government or to the public.

For purposes of paragraph (A), "a nongovernmental program, activity, or organization" includes, but is not limited to group, prepaid, and voluntary legal service programs, activities, or organizations.

[***Publisher's Note re Rule 1-600(B):*** *Operative January 1, 2012, Business and Professions Code section 6010, in part, provides that the State Bar is governed by a board known as the board of trustees of the State Bar and that any provision of law referring to the "board of governors" shall be deemed to refer to the "board of trustees." In accordance with this law, references to the "board of governors" included in the current Rules of Professional Conduct are deemed to refer to the "board of trustees."*]

Rule 1-650 Limited Legal Services Programs

(A) A member who, under the auspices of a program sponsored by a court, government agency, bar association, law school, or nonprofit organization, provides short-term limited legal services to a client without expectation by either the member or the client that the member will provide continuing representation in the matter:

(1) is subject to rule 3-310 only if the member knows that the representation of the client involves a conflict of interest; and

(2) has an imputed conflict of interest only if the member knows that another lawyer associated with the member in a law firm would have a conflict of interest under rule 3-310 with respect to the matter.

(B) Except as provided in paragraph (A)(2), a conflict of interest that arises from a member's participation in a program under paragraph (A) will not be imputed to the member's law firm.

(C) The personal disqualification of a lawyer participating in the program will not be imputed to other lawyers participating in the program.

Discussion:

[1] Courts, government agencies, bar associations, law schools and various nonprofit organizations have established programs through which lawyers provide short-term limited legal services – such as advice or the completion of legal forms – that will assist persons in addressing their legal problems without further representation by a lawyer. In these programs, such as legal-advice hotlines, advice-only clinics or pro se counseling programs, whenever a lawyer-client relationship is established, there is no expectation that the lawyer's representation of the client will continue

beyond that limited consultation. Such programs are normally operated under circumstances in which it is not feasible for a lawyer to systematically screen for conflicts of interest as is generally required before undertaking a representation.

[2] A member who provides short-term limited legal services pursuant to rule 1-650 must secure the client's informed consent to the limited scope of the representation. If a short-term limited representation would not be reasonable under the circumstances, the member may offer advice to the client but must also advise the client of the need for further assistance of counsel. See rule 3-110. Except as provided in this rule 1-650, the Rules of Professional Conduct and the State Bar Act, including the member's duty of confidentiality under Business and Professions Code § 6068(e)(1), are applicable to the limited representation.

[3] A member who is representing a client in the circumstances addressed by rule 1-650 ordinarily is not able to check systematically for conflicts of interest. Therefore, paragraph (A)(1) requires compliance with rule 3-310 only if the member knows that the representation presents a conflict of interest for the member. In addition, paragraph (A)(2) imputes conflicts of interest to the member only if the member knows that another lawyer in the member's law firm would be disqualified under rule 3-310.

[4] Because the limited nature of the services significantly reduces the risk of conflicts of interest with other matters being handled by the member's law firm, paragraph (B) provides that imputed conflicts of interest are inapplicable to a representation governed by this rule except as provided by paragraph (A)(2). Paragraph (A)(2) imputes conflicts of interest to the participating member when the member knows that any lawyer in the member's firm would be disqualified under rule 3-310. By virtue of paragraph (B), moreover, a member's participation in a short-term limited legal services program will not be imputed to the member's law firm or preclude the member's law firm from undertaking or continuing the representation of a client with interests adverse to a client being represented under the program's auspices. Nor will the personal disqualification of a lawyer participating in the program be imputed to other lawyers participating in the program.

[5] If, after commencing a short-term limited representation in accordance with rule 1-650, a member undertakes to represent the client in the matter on an ongoing basis, rule 3-310 and all other rules become applicable. (Added by order of the Supreme Court, operative August 28, 2009.)

Rule 1-700 Member as Candidate for Judicial Office

(A) A member who is a candidate for judicial office in California shall comply with Canon 5 of the Code of Judicial Ethics.

(B) For purposes of this rule, "candidate for judicial office" means a member seeking judicial office by election. The determination of when a member is a candidate for judicial office is defined in the terminology section of the California Code of Judicial Ethics. A member's duty to comply with paragraph (A) shall end when the member announces withdrawal of the member's candidacy or when the results of the election are final, whichever occurs first.

Discussion:

Nothing in rule 1-700 shall be deemed to limit the applicability of any other rule or law. (Added by order of the Supreme Court, operative November 21, 1997.)

Rule 1-710 Member as Temporary Judge, Referee, or Court-Appointed Arbitrator

A member who is serving as a temporary judge, referee, or court-appointed arbitrator, and is subject under the Code of Judicial Ethics to Canon 6D, shall comply with the terms of that canon.

Discussion:

This rule is intended to permit the State Bar to discipline members who violate applicable portions of the Code of Judicial Ethics while acting in a judicial capacity pursuant to an order or appointment by a court.

Nothing in rule 1-710 shall be deemed to limit the applicability of any other rule or law. (Added by order of the Supreme Court, operative March 18, 1999.)

[***Publisher's Note:*** *The California Code of Judicial Ethics is available on-line at the official website of the California Courts located at www.courts.ca.gov. Navigate to the "Forms & Rules" area of the website and select "California Code of Judicial Ethics" under the "Related Links" box.*]

CHAPTER 2.
RELATIONSHIP AMONG MEMBERS

Rule 2-100 Communication With a Represented Party

(A) While representing a client, a member shall not communicate directly or indirectly about the subject of the representation with a party the member knows to be represented by another lawyer in the matter, unless the member has the consent of the other lawyer.

(B) For purposes of this rule, a "party" includes:

(1) An officer, director, or managing agent of a corporation or association, and a partner or managing agent of a partnership; or

(2) An association member or an employee of an association, corporation, or partnership, if the subject of the communication is any act or omission of such person in connection with the matter which may be binding upon or imputed to the organization for purposes of civil or criminal liability or whose statement may constitute an admission on the part of the organization.

(C) This rule shall not prohibit:

(1) Communications with a public officer, board, committee, or body; or

(2) Communications initiated by a party seeking advice or representation from an independent lawyer of the party's choice; or

(3) Communications otherwise authorized by law.

Discussion:

Rule 2-100 is intended to control communications between a member and persons the member knows to be represented by counsel unless a statutory scheme or case law will override the rule. There are a number of express statutory schemes which authorize communications between a member and person who would otherwise be subject to this rule. These statutes protect a variety of other rights such as the right of employees to organize and to engage in collective bargaining, employee health and safety, or equal employment opportunity. Other applicable law also includes the authority of government prosecutors and investigators to conduct criminal investigations, as limited by the relevant decisional law.

Rule 2-100 is not intended to prevent the parties themselves from communicating with respect to the subject matter of the representation, and nothing in the rule prevents a member from advising the client that such communication can be made. Moreover, the rule does not prohibit a member who is also a party to a legal matter from directly or indirectly communicating on his or her own behalf with a represented party. Such a member has independent rights as a party which should not be abrogated because of his or her professional status. To prevent any possible abuse in such situations, the counsel for the opposing party may advise that party (1) about the risks and benefits of communications with a lawyer-party, and (2) not to accept or engage in communications with the lawyer-party.

Rule 2-100 also addresses the situation in which member A is contacted by an opposing party who is represented and, because of dissatisfaction with that party's counsel, seeks A's independent advice. Since A is employed by the opposition, the member cannot give independent advice.

As used in paragraph (A), "the subject of the representation," "matter," and "party" are not limited to a litigation context.

Paragraph (B) is intended to apply only to persons employed at the time of the communication. (See *Triple A Machine Shop, Inc. v. State of California* (1989) 213 Cal.App.3d 131 [261 Cal.Rptr. 493].)

Subparagraph (C)(2) is intended to permit a member to communicate with a party seeking to hire new counsel or to obtain a second opinion. A member contacted by such a party continues to be bound by other Rules of Professional Conduct. (See, e.g., rules 1-400 and 3-310.) (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 2-200 Financial Arrangements Among Lawyers

(A) A member shall not divide a fee for legal services with a lawyer who is not a partner of, associate of, or shareholder with the member unless:

(1) The client has consented in writing thereto after a full disclosure has been made in writing

that a division of fees will be made and the terms of such division; and

(2) The total fee charged by all lawyers is not increased solely by reason of the provision for division of fees and is not unconscionable as that term is defined in rule 4-200.

(B) Except as permitted in paragraph (A) of this rule or rule 2-300, a member shall not compensate, give, or promise anything of value to any lawyer for the purpose of recommending or securing employment of the member or the member's law firm by a client, or as a reward for having made a recommendation resulting in employment of the member or the member's law firm by a client. A member's offering of or giving a gift or gratuity to any lawyer who has made a recommendation resulting in the employment of the member or the member's law firm shall not of itself violate this rule, provided that the gift or gratuity was not offered in consideration of any promise, agreement, or understanding that such a gift or gratuity would be forthcoming or that referrals would be made or encouraged in the future.

Rule 2-300 Sale or Purchase of a Law Practice of a Member, Living or Deceased

All or substantially all of the law practice of a member, living or deceased, including goodwill, may be sold to another member or law firm subject to all the following conditions:

(A) Fees charged to clients shall not be increased solely by reason of such sale.

(B) If the sale contemplates the transfer of responsibility for work not yet completed or responsibility for client files or information protected by Business and Professions Code section 6068, subdivision (e), then;

(1) if the seller is deceased, or has a conservator or other person acting in a representative capacity, and no member has been appointed to act for the seller pursuant to Business and Professions Code section 6180.5, then prior to the transfer;

(a) the purchaser shall cause a written notice to be given to the client stating that the interest in the law practice is being transferred to the purchaser; that the client has the right to retain other counsel; that the client may take possession of any client papers and property, as required by rule 3-700(D); and that if no response is received to the notification within 90 days of the sending of such notice, or in the event the client's rights would be prejudiced by a failure to act during that time, the purchaser may act on behalf of the client until otherwise notified by the client. Such notice shall comply with the requirements as set forth in rule 1-400(D) and any provisions relating to attorney-client fee arrangements, and

(b) the purchaser shall obtain the written consent of the client provided that such consent shall be presumed until otherwise notified by the client if no response is received to the notification specified in subparagraph (a) within 90 days of the date of the sending of such notification to the client's last address as shown on the records of the seller, or the client's rights would be prejudiced by a failure to act during such 90-day period.

(2) in all other circumstances, not less than 90 days prior to the transfer;

(a) the seller, or the member appointed to act for the seller pursuant to Business and Professions Code section 6180.5, shall cause a written notice to be given to the client stating that the interest in the law practice is being transferred to the purchaser; that the client has the right to retain other counsel; that the client may take possession of any client papers and property, as required by rule 3-700(D); and that if no response is received to the notification within 90 days of the sending of such notice, the purchaser may act on behalf of the client until otherwise notified by the client. Such notice shall comply with the requirements as set forth in rule 1-400(D) and any provisions relating to attorney-client fee arrangements, and

(b) the seller, or the member appointed to act for the seller pursuant to Business and Professions Code section 6180.5, shall obtain the written consent of the client prior to the transfer provided that such consent shall be presumed until otherwise notified by the client if no response is

received to the notification specified in subparagraph (a) within 90 days of the date of the sending of such notification to the client's last address as shown on the records of the seller.

(C) If substitution is required by the rules of a tribunal in which a matter is pending, all steps necessary to substitute a member shall be taken.

(D) All activity of a purchaser or potential purchaser under this rule shall be subject to compliance with rules 3-300 and 3-310 where applicable.

(E) Confidential information shall not be disclosed to a non-member in connection with a sale under this rule.

(F) Admission to or retirement from a law partnership or law corporation, retirement plans and similar arrangements, or sale of tangible assets of a law practice shall not be deemed a sale or purchase under this rule.

Discussion:

Paragraph (A) is intended to prohibit the purchaser from charging the former clients of the seller a higher fee than the purchaser is charging his or her existing clients.

"All or substantially all of the law practice of a member" means, for purposes of rule 2-300, that, for example, a member may retain one or two clients who have such a longstanding personal and professional relationship with the member that transfer of those clients' files is not feasible. Conversely, rule 2-300 is not intended to authorize the sale of a law practice in a piecemeal fashion except as may be required by subparagraph (B)(1)(a) or paragraph (D).

Transfer of individual client matters, where permitted, is governed by rule 2-200. Payment of a fee to a non-lawyer broker for arranging the sale or purchase of a law practice is governed by rule 1-320. (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 2-400 Prohibited Discriminatory Conduct in a Law Practice

(A) For purposes of this rule:

(1) "law practice" includes sole practices, law partnerships, law corporations, corporate and governmental legal departments, and other entities which employ members to practice law;

(2) "knowingly permit" means a failure to advocate corrective action where the member knows of a discriminatory policy or practice which results in the unlawful discrimination prohibited in paragraph (B); and

(3) "unlawfully" and "unlawful" shall be determined by reference to applicable state or federal statutes or decisions making unlawful discrimination in employment and in offering goods and services to the public.

(B) In the management or operation of a law practice, a member shall not unlawfully discriminate or knowingly permit unlawful discrimination on the basis of race, national origin, sex, sexual orientation, religion, age or disability in:

(1) hiring, promoting, discharging, or otherwise determining the conditions of employment of any person; or

(2) accepting or terminating representation of any client.

(C) No disciplinary investigation or proceeding may be initiated by the State Bar against a member under this rule unless and until a tribunal of competent jurisdiction, other than a disciplinary tribunal, shall have first adjudicated a complaint of alleged discrimination and found that unlawful conduct occurred. Upon such adjudication, the tribunal finding or verdict shall then be admissible evidence of the occurrence or non-occurrence of the alleged discrimination in any disciplinary proceeding initiated under this rule. In order for discipline to be imposed under this rule, however, the finding of unlawfulness must be upheld and final after appeal, the time for filing an appeal must have expired, or the appeal must have been dismissed.

Discussion:

In order for discriminatory conduct to be actionable under this rule, it must first be found to be unlawful by an appropriate civil administrative or judicial tribunal under applicable state or federal law. Until there is a finding of civil unlawfulness, there is no basis for disciplinary action under this rule.

A complaint of misconduct based on this rule may be filed with the State Bar following a finding of

unlawfulness in the first instance even though that finding is thereafter appealed.

A disciplinary investigation or proceeding for conduct coming within this rule may be initiated and maintained, however, if such conduct warrants discipline under California Business and Professions Code sections 6106 and 6068, the California Supreme Court's inherent authority to impose discipline, or other disciplinary standard. (Added by order of Supreme Court, effective March 1, 1994.)

CHAPTER 3.
PROFESSIONAL RELATIONSHIP WITH CLIENTS

Rule 3-100 Confidential Information of a Client

(A) A member shall not reveal information protected from disclosure by Business and Professions Code section 6068, subdivision (e)(1) without the informed consent of the client, or as provided in paragraph (B) of this rule.

(B) A member may, but is not required to, reveal confidential information relating to the representation of a client to the extent that the member reasonably believes the disclosure is necessary to prevent a criminal act that the member reasonably believes is likely to result in death of, or substantial bodily harm to, an individual.

(C) Before revealing confidential information to prevent a criminal act as provided in paragraph (B), a member shall, if reasonable under the circumstances:

(1) make a good faith effort to persuade the client: (i) not to commit or to continue the criminal act or (ii) to pursue a course of conduct that will prevent the threatened death or substantial bodily harm; or do both (i) and (ii); and

(2) inform the client, at an appropriate time, of the member's ability or decision to reveal information as provided in paragraph (B).

(D) In revealing confidential information as provided in paragraph (B), the member's disclosure must be no more than is necessary to prevent the criminal act, given the information known to the member at the time of the disclosure.

(E) A member who does not reveal information permitted by paragraph (B) does not violate this rule.

Discussion:

[1] *Duty of confidentiality.* Paragraph (A) relates to a member's obligations under Business and Professions Code section 6068, subdivision (e)(1), which provides it is a duty of a member: "To maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client." A member's duty to preserve the confidentiality of client information involves public policies of paramount importance. (*In Re Jordan* (1974) 12 Cal.3d 575, 580 [116 Cal.Rptr. 371].) Preserving the confidentiality of client information contributes to the trust that is the hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. The lawyer needs this information to represent the client effectively and, if necessary, to advise the client to refrain from wrongful conduct. Almost without exception, clients come to lawyers in order to determine their rights and what is, in the complex of laws and regulations, deemed to be legal and correct. Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld. Paragraph (A) thus recognizes a fundamental principle in the client-lawyer relationship that, in the absence of the client's informed consent, a member must not reveal information relating to the representation. (See, e.g., *Commercial Standard Title Co. v. Superior Court* (1979) 92 Cal.App.3d 934, 945 [155 Cal.Rptr. 393].)

[2] *Client-lawyer confidentiality encompasses the attorney-client privilege, the work-product doctrine and ethical standards of confidentiality.* The principle of client-lawyer confidentiality applies to information relating to the representation, whatever its source, and encompasses matters communicated in confidence by the client, and therefore protected by the attorney-client privilege, matters protected by the work product doctrine, and matters protected under ethical standards of confidentiality, all as established in law, rule and policy. (See *In the Matter of Johnson* (Rev. Dept. 2000) 4 Cal. State Bar Ct. Rptr. 179; *Goldstein v. Lees* (1975) 46 Cal.App.3d 614 [120 Cal.Rptr. 253].) The attorney-client privilege and work-product doctrine apply in judicial and other

proceedings in which a member may be called as a witness or be otherwise compelled to produce evidence concerning a client. A member's ethical duty of confidentiality is not so limited in its scope of protection for the client-lawyer relationship of trust and prevents a member from revealing the client's confidential information even when not confronted with such compulsion. Thus, a member may not reveal such information except with the consent of the client or as authorized or required by the State Bar Act, these rules, or other law.

[3] *Narrow exception to duty of confidentiality under this Rule.* Notwithstanding the important public policies promoted by lawyers adhering to the core duty of confidentiality, the overriding value of life permits disclosures otherwise prohibited under Business & Professions Code section 6068, subdivision (e)(1). Paragraph (B), which restates Business and Professions Code section 6068, subdivision (e)(2), identifies a narrow confidentiality exception, absent the client's informed consent, when a member reasonably believes that disclosure is necessary to prevent a criminal act that the member reasonably believes is likely to result in the death of, or substantial bodily harm to an individual. Evidence Code section 956.5, which relates to the evidentiary attorney-client privilege, sets forth a similar express exception. Although a member is not permitted to reveal confidential information concerning a client's past, completed criminal acts, the policy favoring the preservation of human life that underlies this exception to the duty of confidentiality and the evidentiary privilege permits disclosure to prevent a future or ongoing criminal act.

[4] *Member not subject to discipline for revealing confidential information as permitted under this Rule.* Rule 3-100, which restates Business and Professions Code section 6068, subdivision (e)(2), reflects a balancing between the interests of preserving client confidentiality and of preventing a criminal act that a member reasonably believes is likely to result in death or substantial bodily harm to an individual. A member who reveals information as permitted under this rule is not subject to discipline.

[5] *No duty to reveal confidential information*. Neither Business and Professions Code section 6068, subdivision (e)(2) nor this rule imposes an affirmative obligation on a member to reveal information in order to prevent harm. (See rule 1-100(A).) A member may decide not to reveal confidential information. Whether a member chooses to reveal confidential information as permitted under this rule is a matter for the individual member to decide, based on all the facts and circumstances, such as those discussed in paragraph [6] of this discussion.

[6] *Deciding to reveal confidential information as permitted under paragraph (B*). Disclosure permitted under paragraph (B) is ordinarily a last resort, when no other available action is reasonably likely to prevent the criminal act. Prior to revealing information as permitted under paragraph (B), the member must, if reasonable under the circumstances, make a good faith effort to persuade the client to take steps to avoid the criminal act or threatened harm. Among the factors to be considered in determining whether to disclose confidential information are the following:

(1) the amount of time that the member has to make a decision about disclosure;

(2) whether the client or a third party has made similar threats before and whether they have ever acted or attempted to act upon them;

(3) whether the member believes the member's efforts to persuade the client or a third person not to engage in the criminal conduct have or have not been successful;

(4) the extent of adverse effect to the client's rights under the Fifth, Sixth and Fourteenth Amendments of the United States Constitution and analogous rights and privacy rights under Article 1 of the Constitution of the State of California that may result from disclosure contemplated by the member;

(5) the extent of other adverse effects to the client that may result from disclosure contemplated by the member; and

(6) the nature and extent of information that must be disclosed to prevent the criminal act or threatened harm.

A member may also consider whether the prospective harm to the victim or victims is imminent in deciding whether to disclose the confidential information. However, the imminence of the harm is not a prerequisite to disclosure and a member may disclose the information without waiting until immediately before the harm is likely to occur.

[7] *Counseling client or third person not to commit a criminal act reasonably likely to result in death of substantial bodily harm.* Subparagraph (C)(1)

provides that before a member may reveal confidential information, the member must, if reasonable under the circumstances, make a good faith effort to persuade the client not to commit or to continue the criminal act, or to persuade the client to otherwise pursue a course of conduct that will prevent the threatened death or substantial bodily harm, or if necessary, do both. The interests protected by such counseling is the client's interest in limiting disclosure of confidential information and in taking responsible action to deal with situations attributable to the client. If a client, whether in response to the member's counseling or otherwise, takes corrective action – such as by ceasing the criminal act before harm is caused – the option for permissive disclosure by the member would cease as the threat posed by the criminal act would no longer be present. When the actor is a nonclient or when the act is deliberate or malicious, the member who contemplates making adverse disclosure of confidential information may reasonably conclude that the compelling interests of the member or others in their own personal safety preclude personal contact with the actor. Before counseling an actor who is a nonclient, the member should, if reasonable under the circumstances, first advise the client of the member's intended course of action. If a client or another person has already acted but the intended harm has not yet occurred, the member should consider, if reasonable under the circumstances, efforts to persuade the client or third person to warn the victim or consider other appropriate action to prevent the harm. Even when the member has concluded that paragraph (B) does not permit the member to reveal confidential information, the member nevertheless is permitted to counsel the client as to why it may be in the client's best interest to consent to the attorney's disclosure of that information.

[8] *Disclosure of confidential information must be no more than is reasonably necessary to prevent the criminal act.* Under paragraph (D), disclosure of confidential information, when made, must be no more extensive than the member reasonably believes necessary to prevent the criminal act. Disclosure should allow access to the confidential information to only those persons who the member reasonably believes can act to prevent the harm. Under some circumstances, a member may determine that the best course to pursue is to make an anonymous disclosure to the potential victim or relevant law-enforcement authorities. What particular measures are reasonable depends on the circumstances known to the member. Relevant circumstances include the time available, whether the victim might be unaware of the threat, the member's prior course of dealings with the client, and the extent of the adverse effect on the client that may result from the disclosure contemplated by the member.

[9] *Informing client of member's ability or decision to reveal confidential information under subparagraph (C)(2).* A member is required to keep a client reasonably informed about significant developments regarding the employment or representation. Rule 3-500; Business and Professions Code, section 6068, subdivision (m). Paragraph (C)(2), however, recognizes that under certain circumstances, informing a client of the member's ability or decision to reveal confidential information under paragraph (B) would likely increase the risk of death or substantial bodily harm, not only to the originally-intended victims of the criminal act, but also to the client or members of the client's family, or to the member or the member's family or associates. Therefore, paragraph (C)(2) requires a member to inform the client of the member's ability or decision to reveal confidential information as provided in paragraph (B) only if it is reasonable to do so under the circumstances. Paragraph (C)(2) further recognizes that the appropriate time for the member to inform the client may vary depending upon the circumstances. (See paragraph [10] of this discussion.) Among the factors to be considered in determining an appropriate time, if any, to inform a client are:

(1) whether the client is an experienced user of legal services;

(2) the frequency of the member's contact with the client;

(3) the nature and length of the professional relationship with the client;

(4) whether the member and client have discussed the member's duty of confidentiality or any exceptions to that duty;

(5) the likelihood that the client's matter will involve information within paragraph (B);

(6) the member's belief, if applicable, that so informing the client is likely to increase the likelihood that a criminal act likely to result in the death of, or substantial bodily harm to, an individual; and

(7) the member's belief, if applicable, that good faith efforts to persuade a client not to act on a threat have failed.

[10] *Avoiding a chilling effect on the lawyer-client relationship.* The foregoing flexible approach to the member's informing a client of his or her ability or decision to reveal confidential information recognizes the concern that informing a client about limits on confidentiality may have a chilling effect on client communication. (See Discussion paragraph [1].) To avoid that chilling effect, one member may choose to inform the client of the member's ability to reveal information as early as the outset of the representation, while another member may choose to inform a client only at a point when that client has imparted information that may fall under paragraph (B), or even choose not to inform a client until such time as the member attempts to counsel the client as contemplated in Discussion paragraph [7]. In each situation, the member will have discharged properly the requirement under subparagraph (C)(2), and will not be subject to discipline.

[11] *Informing client that disclosure has been made; termination of the lawyer-client relationship.* When a member has revealed confidential information under paragraph (B), in all but extraordinary cases the relationship between member and client will have deteriorated so as to make the member's representation of the client impossible. Therefore, the member is required to seek to withdraw from the representation (see rule 3-700(B)), unless the member is able to obtain the client's informed consent to the member's continued representation. The member must inform the client of the fact of the member's disclosure unless the member has a compelling interest in not informing the client, such as to protect the member, the member's family or a third person from the risk of death or substantial bodily harm.

[12] *Other consequences of the member's disclosure.* Depending upon the circumstances of a member's disclosure of confidential information, there may be other important issues that a member must address. For example, if a member will be called as a witness in the client's matter, then rule 5-210 should be considered. Similarly, the member should consider his or her duties of loyalty and competency (rule 3-110).

[13] *Other exceptions to confidentiality under California law.* Rule 3-100 is not intended to augment, diminish, or preclude reliance upon, any other exceptions to the duty to preserve the confidentiality of client information recognized under California law. (Added by order of the Supreme Court, operative July 1, 2004.)

Rule 3-110 Failing to Act Competently

(A) A member shall not intentionally, recklessly, or repeatedly fail to perform legal services with competence.

(B) For purposes of this rule, "competence" in any legal service shall mean to apply the 1) diligence, 2) learning and skill, and 3) mental, emotional, and physical ability reasonably necessary for the performance of such service.

(C) If a member does not have sufficient learning and skill when the legal service is undertaken, the member may nonetheless perform such services competently by 1) associating with or, where appropriate, professionally consulting another lawyer reasonably believed to be competent, or 2) by acquiring sufficient learning and skill before performance is required.

Discussion:

The duties set forth in rule 3-110 include the duty to supervise the work of subordinate attorney and non-attorney employees or agents. (See, e.g., *Waysman v. State Bar* (1986) 41 Cal.3d 452; *Trousil v. State Bar* (1985) 38 Cal.3d 337, 342 [211 Cal.Rptr. 525]; *Palomo v. State Bar* (1984) 36 Cal.3d 785 [205 Cal.Rptr. 834]; *Crane v. State Bar* (1981) 30 Cal.3d 117, 122; *Black v. State Bar* (1972) 7 Cal.3d 676, 692 [103 Cal.Rptr. 288; 499 P.2d 968]; *Vaughn v. State Bar* (1972) 6 Cal.3d 847, 857-858 [100 Cal.Rptr. 713; 494 P.2d 1257]; *Moore v. State Bar* (1964) 62 Cal.2d 74, 81 [41 Cal.Rptr. 161; 396 P.2d 577].)

In an emergency a lawyer may give advice or assistance in a matter in which the lawyer does not have the skill ordinarily required where referral to or consultation with another lawyer would be impractical. Even in an emergency, however, assistance should be limited to that reasonably necessary in the circumstances. (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 3-120 Sexual Relations With Client

(A) For purposes of this rule, "sexual relations" means sexual intercourse or the touching of an

intimate part of another person for the purpose of sexual arousal, gratification, or abuse.

(B) A member shall not:

(1) Require or demand sexual relations with a client incident to or as a condition of any professional representation; or

(2) Employ coercion, intimidation, or undue influence in entering into sexual relations with a client; or

(3) Continue representation of a client with whom the member has sexual relations if such sexual relations cause the member to perform legal services incompetently in violation of rule 3-110.

(C) Paragraph (B) shall not apply to sexual relations between members and their spouses or to ongoing consensual sexual relationships which predate the initiation of the lawyer-client relationship.

(D) Where a lawyer in a firm has sexual relations with a client but does not participate in the representation of that client, the lawyers in the firm shall not be subject to discipline under this rule solely because of the occurrence of such sexual relations.

Discussion:

Rule 3-120 is intended to prohibit sexual exploitation by a lawyer in the course of a professional representation. Often, based upon the nature of the underlying representation, a client exhibits great emotional vulnerability and dependence upon the advice and guidance of counsel. Attorneys owe the utmost duty of good faith and fidelity to clients. (See, e.g., *Greenbaum v. State Bar* (1976) 15 Cal.3d 893, 903 [126 Cal.Rptr. 785]; *Alkow v. State Bar* (1971) 3 Cal.3d 924, 935 [92 Cal.Rptr. 278]; *Cutler v. State Bar* (1969) 71 Cal.2d 241, 251 [78 Cal.Rptr 172]; *Clancy v. State Bar* (1969) 71 Cal.2d 140, 146 [77 Cal.Rptr. 657].) The relationship between an attorney and client is a fiduciary relationship of the very highest character and all dealings between an attorney and client that are beneficial to the attorney will be closely scrutinized with the utmost strictness for unfairness. (See, e.g., *Giovanazzi v. State Bar* (1980) 28 Cal.3d 465, 472 [169 Cal Rptr. 581]; *Benson v. State Bar* (1975) 13 Cal.3d 581, 586 [119 Cal.Rptr. 297]; *Lee v. State Bar* (1970) 2 Cal.3d 927, 939 [88 Cal.Rptr. 361]; *Clancy v. State Bar* (1969) 71 Cal.2d 140, 146 [77 Cal.Rptr. 657].) Where attorneys exercise undue influence over clients or take unfair advantage of clients, discipline is appropriate. (See, e.g., *Magee v. State Bar* (1962) 58 Cal.2d 423 [24 Cal.Rptr. 839]; *Lantz v. State Bar* (1931) 212 Cal. 213 [298 P. 497].) In all client matters, a member is advised to keep clients' interests paramount in the course of the member's representation.

For purposes of this rule, if the client is an organization, any individual overseeing the representation shall be deemed to be the client. (See rule 3-600.)

Although paragraph (C) excludes representation of certain clients from the scope of rule 3-120, such exclusion is not intended to preclude the applicability of other Rules of Professional Conduct, including rule 3-110. (Added by order of Supreme Court, operative September 14, 1992.)

Rule 3-200 Prohibited Objectives of Employment

A member shall not seek, accept, or continue employment if the member knows or should know that the objective of such employment is:

(A) To bring an action, conduct a defense, assert a position in litigation, or take an appeal, without probable cause and for the purpose of harassing or maliciously injuring any person; or

(B) To present a claim or defense in litigation that is not warranted under existing law, unless it can be supported by a good faith argument for an extension, modification, or reversal of such existing law.

Rule 3-210 Advising the Violation of Law

A member shall not advise the violation of any law, rule, or ruling of a tribunal unless the member believes in good faith that such law, rule, or ruling is invalid. A member may take appropriate steps in good faith to test the validity of any law, rule, or ruling of a tribunal.

Discussion:

Rule 3-210 is intended to apply not only to the prospective conduct of a client but also to the interaction between the member and client and to the specific legal service sought by the client from the

member. An example of the former is the handling of physical evidence of a crime in the possession of the client and offered to the member. (See *People v. Meredith* (1981) 29 Cal.3d 682 [175 Cal.Rptr. 612].) An example of the latter is a request that the member negotiate the return of stolen property in exchange for the owner's agreement not to report the theft to the police or prosecutorial authorities. (See *People v. Pic'l* (1982) 31 Cal.3d 731 [183 Cal.Rptr. 685].)

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.)

Rule 3-310 Avoiding the Representation of Adverse Interests

(A) For purposes of this rule:

(1) "Disclosure" means informing the client or former client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client or former client;

(2) "Informed written consent" means the client's or former client's written agreement to the representation following written disclosure;

(3) "Written" means any writing as defined in Evidence Code section 250.

(B) A member shall not accept or continue representation of a client without providing written disclosure to the client where:

(1) The member has a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; or

(2) The member knows or reasonably should know that:

(a) the member previously had a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; and

(b) the previous relationship would substantially affect the member's representation; or

(3) The member has or had a legal, business, financial, professional, or personal relationship with another person or entity the member knows or reasonably should know would be affected substantially by resolution of the matter; or

(4) The member has or had a legal, business, financial, or professional interest in the subject matter of the representation.

(C) A member shall not, without the informed written consent of each client:

(1) Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or

(2) Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or

(3) Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter.

(D) A member who represents two or more clients shall not enter into an aggregate settlement of the claims of or against the clients without the informed written consent of each client.

(E) A member shall not, without the informed written consent of the client or former client, accept employment adverse to the client or former client where, by reason of the representation of the client or former client, the member has obtained confidential information material to the employment.

(F) A member shall not accept compensation for representing a client from one other than the client unless:

(1) There is no interference with the member's independence of professional judgment or with the client-lawyer relationship; and

(2) Information relating to representation of the client is protected as required by Business and Professions Code section 6068, subdivision (e); and

(3) The member obtains the client's informed written consent, provided that no disclosure or consent is required if:

(a) such nondisclosure is otherwise authorized by law; or

(b) the member is rendering legal services on behalf of any public agency which provides legal services to other public agencies or the public.

Discussion:

Rule 3-310 is not intended to prohibit a member from representing parties having antagonistic positions on the same legal question that has arisen in different cases, unless representation of either client would be adversely affected.

Other rules and laws may preclude making adequate disclosure under this rule. If such disclosure is precluded, informed written consent is likewise precluded. (See, e.g., Business and Professions Code section 6068, subdivision (e).)

Paragraph (B) is not intended to apply to the relationship of a member to another party's lawyer. Such relationships are governed by rule 3-320.

Paragraph (B) is not intended to require either the disclosure of the new engagement to a former client or the consent of the former client to the new engagement. However, both disclosure and consent are required if paragraph (E) applies.

While paragraph (B) deals with the issues of adequate disclosure to the present client or clients of the member's present or past relationships to other parties or witnesses or present interest in the subject matter of the representation, paragraph (E) is intended to protect the confidences of another present or former client. These two paragraphs are to apply as complementary provisions.

Paragraph (B) is intended to apply only to a member's own relationships or interests, unless the member knows that a partner or associate in the same firm as the member has or had a relationship with another party or witness or has or had an interest in the subject matter of the representation.

Subparagraphs (C)(1) and (C)(2) are intended to apply to all types of legal employment, including the concurrent representation of multiple parties in litigation or in a single transaction or in some other common enterprise or legal relationship. Examples of the latter include the formation of a partnership for several partners or a corporation for several shareholders, the preparation of an ante-nuptial agreement, or joint or reciprocal wills for a husband and wife, or the resolution of an "uncontested" marital dissolution. In such situations, for the sake of convenience or economy, the parties may well prefer to employ a single counsel, but a member must disclose the potential adverse aspects of such multiple representation (e.g., Evid. Code, §962) and must obtain the informed written consent of the clients

thereto pursuant to subparagraph (C)(1). Moreover, if the potential adversity should become actual, the member must obtain the further informed written consent of the clients pursuant to subparagraph (C)(2).

Subparagraph (C)(3) is intended to apply to representations of clients in both litigation and transactional matters.

In *State Farm Mutual Automobile Insurance Company v. Federal Insurance Company* (1999) 72 Cal.App.4th 1422 [86 Cal.Rptr.2d 20], the court held that subparagraph (C)(3) was violated when a member, retained by an insurer to defend one suit, and while that suit was still pending, filed a direct action against the same insurer in an unrelated action without securing the insurer's consent. Notwithstanding State Farm, subparagraph (C)(3) is not intended to apply with respect to the relationship between an insurer and a member when, in each matter, the insurer's interest is only as an indemnity provider and not as a direct party to the action.

There are some matters in which the conflicts are such that written consent may not suffice for non-disciplinary purposes. (See *Woods v. Superior Court* (1983) 149 Cal.App.3d 931 [197 Cal.Rptr. 185]; *Klemm v. Superior Court* (1977) 75 Cal.App.3d 893 [142 Cal.Rptr. 509]; *Ishmael v. Millington* (1966) 241 Cal.App.2d 520 [50 Cal.Rptr. 592].)

Paragraph (D) is not intended to apply to class action settlements subject to court approval.

Paragraph (F) is not intended to abrogate existing relationships between insurers and insureds whereby the insurer has the contractual right to unilaterally select counsel for the insured, where there is no conflict of interest. (See *San Diego Navy Federal Credit Union v. Cumis Insurance Society* (1984) 162 Cal.App.3d 358 [208 Cal.Rptr. 494].) (Amended by order of Supreme Court, operative September 14, 1992; operative March 3, 2003.)

Rule 3-320 Relationship With Other Party's Lawyer

A member shall not represent a client in a matter in which another party's lawyer is a spouse, parent, child, or sibling of the member, lives with the member, is a client of the member, or has an intimate personal relationship with the member, unless the member informs the client in writing of the relationship.

Discussion:

Rule 3-320 is not intended to apply to circumstances in which a member fails to advise the client of a relationship with another lawyer who is merely a partner or associate in the same law firm as the adverse party's counsel, and who has no direct involvement in the matter. (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 3-400 Limiting Liability to Client

A member shall not:

(A) Contract with a client prospectively limiting the member's liability to the client for the member's professional malpractice; or

(B) Settle a claim or potential claim for the member's liability to the client for the member's professional malpractice, unless the client is informed in writing that the client may seek the advice of an independent lawyer of the client's choice regarding the settlement and is given a reasonable opportunity to seek that advice.

Discussion:

Rule 3-400 is not intended to apply to customary qualifications and limitations in legal opinions and memoranda, nor is it intended to prevent a member from reasonably limiting the scope of the member's employment or representation. (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 3-410 Disclosure of Professional Liability Insurance

(A) A member who knows or should know that he or she does not have professional liability insurance shall inform a client in writing, at the time of the client's engagement of the member, that the member does not have professional liability insurance whenever it is reasonably foreseeable that the total amount of the member's legal representation of the client in the matter will exceed four hours.

(B) If a member does not provide the notice required under paragraph (A) at the time of a client's engagement of the member, and the member

subsequently knows or should know that he or she no longer has professional liability insurance during the representation of the client, the member shall inform the client in writing within thirty days of the date that the member knows or should know that he or she no longer has professional liability insurance.

(C) This rule does not apply to a member who is employed as a government lawyer or in-house counsel when that member is representing or providing legal advice to a client in that capacity.

(D) This rule does not apply to legal services rendered in an emergency to avoid foreseeable prejudice to the rights or interests of the client.

(E) This rule does not apply where the member has previously advised the client under Paragraph (A) or (B) that the member does not have professional liability insurance.

Discussion:

[1] The disclosure obligation imposed by Paragraph (A) of this rule applies with respect to new clients and new engagements with returning clients.

[2] A member may use the following language in making the disclosure required by rule 3-410(A), and may include that language in a written fee agreement with the client or in a separate writing:

> *"Pursuant to California Rule of Professional Conduct 3-410, I am informing you in writing that I do not have professional liability insurance."*

[3] A member may use the following language in making the disclosure required by rule 3-410(B):

> *"Pursuant to California Rule of Professional Conduct 3-410, I am informing you in writing that I no longer have professional liability insurance."*

[4] Rule 3-410(C) provides an exemption for a "government lawyer or in-house counsel when that member is representing or providing legal advice to a client in that capacity." The basis of both exemptions is essentially the same. The purpose of this rule is to provide information directly to a client if a member is not covered by professional liability insurance. If a member is employed directly by and provides legal services directly for a private entity or a federal, state or local governmental entity, that entity presumably knows whether the member is or is not covered by professional liability insurance. The exemptions under this rule are limited to situations involving direct employment and representation, and do not, for example, apply to outside counsel for a private or governmental entity, or to counsel retained by an insurer to represent an insured. (Added by order of the Supreme Court, operative January 1, 2010.)

Rule 3-500 Communication

A member shall keep a client reasonably informed about significant developments relating to the employment or representation, including promptly complying with reasonable requests for information and copies of significant documents when necessary to keep the client so informed.

Discussion:

Rule 3-500 is not intended to change a member's duties to his or her clients. It is intended to make clear that, while a client must be informed of significant developments in the matter, a member will not be disciplined for failing to communicate insignificant or irrelevant information. (See Bus. & Prof. Code, § 6068, subd. (m).)

A member may contract with the client in their employment agreement that the client assumes responsibility for the cost of copying significant documents. This rule is not intended to prohibit a claim for the recovery of the member's expense in any subsequent legal proceeding.

Rule 3-500 is not intended to create, augment, diminish, or eliminate any application of the work product rule. The obligation of the member to provide work product to the client shall be governed by relevant statutory and decisional law. Additionally, this rule is not intended to apply to any document or correspondence that is subject to a protective order or non-disclosure agreement, or to override applicable statutory or decisional law requiring that certain information not be provided to criminal defendants who are clients of the member. (Amended by order of the Supreme Court, operative June 5, 1997.)

Rule 3-510 Communication of Settlement Offer

(A) A member shall promptly communicate to the member's client:

(1) All terms and conditions of any offer made to the client in a criminal matter; and

(2) All amounts, terms, and conditions of any written offer of settlement made to the client in all other matters.

(B) As used in this rule, "client" includes a person who possesses the authority to accept an offer of settlement or plea, or, in a class action, all the named representatives of the class.

Discussion:

Rule 3-510 is intended to require that counsel in a criminal matter convey all offers, whether written or oral, to the client, as give and take negotiations are less common in criminal matters, and, even were they to occur, such negotiations should require the participation of the accused.

Any oral offers of settlement made to the client in a civil matter should also be communicated if they are "significant" for the purposes of rule 3-500.

Rule 3-600 Organization as Client

(A) In representing an organization, a member shall conform his or her representation to the concept that the client is the organization itself, acting through its highest authorized officer, employee, body, or constituent overseeing the particular engagement.

(B) If a member acting on behalf of an organization knows that an actual or apparent agent of the organization acts or intends or refuses to act in a manner that is or may be a violation of law reasonably imputable to the organization, or in a manner which is likely to result in substantial injury to the organization, the member shall not violate his or her duty of protecting all confidential information as provided in Business and Professions Code section 6068, subdivision (e). Subject to Business and Professions Code section 6068, subdivision (e), the member may take such actions as appear to the member to be in the best lawful interest of the organization. Such actions may include among others:

(1) Urging reconsideration of the matter while explaining its likely consequences to the organization; or

(2) Referring the matter to the next higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest internal authority that can act on behalf of the organization.

(C) If, despite the member's actions in accordance with paragraph (B), the highest authority that can act on behalf of the organization insists upon action or a refusal to act that is a violation of law and is likely to result in substantial injury to the organization, the member's response is limited to the member's right, and, where appropriate, duty to resign in accordance with rule 3-700.

(D) In dealing with an organization's directors, officers, employees, members, shareholders, or other constituents, a member shall explain the identity of the client for whom the member acts, whenever it is or becomes apparent that the organization's interests are or may become adverse to those of the constituent(s) with whom the member is dealing. The member shall not mislead such a constituent into believing that the constituent may communicate confidential information to the member in a way that will not be used in the organization's interest if that is or becomes adverse to the constituent.

(E) A member representing an organization may also represent any of its directors, officers, employees, members, shareholders, or other constituents, subject to the provisions of rule 3-310. If the organization's consent to the dual representation is required by rule 3-310, the consent shall be given by an appropriate constituent of the organization other than the individual or constituent who is to be represented, or by the shareholder(s) or organization members.

Discussion:

Rule 3-600 is not intended to enmesh members in the intricacies of the entity and aggregate theories of partnership.

Rule 3-600 is not intended to prohibit members from representing both an organization and other parties connected with it, as for instance (as simply one example) in establishing employee benefit packages for closely held corporations or professional partnerships.

Rule 3-600 is not intended to create or to validate artificial distinctions between entities and their officers, employees, or members, nor is it the purpose of the rule to deny the existence or importance of such formal distinctions. In dealing with a close corporation or small association, members commonly perform professional engagements for both the organization and its major constituents. When a change in control occurs or is threatened, members are faced with complex decisions involving personal and institutional relationships and loyalties and have frequently had difficulty in perceiving their correct duty. (See *People ex rel Deukmejian v. Brown* (1981) 29 Cal.3d 150 [172 Cal.Rptr. 478]; *Goldstein v. Lees* (1975) 46 Cal.App.3d 614 [120 Cal.Rptr. 253]; *Woods v. Superior Court* (1983) 149 Cal.App.3d 931 [197 Cal.Rptr. 185]; *In re Banks* (1978) 283 Ore. 459 [584 P.2d 284]; 1 A.L.R.4th 1105.) In resolving such multiple relationships, members must rely on case law.

Rule 3-700 Termination of Employment

(A) In General.

(1) If permission for termination of employment is required by the rules of a tribunal, a member shall not withdraw from employment in a proceeding before that tribunal without its permission.

(2) A member shall not withdraw from employment until the member has taken reasonable steps to avoid reasonably foreseeable prejudice to the rights of the client, including giving due notice to the client, allowing time for employment of other counsel, complying with rule 3-700(D), and complying with applicable laws and rules.

(B) Mandatory Withdrawal.

A member representing a client before a tribunal shall withdraw from employment with the permission of the tribunal, if required by its rules, and a member representing a client in other matters shall withdraw from employment, if:

(1) The member knows or should know that the client is bringing an action, conducting a defense, asserting a position in litigation, or taking an appeal, without probable cause and for the purpose of harassing or maliciously injuring any person; or

(2) The member knows or should know that continued employment will result in violation of these rules or of the State Bar Act; or

(3) The member's mental or physical condition renders it unreasonably difficult to carry out the employment effectively.

(C) Permissive Withdrawal.

If rule 3-700(B) is not applicable, a member may not request permission to withdraw in matters pending before a tribunal, and may not withdraw in other matters, unless such request or such withdrawal is because:

(1) The client

(a) insists upon presenting a claim or defense that is not warranted under existing law and cannot be supported by good faith argument for an extension, modification, or reversal of existing law, or

(b) seeks to pursue an illegal course of conduct, or

(c) insists that the member pursue a course of conduct that is illegal or that is prohibited under these rules or the State Bar Act, or

(d) by other conduct renders it unreasonably difficult for the member to carry out the employment effectively, or

(e) insists, in a matter not pending before a tribunal, that the member engage in conduct that is contrary to the judgment and advice of the member but not prohibited under these rules or the State Bar Act, or

(f) breaches an agreement or obligation to the member as to expenses or fees.

(2) The continued employment is likely to result in a violation of these rules or of the State Bar Act; or

(3) The inability to work with co-counsel indicates that the best interests of the client likely will be served by withdrawal; or

(4) The member's mental or physical condition renders it difficult for the member to carry out the employment effectively; or

(5) The client knowingly and freely assents to termination of the employment; or

(6) The member believes in good faith, in a proceeding pending before a tribunal, that the tribunal will find the existence of other good cause for withdrawal.

(D) Papers, Property, and Fees.

A member whose employment has terminated shall:

(1) Subject to any protective order or non-disclosure agreement, promptly release to the client, at the request of the client, all the client papers and property. "Client papers and property" includes correspondence, pleadings, deposition transcripts, exhibits, physical evidence, expert's reports, and other items reasonably necessary to the client's representation, whether the client has paid for them or not; and

(2) Promptly refund any part of a fee paid in advance that has not been earned. This provision is not applicable to a true retainer fee which is paid solely for the purpose of ensuring the availability of the member for the matter.

Discussion:

Subparagraph (A)(2) provides that "a member shall not withdraw from employment until the member has taken reasonable steps to avoid reasonably foreseeable prejudice to the rights of the clients." What such steps would include, of course, will vary according to the circumstances. Absent special circumstances, "reasonable steps" do not include providing additional services to the client once the successor counsel has been employed and rule 3-700(D) has been satisfied.

Paragraph (D) makes clear the member's duties in the recurring situation in which new counsel seeks to obtain client files from a member discharged by the client. It codifies existing case law. (See *Academy of California Optometrists v. Superior Court* (1975) 51 Cal.App.3d 999 [124 Cal.Rptr. 668]; *Weiss v. Marcus* (1975) 51 Cal.App.3d 590 [124 Cal.Rptr. 297].) Paragraph (D) also requires that the member "promptly" return unearned fees paid in advance. If a client disputes the amount to be returned, the member shall comply with rule 4-100(A)(2).

Paragraph (D) is not intended to prohibit a member from making, at the member's own expense, and retaining copies of papers released to the client, nor to prohibit a claim for the recovery of the member's expense in any subsequent legal proceeding.

CHAPTER 4.
FINANCIAL RELATIONSHIP WITH CLIENTS

Rule 4-100 Preserving Identity of Funds and Property of a Client

(A) All funds received or held for the benefit of clients by a member or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable bank accounts labeled "Trust Account," "Client's Funds Account" or words of similar import, maintained in the State of California, or, with written consent of the client, in any other jurisdiction where there is a substantial relationship between the client or the client's business and the other jurisdiction. No funds belonging to the member or the law firm shall be deposited therein or otherwise commingled therewith except as follows:

(1) Funds reasonably sufficient to pay bank charges.

(2) In the case of funds belonging in part to a client and in part presently or potentially to the member or the law firm, the portion belonging to the member or law firm must be withdrawn at the earliest reasonable time after the member's interest in that portion becomes fixed. However, when the right of the member or law firm to receive a portion of trust funds is disputed by the client, the disputed portion shall not be withdrawn until the dispute is finally resolved.

(B) A member shall:

(1) Promptly notify a client of the receipt of the client's funds, securities, or other properties.

(2) Identify and label securities and properties of a client promptly upon receipt

and place them in a safe deposit box or other place of safekeeping as soon as practicable.

(3) Maintain complete records of all funds, securities, and other properties of a client coming into the possession of the member or law firm and render appropriate accounts to the client regarding them; preserve such records for a period of no less than five years after final appropriate distribution of such funds or properties; and comply with any order for an audit of such records issued pursuant to the Rules of Procedure of the State Bar.

(4) Promptly pay or deliver, as requested by the client, any funds, securities, or other properties in the possession of the member which the client is entitled to receive.

(C) The Board of Governors of the State Bar shall have the authority to formulate and adopt standards as to what "records" shall be maintained by members and law firms in accordance with subparagraph (B)(3). The standards formulated and adopted by the Board, as from time to time amended, shall be effective and binding on all members.

[Publisher's Note re Rule 4-100(C): *Operative January 1, 2012, Business and Professions Code section 6010, in part, provides that the State Bar is governed by a board known as the board of trustees of the State Bar and that any provision of law referring to the "board of governors" shall be deemed to refer to the "board of trustees." In accordance with this law, references to the "board of governors" included in the current Rules of Professional Conduct are deemed to refer to the "board of trustees."]*

Standards:

Pursuant to rule 4-100(C) the Board adopted the following standards, effective January 1, 1993, as to what "records" shall be maintained by members and law firms in accordance with subparagraph (B)(3).

(1) A member shall, from the date of receipt of client funds through the period ending five years from the date of appropriate disbursement of such funds, maintain:

(a) a written ledger for each client on whose behalf funds are held that sets forth:

(i) the name of such client,

(ii) the date, amount and source of all funds received on behalf of such client,

(iii) the date, amount, payee and purpose of each disbursement made on behalf of such client, and

(iv) the current balance for such client;

(b) a written journal for each bank account that sets forth:

(i) the name of such account,

(ii) the date, amount and client affected by each debit and credit, and

(iii) the current balance in such account;

(c) all bank statements and canceled checks for each bank account; and

(d) each monthly reconciliation (balancing) of (a), (b), and (c).

(2) A member shall, from the date of receipt of all securities and other properties held for the benefit of client through the period ending five years from the date of appropriate disbursement of such securities and other properties, maintain a written journal that specifies:

(a) each item of security and property held;

(b) the person on whose behalf the security or property is held;

(c) the date of receipt of the security or property;

(d) the date of distribution of the security or property; and

(e) person to whom the security or property was distributed.

[Publisher's Note: *Trust Account Record Keeping Standards as adopted by the Board on July 11, 1992, effective January 1, 1993.]*

Rule 4-200 Fees for Legal Services

(A) A member shall not enter into an agreement for, charge, or collect an illegal or unconscionable fee.

(B) Unconscionability of a fee shall be determined on the basis of all the facts and circumstances existing at the time the agreement is entered into except where the parties contemplate that the fee will be affected by later events. Among the factors to be considered, where appropriate, in determining the conscionability of a fee are the following:

(1) The amount of the fee in proportion to the value of the services performed.

(2) The relative sophistication of the member and the client.

(3) The novelty and difficulty of the questions involved and the skill requisite to perform the legal service properly.

(4) The likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the member.

(5) The amount involved and the results obtained.

(6) The time limitations imposed by the client or by the circumstances.

(7) The nature and length of the professional relationship with the client.

(8) The experience, reputation, and ability of the member or members performing the services.

(9) Whether the fee is fixed or contingent.

(10) The time and labor required.

(11) The informed consent of the client to the fee.

(Amended by order of Supreme Court, operative September 14, 1992.)

Rule 4-210 Payment of Personal or Business Expenses Incurred by or for a Client

(A) A member shall not directly or indirectly pay or agree to pay, guarantee, represent, or sanction a representation that the member or member's law firm will pay the personal or business expenses of a prospective or existing client, except that this rule shall not prohibit a member:

(1) With the consent of the client, from paying or agreeing to pay such expenses to third persons from funds collected or to be collected for the client as a result of the representation; or

(2) After employment, from lending money to the client upon the client's promise in writing to repay such loan; or

(3) From advancing the costs of prosecuting or defending a claim or action or otherwise protecting or promoting the client's interests, the repayment of which may be contingent on the outcome of the matter. Such costs within the meaning of this subparagraph (3) shall be limited to all reasonable expenses of litigation or reasonable expenses in preparation for litigation or in providing any legal services to the client.

(B) Nothing in rule 4-210 shall be deemed to limit rules 3-300, 3-310, and 4-300.

Rule 4-300 Purchasing Property at a Foreclosure or a Sale Subject to Judicial Review

(A) A member shall not directly or indirectly purchase property at a probate, foreclosure, receiver's, trustee's, or judicial sale in an action or proceeding in which such member or any lawyer affiliated by reason of personal, business, or professional relationship with that member or with that member's law firm is acting as a lawyer for a party or as executor, receiver, trustee, administrator, guardian, or conservator.

(B) A member shall not represent the seller at a probate, foreclosure, receiver, trustee, or judicial sale in an action or proceeding in which the purchaser is a spouse or relative of the member or of another lawyer in the member's law firm or is an employee of the member or the member's law

firm. (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 4-400 Gifts From Client

A member shall not induce a client to make a substantial gift, including a testamentary gift, to the member or to the member's parent, child, sibling, or spouse, except where the client is related to the member.

Discussion:

A member may accept a gift from a member's client, subject to general standards of fairness and absence of undue influence. The member who participates in the preparation of an instrument memorializing a gift which is otherwise permissible ought not to be subject to professional discipline. On the other hand, where impermissible influence occurred, discipline is appropriate. (See *Magee v. State Bar* (1962) 58 Cal.2d 423 [24 Cal.Rptr. 839].)

CHAPTER 5.
ADVOCACY AND REPRESENTATION

Rule 5-100 Threatening Criminal, Administrative, or Disciplinary Charges

(A) A member shall not threaten to present criminal, administrative, or disciplinary charges to obtain an advantage in a civil dispute.

(B) As used in paragraph (A) of this rule, the term "administrative charges" means the filing or lodging of a complaint with a federal, state, or local governmental entity which may order or recommend the loss or suspension of a license, or may impose or recommend the imposition of a fine, pecuniary sanction, or other sanction of a quasi-criminal nature but does not include filing charges with an administrative entity required by law as a condition precedent to maintaining a civil action.

(C) As used in paragraph (A) of this rule, the term "civil dispute" means a controversy or potential controversy over the rights and duties of two or more parties under civil law, whether or not an action has been commenced, and includes an administrative proceeding of a quasi-civil nature pending before a federal, state, or local governmental entity.

Discussion:

Rule 5-100 is not intended to apply to a member's threatening to initiate contempt proceedings against a party for a failure to comply with a court order.

Paragraph (B) is intended to exempt the threat of filing an administrative charge which is a prerequisite to filing a civil complaint on the same transaction or occurrence.

For purposes of paragraph (C), the definition of "civil dispute" makes clear that the rule is applicable prior to the formal filing of a civil action.

Rule 5-110 Performing the Duty of Member in Government Service

A member in government service shall not institute or cause to be instituted criminal charges when the member knows or should know that the charges are not supported by probable cause. If, after the institution of criminal charges, the member in government service having responsibility for prosecuting the charges becomes aware that those charges are not supported by probable cause, the member shall promptly so advise the court in which the criminal matter is pending.

Rule 5-120 Trial Publicity

(A) A member who is participating or has participated in the investigation or litigation of a matter shall not make an extrajudicial statement that a reasonable person would expect to be disseminated by means of public communication if the member knows or reasonably should know that it will have a substantial likelihood of materially prejudicing an adjudicative proceeding in the matter.

(B) Notwithstanding paragraph (A), a member may state:

(1) the claim, offense or defense involved and, except when prohibited by law, the identity of the persons involved;

(2) the information contained in a public record;

(3) that an investigation of the matter is in progress;

(4) the scheduling or result of any step in litigation;

(5) a request for assistance in obtaining evidence and information necessary thereto;

(6) a warning of danger concerning the behavior of a person involved, when there is reason to believe that there exists the likelihood of substantial harm to an individual or the public interest; and

(7) in a criminal case, in addition to subparagraphs (1) through (6):

(a) the identity, residence, occupation, and family status of the accused;

(b) if the accused has not been apprehended, the information necessary to aid in apprehension of that person;

(c) the fact, time, and place of arrest; and

(d) the identity of investigating and arresting officers or agencies and the length of the investigation.

(C) Notwithstanding paragraph (A), a member may make a statement that a reasonable member would believe is required to protect a client from the substantial undue prejudicial effect of recent publicity not initiated by the member or the member's client. A statement made pursuant to this paragraph shall be limited to such information as is necessary to mitigate the recent adverse publicity.

Discussion:

Rule 5-120 is intended to apply equally to prosecutors and criminal defense counsel.

Whether an extrajudicial statement violates rule 5-120 depends on many factors, including: (1) whether the extrajudicial statement presents information clearly inadmissible as evidence in the matter for the purpose of proving or disproving a material fact in issue; (2) whether the extrajudicial statement presents information the member knows is false, deceptive, or the use of which would violate Business and Professions Code section 6068(d); (3) whether the extrajudicial statement violates a lawful "gag" order, or protective order, statute, rule of court, or special rule of confidentiality (for example, in juvenile, domestic, mental disability, and certain criminal proceedings); and (4) the timing of the statement.

Paragraph (A) is intended to apply to statements made by or on behalf of the member.

Subparagraph (B)(6) is not intended to create, augment, diminish, or eliminate any application of the lawyer-client privilege or of Business and Professions Code section 6068(e) regarding the member's duty to maintain client confidence and secrets. (Added by order of the Supreme Court, operative October 1, 1995.)

Rule 5-200 Trial Conduct

In presenting a matter to a tribunal, a member:

(A) Shall employ, for the purpose of maintaining the causes confided to the member such means only as are consistent with truth;

(B) Shall not seek to mislead the judge, judicial officer, or jury by an artifice or false statement of fact or law;

(C) Shall not intentionally misquote to a tribunal the language of a book, statute, or decision;

(D) Shall not, knowing its invalidity, cite as authority a decision that has been overruled or a statute that has been repealed or declared unconstitutional; and

(E) Shall not assert personal knowledge of the facts at issue, except when testifying as a witness.

Rule 5-210 Member as Witness

A member shall not act as an advocate before a jury which will hear testimony from the member unless:

(A) The testimony relates to an uncontested matter; or

(B) The testimony relates to the nature and value of legal services rendered in the case; or

(C) The member has the informed, written consent of the client. If the member represents the People or a governmental entity, the consent shall be obtained from the head of the office or a designee of the head of the office by which the member is employed and shall be consistent with principles of recusal.

Discussion:

Rule 5-210 is intended to apply to situations in which the member knows or should know that he or she ought to be called as a witness in litigation in which there is a jury. This rule is not intended to encompass situations in which the member is representing the client in an adversarial proceeding and is testifying before a judge. In non-adversarial proceedings, as where the member testifies on behalf of the client in a hearing before a legislative body, rule 5-210 is not applicable.

Rule 5-210 is not intended to apply to circumstances in which a lawyer in an advocate's firm will be a witness. (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 5-220 Suppression of Evidence

A member shall not suppress any evidence that the member or the member's client has a legal obligation to reveal or to produce.

Rule 5-300 Contact With Officials

(A) A member shall not directly or indirectly give or lend anything of value to a judge, official, or employee of a tribunal unless the personal or family relationship between the member and the judge, official, or employee is such that gifts are customarily given and exchanged. Nothing contained in this rule shall prohibit a member from contributing to the campaign fund of a judge running for election or confirmation pursuant to applicable law pertaining to such contributions.

(B) A member shall not directly or indirectly communicate with or argue to a judge or judicial officer upon the merits of a contested matter pending before such judge or judicial officer, except:

(1) In open court; or

(2) With the consent of all other counsel in such matter; or

(3) In the presence of all other counsel in such matter; or

(4) In writing with a copy thereof furnished to such other counsel; or

(5) In ex parte matters.

(C) As used in this rule, "judge" and "judicial officer" shall include law clerks, research attorneys, or other court personnel who participate in the decision-making process. (Amended by order of Supreme Court, operative September 14, 1992.)

Rule 5-310 Prohibited Contact With Witnesses

A member shall not:

(A) Advise or directly or indirectly cause a person to secrete himself or herself or to leave the jurisdiction of a tribunal for the purpose of making that person unavailable as a witness therein.

(B) Directly or indirectly pay, offer to pay, or acquiesce in the payment of compensation to a witness contingent upon the content of the witness's testimony or the outcome of the case. Except where prohibited by law, a member may advance, guarantee, or acquiesce in the payment of:

(1) Expenses reasonably incurred by a witness in attending or testifying.

(2) Reasonable compensation to a witness for loss of time in attending or testifying.

(3) A reasonable fee for the professional services of an expert witness.

Rule 5-320 Contact With Jurors

(A) A member connected with a case shall not communicate directly or indirectly with anyone the member knows to be a member of the venire from which the jury will be selected for trial of that case.

(B) During trial a member connected with the case shall not communicate directly or indirectly with any juror.

(C) During trial a member who is not connected with the case shall not communicate directly or indirectly concerning the case with anyone the member knows is a juror in the case.

(D) After discharge of the jury from further consideration of a case a member shall not ask questions of or make comments to a member of that jury that are intended to harass or embarrass the juror or to influence the juror's actions in future jury service.

(E) A member shall not directly or indirectly conduct an out of court investigation of a person who is either a member of the venire or a juror in a manner likely to influence the state of mind of such person in connection with present or future jury service.

(F) All restrictions imposed by this rule also apply to communications with, or investigations of, members of the family of a person who is either a member of the venire or a juror.

(G) A member shall reveal promptly to the court improper conduct by a person who is either a member of a venire or a juror, or by another toward a person who is either a member of a venire or a juror or a member of his or her family, of which the member has knowledge.

(H) This rule does not prohibit a member from communicating with persons who are members of a venire or jurors as a part of the official proceedings.

(I) For purposes of this rule, "juror" means any empanelled, discharged, or excused juror. (Amended by order of Supreme Court, operative September 14, 1992.)