THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 19-0003
ADVISING CLIENT ON ILLEGAL CONTRACT PROVISIONS

ISSUES: What are a lawyer's ethical duties when advising a client regarding the use of a contract provision in a transaction with a third party that is illegal under the law of the jurisdiction applicable to the transaction?

DIGEST: A California lawyer has a duty not to counsel or assist a client in conduct that the lawyer knows is criminal, fraudulent, or a violation of any law, rule, or ruling of a tribunal. That conduct includes promulgating or enforcing a contract provision in a transaction with a third party that is illegal under the law of the jurisdiction applicable to the transaction. If the lawyer knows that the provision is illegal as applied to the transaction, the lawyer should advise the client accordingly, may not recommend the use of the provision, and must counsel the client not to use it. If the client insists on the use of the illegal provision against the lawyer's advice, the lawyer may not participate in promulgating or enforcing the illegal provision against a third party. The lawyer is permitted to withdraw from the representation if the client insists on using the illegal provision and, depending on the client's continued conduct, may be required to do so. If the lawyer concludes that the client's conduct is a violation of law reasonably imputable to the organization and likely to result in substantial injury to the organization, the lawyer for an organization must report the actions of the client constituent to a higher authority within the organization, unless the lawyer reasonably concludes that it is not in the best lawful interest of the organization to do so.

AUTHORITIES INTERPRETED: California Rules of Professional Conduct 1.1, 1.2.1, 1.4, 1.13, 1.16(b), 4.1, 8.4(c).[1]

Business and Professions Code section 6068(d).

[1/] Unless otherwise indicated, all references to "rules" in this opinion will be to the Rules of Professional Conduct of the State Bar of California.

INTRODUCTION

Certain types of contract provisions are illegal under California law. For example, provisions in employment contracts that impair the ability of employees to compete against their employers following termination of employment have generally been found to be illegal under California law, subject to limited exceptions. See *Edwards v. Arthur Andersen LLP* (2008) 44 Cal.4th 937, 945 [81 Cal.Rptr.3d 282]; *Robinson v. U-Haul Co. of California* (2016) 4 Cal.App.5th 304, 309 [209 Cal.Rptr.3d 81]; Business and Professions Code section 16600. For purposes of this opinion, the Committee does not opine on whether a particular clause in a contract is illegal as this raises an issue of law; instead, the Committee confines its discussion to the ethical issues presented by the factual scenarios below and assumes that the contract provision at issue is illegal at the time the agreement is made and not potentially subject to an exception that would make the provision legal.[2/]

STATEMENT OF FACTS

Lawyer works for a large California corporation ("Company") providing employment law advice to the Human Resources department ("HR") responsible for all non-executive hiring. Employees hired through HR are presented with a standard form written employment agreement ("Agreement"). This Agreement is presented by HR to new hires in California as a nonnegotiable agreement that must be signed as a condition of employment. Lawyer is tasked with reviewing and updating the Agreement, which contains a material provision that is illegal under California law.

FACTUAL SCENARIOS

Scenario 1

Lawyer knows that the provision is illegal under California law but advises HR to use the Agreement anyway, without informing HR of the illegality.

Scenario 2

Lawyer does not know that the provision is illegal under California law and Lawyer performs no research or analysis to determine the legality of the provision but advises HR to use the Agreement anyway.

[2/] The use of the term "illegal" in this opinion refers to a provision that is illegal under the law of the jurisdiction applicable to the transaction. The opinion is not intended to address provisions that are legal, but against public policy, unenforceable or subject to some other prohibition; Nor is it intended to address situations where the lawyer knows a court has held the provision to be unlawful, but nonetheless has a good faith belief that the ruling was incorrect, another court in the controlling jurisdiction has ruled or would rule otherwise, or the provision might be enforceable against the person who is being asked to sign it under reasonably foreseeable circumstances. See Rule 1.2.1, Comment [3].

Scenario 3

Lawyer advises HR that the provision is illegal under California law but does not recommend against including the provision.

Scenario 4

Lawyer advises HR that the contract provision is illegal under California law and recommends against including the provision. HR advises Lawyer that it understands the provision is illegal but would still like to include it in the Agreement for its chilling effect. HR has asked the Lawyer to assist in enforcing the provision.

DISCUSSION

A. Duty to Advise of an Illegal Contract Provision

Rule of Professional Conduct 1.2.1(a) states that a "lawyer shall not counsel a client to engage, or assist a client in conduct that the lawyer *knows* is criminal, fraudulent, *or a violation of any law, rule, or ruling of a tribunal*." (Emphasis added.) Rule 1.2.1 is modeled in substance after former rule 3-210 but adds clarifying language derived from ABA Model Rule 1.2(d). The California rule is broader than ABA Model Rule 1.2(d), which merely prohibits counseling or assisting a client on conduct known to be criminal or fraudulent.[3/] Both the California rule[4/] and the ABA Model Rule allow a lawyer to discuss the legal consequences of any proposed course of action and counsel or assist the client in interpreting the application of any law, rule or ruling to that course of action.[5/]

The California rule on its terms applies to every type of legal representation, including transactional work and negotiation. A lawyer shall not knowingly advise a client to propose an illegal provision in a contract that will be offered to a third party. See ABA Model Rule 1.2, Comment [10] ("The lawyer is required to avoid assisting the client, for example, by drafting or delivering documents that the lawyer knows are fraudulent or by suggesting how the wrongdoing might be concealed."); ABA Section of Litigation, *Ethical Guidelines For Settlement*

[3/] 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, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law."

[4/] Rule 1.2.1(b): "Notwithstanding paragraph (a), a lawyer may: (1) discuss the legal consequences of any proposed course of conduct with a client; and (2) counsel or assist a client to make a good faith effort to determine the validity, scope, meaning, or application of a law, rule, or ruling of a tribunal."

[5/] See Cal. State Bar Formal Opn. 2020-202, generally, for discussion on the scope of permitted advice and assistance a lawyer may provide to clients related to conduct described in rule 1.2.1(a).

Negotiations (August 2002), at pp. 46-47) ("A lawyer should not negotiate a settlement provision that the lawyer knows to be illegal.").[6/]

In Scenario 1, Lawyer recommends the inclusion of a provision that Lawyer knows is illegal under California law in violation of rule 1.2.1(a) and not potentially subject to an exception that would make the provision legal.[7/] Rule 1.0.1(f) helps to define knowing: "'Knowingly,' 'known,' or 'knows' means actual knowledge of the fact in question. A person's knowledge may be inferred from circumstances." Here, knowing means the lawyer has actual knowledge that the provision in question is prohibited by the controlling legal authority in the jurisdiction whose law is applicable to the transaction or contract.

Conversely, in Scenario 2, Lawyer does not know that the specific type of contract provision is illegal under the controlling legal authority of the applicable jurisdiction. Therefore, the lawyer does not violate rule 1.2.1.

However, in Scenario 2, the Lawyer likely violated the duty of competence under rule 1.1(a) because Lawyer's conduct reflects a deliberate or reckless disregard for the lawfulness of the subject provision. Knowing that the specific provision is illegal is likely to be reasonably necessary to provide competent legal advice to HR on employment law matters consistent with rule 1.1(b), particularly to the extent it is well-established that this type of provision is illegal. Rule 1.1(c) allows a lawyer to fulfill the duty of competence by associating or consulting a lawyer the lawyer reasonably believes to be competent or acquiring sufficient learning and skill to become competent before advising the client on a material legal provision. A lawyer's failure to do so might be reckless or grossly negligent under rule 1.1(a). See, *In the Matter of Morse* (Review Dept. 1994) 3 Cal. State Bar Ct. Rptr. 24 (Respondent's mass advertising without thoroughly researching relevant statute to evaluate exemption was "grossly negligent and could be characterized as reckless or intentional after he disregarded the later request from the Attorney General's Office that he stop mailing unlawful advertisements."); see also rule 1.1(b).

B. Duty Not to Assist Enforcement of an Illegal Contract Provision

While the ABA frames this issue in terms of fraud or crime, the duty is broader in California because our variation of ABA Model Rule 1.2(d), rule 1.2.1, also adds violation of any law, rule, or ruling of a tribunal, even if those violations do not amount to a crime or fraud.

In Scenario 3, Lawyer has a duty under rule 1.2.1 not only to advise the client or client constituent, HR, on the applicable law and the possible consequences of using the provision in

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[6/] The ABA Model Rules may be looked to for guidance on proper professional conduct, particularly in areas where there is no contrary California authority or conflicting public policy. See Cal. Rule of Professional Conduct 1.0, Cmt. [4] ("Ethics opinions and rules and standards promulgated by other jurisdictions and bar associations may also be considered" for guidance on proper professional conduct.).

[7/] The committee would reach the same conclusion in all four scenarios if Lawyer was the original drafter of the agreement.

question, but also to recommend against its use and avoid assisting the client's promulgation or enforcement of the illegal provision. See also rule 1.4(b) ("A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.").

In Scenario 4, because the client or client constituent insists on including the illegal provision for its chilling effect contrary to Lawyer's advice, Lawyer must advise Corporation regarding the limitations on Lawyer's conduct, including that Lawyer will not represent Corporation in promulgating or attempting to enforce the illegal provision. Rule 1.2.1, Comment [5]; rule 1.4(a)(4).

If Lawyer ultimately decides to assist Corporation in promulgating or enforcing the illegal provision, Lawyer's conduct may be a misrepresentation by omission or an affirmative misrepresentation that the provision is legal. See rule 4.1(a), Comment [1].

A lawyer shall not knowingly make a false statement of law to a third person. Rule 4.1(a). Rule 8.4(c) states that it is professional misconduct for a lawyer to "engage in conduct involving dishonesty, fraud, deceit, or reckless or intentional misrepresentation." Promulgating or enforcing a knowingly illegal provision in an employment agreement for its chilling effect[8/] on third parties would violate rule 4.1(a), rule 8.4(c), and Business and Professions Code section 6068(d). See also, California State Bar Formal Opn. 2015-194, where this committee opined that a lawyer may not knowingly make false statements of fact or implicit misrepresentations of material fact during negotiations.[9/]

Traditionally, in representing a client in arm's length business negotiations, a lawyer owes a limited duty to the other side that does not include a duty to inform that party of relevant facts. "[I]n drafting an agreement or other document on behalf of a client, a lawyer does not necessarily affirm or vouch for the truthfulness of representations made by the client in the agreement or document." Rule 4.1, Comment [1]. Nonetheless, a "nondisclosure can be the equivalent of a false statement of material fact *or law* under paragraph (a) where a lawyer makes a partially true but misleading material statement or material omission." *Id*.; see also California State Bar Formal Opn. 2015-194.

In addition, a lawyer may not make or ratify a false statement of law or fact made by the client that the lawyer knows is false. See rule 4.1(a); see also South Carolina Bar Ethics Opn. 05-03 (2005) (lawyer for ex-wife sent letter to ex-husband falsely claiming that ex-husband was required under divorce decree to undergo drug testing; this conduct violated South Carolina Rules of Professional Conduct 4.1 and 8.4(c)); *In re Discipline of Attorney* (2008) 451 Mass. 131

[8/] The chilling effect includes situations where a client wants to include a term not merely to frighten employees, but to obtain the client's desired result by inducing employees to comply with an illegal provision out of a mistaken fear of liability or fear of the risks and costs of litigation.

[9/] Cal. State Bar Formal Opn. 2015-194 was issued prior to the time that rule 4.1 was enacted; the committee principally relied on existing statutory law (Bus. & Prof. Code, §§ 6106, 6128(a), and 6068(d)), and related California case law, but it also relied on ABA Model Rule 4.1 in support of its argument.

[884 N.E.2d 450] (lawyer disciplined under Massachusetts rule 8.4(c) alone for sending letters to insurers of opposing parties falsely claiming entitlement to lien on insurance payments payable to his clients).

Rule 4.1(b) is limited to a failure to disclose a material fact necessary to avoid assisting in a "criminal or fraudulent" act by a client, which is narrower than illegal conduct.[10/] However, the advocacy of a contract provision known both by the client and the lawyer to be illegal for its chilling effect could be viewed as a fraudulent act by the client. Whether rule 4.1(b) applies will depend on the scope of the lawyer's conduct in promulgating or enforcing the provision.

C. Lawyer May Have a Duty to Withdraw from the Representation

In Scenario 4, if HR insists on including the illegal provision in Company's employment agreements, Lawyer may withdraw, but is not compelled to withdraw merely because the client chooses to use the illegal provision despite Lawyer's admonition. Even where the use of that contract provision is deemed fraudulent or even criminal, withdrawal from representation is permissive, not mandatory (see rule 1.2.1, Comment [1]; rule 1.16(b)(1)–(3).)[11/]

If, however, HR not only ignores Lawyer's advice but insists that Lawyer be involved with promulgating or enforcing the illegal contract provision, Lawyer would likely be required to terminate his representation of Company with respect to this matter.[12/] Rule 1.16(a)(2) provides that withdrawal is mandatory if "the lawyer knows or reasonably should know that the representation will result in violation of these rules or of the State Bar Act." Lawyer's continued,

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[10/] Under rule 1.0.1(d): "Fraud" or "fraudulent" means conduct that is fraudulent under the law of the applicable jurisdiction and has a purpose to deceive.

[11/] See rule 1.16 (b) ("Except as stated in paragraph (c), a lawyer *may* withdraw from representing a client if: (1) the client insists upon presenting a claim or defense in litigation, or *asserting a position or making a demand in a non-litigation matter, that is not warranted under existing law and cannot be supported by good faith argument for an extension, modification, or reversal of existing law*; (2) the client either seeks to pursue a criminal or fraudulent course of conduct or has used the lawyer's services to advance a course of conduct that the lawyer reasonably believes was a crime or fraud; (3) the client insists that the lawyer pursue a course of conduct that is criminal or fraudulent . . . ."). (Emphasis added.)

[12/] In the case of an in-house lawyer, we assume that Lawyer would be permitted to ethically limit the scope of the representation to exclude this matter or decline the representation if HR sought to have Lawyer negotiate, advocate or litigate the illegal provision. See rules 1.2(b); 1.16(a)(2). Whether Lawyer would need to withdraw from other matters or whether Lawyer would be required to terminate Lawyer's employment at Company is beyond the scope of this opinion and depends on specific facts, including HR's instructions or continued demands, and whether the withdrawal from representation relating to the illegal provision would impact Lawyer's representation of Company on other matters.

active participation in promulgating and enforcing the illegal contract provision would likely violate rules 1.2.1, 4.1, 8.4, and possibly Business and Professions Code section 6068(d).[13]

D. Duty to Report Up in An Organization

Lawyer in Scenario 4 has a duty to report the conduct of the corporate constituent (*e.g.*, HR) to a higher authority within Company because the lawyer knows that HR's conduct is illegal and is "likely to result in substantial injury to the organization." See rule 1.13(b).[14/] Rule 1.13(b) provides for an exception to reporting up if the facts indicate that "it is not necessary in the best lawful interest of the organization to do so." *Id.* While the duty to report up is fact specific, in Scenario 4, if HR insists on using the illegal provision or that Lawyer participates in promulgating or enforcing the illegal provision, reporting up would very likely be in the best lawful interest of Company.

Moreover, because Lawyer has a duty not to withdraw without taking reasonable steps to avoid reasonably foreseeable prejudice to the organization client under rule 1.16(d), this disclosure must be made even if Lawyer opts to withdraw under the permissive withdrawal provisions in rule 1.16(b)(1)–(3). Beyond this scenario, a lawyer should evaluate carefully whether disclosure to a higher authority within the organization is reasonably necessary, which will depend on the relevant circumstances.

CONCLUSION

A California lawyer has a duty not to counsel or assist a client in conduct that the lawyer knows is criminal, fraudulent, or a violation of any law, rule, or ruling of a tribunal. As such, a lawyer shall not knowingly promulgate or enforce a contract provision in a transaction with a third party that is illegal under the law of the jurisdiction applicable to the transaction and not potentially subject to an exception that would make the provision legal. If the lawyer knows that the provision is illegal, the lawyer: (1) should advise the client accordingly; (2) may not recommend the use of the provision; and (3) must counsel the client not to use it.

If the client insists on using the illegal provision against the lawyer's advice, the lawyer shall not participate in presenting the illegal provision to the third party and shall not assist the client in

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[13/] If this matter was before a tribunal, Lawyer may not reveal confidential advice or information regarding the use of the illegal provision in seeking withdrawal, except as required by rule 1.13. (See rule 1.6 and Cal. Bus. & Prof. Code, § 6068(e)(1). See also, Cal. State Bar Formal Opn. 2015-192, generally, for discussion on lawyer's duty to maintain confidential information when withdrawing from a client representation.)

[14/] Company's use of an illegal provision is likely to result in substantial injury to the organization. See also, Cal. Lab. Code, § 432.5 ("No employer, or agent, manager, superintendent, or officer thereof, shall require any employee or applicant for employment to agree, in writing, to any term or condition which is known by such employer, or agent, manager, superintendent, or officer thereof to be prohibited by law.")

enforcing the provision against a third party. The lawyer is permitted to withdraw from the representation if the client insists on using the illegal provision and, depending on the client's continued conduct, may be required to do so.

If the lawyer concludes that the conduct is a violation of law reasonably imputable to the organization and likely to result in substantial injury to the organization, the lawyer for an organization must report the actions of the client constituent to a higher authority within the organization, unless the lawyer reasonably concludes that it is not in the best lawful interest of the organization to do so.