THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
PROPOSED FORMAL OPINION INTERIM NO. 21-0003
ETHICS OF IN-HOUSE COUNSEL

ISSUES:

1. Is there a conflict of interest when an in-house lawyer moves from one company to another?

2. Does a stock option agreement present a lawyer with any conflicts of interest and, if so, how and when should such conflicts of interest be addressed with the employer?

DIGEST:

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

A former client conflict of interest under Rule of Professional Conduct[1] 1.9 does not arise simply because an in-house lawyer moves between companies that are economic competitors. A conflict of interest will arise if the lawyer was personally involved in representing their former employer on a matter that is factually and legally identical or similar to a matter the lawyer is to handle for their new employer, and in which the companies are materially adverse. Alternatively, a conflict of interest will arise if the lawyer was not personally involved in the representation, but they obtained confidential information during their prior employment concerning the same or substantially similar, adverse matter. The conflict may be imputed to the entire legal department of the new employer unless screening measures may be implemented under rule 1.10.

In-house lawyers are often offered employee stock options as part of their compensation package. In a typical attorney-client relationship—which is inherently imbalanced in favor of the attorney—taking stock in a client requires compliance with rule 1.8.1: the transaction must be fair and reasonable; the lawyer's role in the transaction must be fully and plainly disclosed to the client in writing; the client must be advised in writing to consult with independent counsel about the transaction and

[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.

the client must thereafter provide informed written consent to the transaction. However, in the in-house context, where the new lawyer is offered the same general compensation terms as those offered to other employees and indicia of inequality do not exist, compliance with rule 1.8.1 would not be required. (See rule 1.8.1, Cmt. [6].) Factors to consider in determining whether rule 1.8.1 applies to an in-house lawyer's compensation include: (1) whether the lawyer was involved in advising on the organization's formation; (2) whether the proposed compensation agreement is drafted and proposed by the organization (or its counsel) or the lawyer; (3) whether the organization has independent counsel concerning the compensation agreement; (4) whether the compensation terms offered to the lawyer are substantively similar to those offered to employees at the same level; and (5) whether the compensation is part of the lawyer's initial employment agreement, or modifications thereto, or related to lawyer's work on a specific transaction. These factors are not exhaustive but are intended as an analytical tool to determine whether an indicia of inequality exists. If so, compliance with rule 1.8.1 is required.

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

AUTHORITIES INTERPRETED: Rules 1.0.1, 1.7, 1.8.1, 1.9, 1.10, and 1.13 of the Rules of Professional Conduct of the State Bar of California.

STATEMENT OF FACTS

After practicing law for 5 years as in-house legal counsel for a software company (Old Company), Lawyer has decided to take a position as general counsel for a closely held software company (Company), formed by three founders (Founders). The Founders make up the Board of Directors (Board). Lawyer is expected to head a small team of three lawyers (Legal Department). There are approximately 75 salaried employees who own stock and/or stock options.

Lawyer's Scope of Employment with Old Company and Company

Company is a competitor of Old Company in that they both sell similar technology protected through several patents and other intellectual property rights. Old Company is publicly held, with several divisions. Old Company has a central legal department managed by a general counsel. The legal department is divided into teams. Lawyer was assigned to the Labor and Employment team. Lawyer was not part of the team that advised Old Company concerning its technology and patent applications. However, Lawyer will be expected to advise Company on all legal issues, including those relating to Company's technology and patent applications.

Lawyer's Employment Agreement with Company

As part of Lawyer's employment agreement with Company, Lawyer is presented with a stock option agreement that is offered to Company's salaried employees. The agreement states that Lawyer has an option to purchase a certain number of shares of Company's common stock at an exercise price equal to the fair market value of such shares on the date of the grant, based on the Company's Stock Incentive Plan. The agreement states that the securities will vest at increasing percentages over the course of five years. The agreement also states that in the event of a merger with or acquisition by another company, the vesting of Lawyer's option will immediately accelerate and become fully vested.

DISCUSSION

"[C]ounsel working for a corporation in-house and private counsel engaged with respect to a specific matter or on retainer" are "bound by the same fiduciary and ethical duties to their clients." (*PLCM Group, Inc. v. Drexler* (2000) 22 Cal.4th 1084, 1094 [95 Cal.Rptr.2d 198].) In-house lawyers have attorney-client relationships with the organizations that employ them. (*Gutierrez v. G & M Oil Co., Inc.* (2010) 184 Cal.App.4th 551, 559 [108 Cal.Rptr.3d 864].) An organization's legal department is encompassed within the definition of "law firm." "'Firm' or 'law firm' means . . . lawyers employed in a legal services organization or in the legal department, division or office of a corporation, of a government organization, or of another organization." (Rule 1.0.1(c).) A lawyer's duties to an organizational client are the same whether they are employed or retained by the organization. (Rule 1.13(a).) In short, the underlying purposes of a lawyer's fiduciary duties—protecting the public and the integrity of the legal system and promoting the administration of justice and confidence in the legal profession—are not diminished simply because the lawyer is employed rather than retained by an organizational client.

However, in many circumstances, analysis of an in-house lawyer's fiduciary and ethical duties must be placed in the context of the employer-employee relationship. "For example, in-house lawyers may be seen to owe different duties than independent lawyers, perhaps because they are viewed as employees of the client directly rather than indirectly." (Klein, *No Fool for a Client: The Finance and Incentives behind Stock-Based Compensation for Corporate Attorneys* (1999) 1999 Colum. Bus. L.Rev. 329.) Accordingly, "[t]he dual status of in-house counsel—acting

as both employee and attorney—and the dual status of the company—acting as both employer and client—can pose some challenging questions about when one role takes precedence over another." (*Missakian v. Amusement Industry, Inc.* (2021) 69 Cal.App.5th 630, 652 [285 Cal.Rptr.3d 23]; see also *General Dynamics Corp. v. Superior Court (Rose)* (1994) 7 Cal.4th 1164 [32 Cal.Rptr.2d 1] (recognizing this dynamic in the employment law context).)

Potential conflicts of interest arising from an in-house lawyer's movement from one in-house position to another[2] and an in-house lawyer's ownership of stock or stock options in the employer are two common situations in which these challenging questions often arise. As explained below, although the Rules of Professional Conduct apply with equal force to in-house lawyers as they do to independent lawyers, they must be analyzed in the context of both the attorney-client and employer-employee relationships at issue.

APPLICATION TO ISSUES PRESENTED

1. Is There a Conflict of Interest When an In-House Lawyer Moves from One Company to Another?

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

Rule 1.9(a) prohibits representation of a client, including an organization, whose interests are materially adverse in the same or substantially related matter to those of the lawyer's former client if the lawyer personally represented the former client in the matter. Even if the lawyer did not personally represent the former client, a conflict of interest exists under rule 1.9(b) based on their association with their prior law firm or legal department if the lawyer obtained confidential information that is material to the same or substantially related matter in which the two clients' interests are adverse. Informed written consent from the former client is required if rule 1.9(a) or (b) applies to the scope of employment, unless rule 1.10 applies and its screening requirements are satisfied.

In short, a conflict of interest exists based on a lawyer's personal representation of a former client *or* acquisition of confidential information material to a particular matter, provided that

[2] See ABA Formal Opn. No. 99-415 (1999) ("The increased frequency with which lawyers employed by an organization are hired by a competitor or by a law firm seeking the expertise gained by the lawyer in his former position has resulted in a greater focus on this issue. Current and prospective employers as well as in-house counsel themselves have reason for concern.").

the matters are the same or substantially related and the interests of the clients are materially adverse regarding the new matter.[3]

The analysis involves an examination of the matter handled for the former client and the proposed scope of representation for the matter to be handled for the new client. This exercise may be challenging for the in-house lawyer given the lawyer's relatively broad scope of employment. "Matters" are not as easily discernable as they are in a law firm setting. "Many corporate legal departments do not maintain the detailed time records customarily maintained by private law firms. In light of the factual nature of the determination of whether a lawyer has 'represented' the organization, it is desirable for in-house lawyers at least to maintain logs describing those matters on which they work." (ABA Formal Opn. No. 99-415 (1999), fn. 7.) However, this does not mean rule 1.9 is inapplicable to in-house lawyers; indeed, the representation is akin to an independent lawyer who is hired on retainer. (*PLCM Group, Inc. v. Drexler*, *supra,* 22 Cal.4th 1084, 1093.) The scope of the representation could encompass all legal issues or those limited to a particular subject matter, such as employment law issues.

A. Rule 1.9(a)—Personal Representation of Former Client

ABA Formal Opinion No. 99-415 discusses the personal representation prong of ABA Model Rule 1.9(a). "Even if the matter involved in the potential conflict was being handled by the legal department of the former employer prior to the in-house lawyer's departure, Rule 1.9(a) does not apply unless the in-house lawyer personally represented the former client." (ABA Form. Opn. No. 99-415 (1999).) Thus, "[a] distinction may be made between a lawyer who has been heavily involved in a matter and one who has dealt with issues and not with factual analysis." (*Ibid.*) In this respect, the same test applies whether the lawyer worked in the former client's legal department or for the law firm retained by the former client. There must be a "direct professional relationship with the former client in which the attorney personally provided legal advice and services on a legal issue that is closely related to the legal issue in the present representation." (*City and County of San Francisco v. Cobra Solutions, Inc.* (2006) 38 Cal.4th 839, 847 [43 Cal.Rptr.3d 771] [hereafter *Cobra Solutions*].)

The inquiry involves an examination of the lawyer's duties with their former employer. ABA Form. Opn. No. 99-415 (1999).) Here, Lawyer was not part of the team that advised Old Company concerning its technology and patent applications. Lawyer advised Old Company on labor and employment law issues. Thus, similar to a law firm lawyer who worked in a particular practice group and was not involved in representing firm clients on matters handled by lawyers in a different practice group, Lawyer's handling of labor and employment issues may not establish that Lawyer personally represented Old Company regarding its patents and technology. (See generally *Dieter v. Regents of the University of California* (E.D.Cal. 1997) 963

[3] Regardless of whether rule 1.9(a) or (b) applies, rule 1.9(c)(1) and (2) prohibits the use and disclosure of confidential information unless certain exceptions apply or the information has become "generally known." Note, however, that, "'[t]he fact that information can be discovered in a public record does not, by itself, render that information generally known under paragraph (c).'" See generally *In the Matter of Johnson* (Review Dept. 2000) 4 Cal. State Bar Ct. Rptr. 179; rule 1.9, Cmt. [5].

F.Supp. 908 [disqualification improper where lawyers who moved to new firm worked out of different offices and had no personal involvement in representing former client on substantially related, adverse matters].)[4] For purposes of analysis of conflicts under rule 1.9(a), this is true even if Lawyer's advice to, and representation of, Old Company related to employees who worked on Old Company's technology and patents. However, to the extent Lawyer acquired confidential information relating to technology and patents (or other client confidences), rule 1.9(b) and (c) govern Lawyer's duties and conduct.

Accordingly, under the facts presented, Lawyer did not personally represent Old Company with respect to its patent and technology matters. Therefore, rule 1.9(a) would not prohibit Lawyer from representing Company on such matters even if there is an adverse relationship with Old Company. Lawyer must then consider whether rule 1.9(b) applies.[5]

B. Rule 1.9(b)—Imputed Conflict of Interest Based on a Lawyer's Association with a Former Client's Legal Department

Even where no conflict arises under rule 1.9(a), a conflict of interest may still exist under rule 1.9(b). Rule 1.9(b) "prohibits an attorney whose firm represented a client on the same or substantially related matter from subsequently taking a position adverse to that client, but only *if* the lawyer had acquired confidential information 'material to the matter.'" (*Adams v. Aerojet-General Corp.* (2001) 86 Cal.App.4th 1324, 1337 [104 Cal.Rptr.2d 116] (interpreting ABA Model Rule 1.9(b)).) Thus, "[e]ven if a former in-house lawyer did not represent his former employer in the same or substantially related matter in which a new client is materially adverse, he still may be disqualified from representing the new client if he acquired protected information that is material to the new matter he wishes to undertake." (ABA Form. Opn. No. 99-415 (1999).) The analysis encompasses a fact-specific, flexible inquiry designed to balance the competing interests of loyalty owed to the former client and the choice of counsel of the new client. (*Adams v. Aerojet-General Corp*., *supra,* 86 Cal.App.4th at pp. 1337–1338; ABA Model Rule 1.7, Cmt. [3].)

i. Possession of Confidential Information

Lawyer will serve as Company's general counsel with direct and managerial responsibility over all legal issues, including those relating to Company's technology and intellectual property.

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[4] Cf. *Dynamic 3D Geosolutions LLC v. Schlumberger Ltd. (Schlumberger N.V.)* (Fed. Cir. 2016) 837 F.3d 1280, 1280 (holding that under Tex. Disciplinary R. Prof. Conduct 1.09 "[i]t was inappropriate to hire a senior attorney, one intimately knowledgeable concerning a particular product, its competitors, and its associated business strategies and intellectual property, into a position in which she not only participated in but in fact played a significant role in acquiring a patent used to accuse her former employer's product of patent infringement").

[5] Rule 1.9(a) may prohibit Lawyer from representing Company on labor and employment matters to the extent those matters are the same or substantially related to the matters Lawyer handled while employed at Old Company and the interests of Old Company and Company are materially adverse with respect to those matters.

Accordingly, Lawyer must consider whether they obtained confidential information relevant to this new, expansive role. (See generally *H.F. Ahmanson & Co. v. Salomon Brothers, Inc.* (1991) 229 Cal.App.3d 1445, 1454 [280 Cal.Rptr. 614] ["substantial relationship" test evaluates "whether 'confidential information material to the current dispute would normally have been imparted to the attorney by virtue of the nature of the former representation'"); *Dieter v. Regents, supra,* 963 F.Supp. at pp. 911–912 ["California courts look to whether 'confidential information material to the current dispute would normally have been imparted to the attorney by virtue of the nature of the former representation.'"] [Citations omitted].) "Application of paragraph (b) depends on a situation's particular facts, aided by inferences, deductions or working presumptions that reasonably may be made about the way in which lawyers work together." (ABA Model Rule 1.9(b), Cmt. [6].) In the in-house context, "[d]epending on the size and structure of the legal department and the extent to which it limits access to confidential information to those lawyers working on a matter, the lawyer may have obtained information as the result of shared confidences, requiring disqualification under Rule 1.9(b)." (ABA Form. Opn. No. 99-415 (1999).)

Lawyer should examine their matters at Old Company, Old Company's legal department structure, and the overall culture within Old Company concerning the exchange of confidential or proprietary information to determine whether they possess confidential information that may be material to Lawyer's new role as Company's general counsel. For example, although Lawyer's representation was limited to labor and employment matters, it is reasonably plausible that during the course of relevant communications with Old Company's employees and principals, technology issues, and related facts may have been discussed.

However, knowledge of a company's general business practices or philosophies (i.e., its "playbook") alone is not enough to disqualify a lawyer or violate rule 1.9(b). Instead, there must be a showing that the information gained from the "playbook" is of "critical importance" or is material to the matter at hand. (See rule 1.9(b)(2); *Fremont Indemnity Co. v. Fremont General Corp.* (2006) 143 Cal.App.4th 50, 65 [49 Cal.Rptr.3d 82].) "Under California law, a law firm is not subject to disqualification because one of its attorneys possesses information concerning an adversary's general business practices or litigation philosophy . . . ." (*Victaulic Co. v. American Home Assurance Co.* (2022) 80 Cal.App.5th 485, 512 [295 Cal.Rptr.3d 738], quoting, *Wu v. O'Gara Coach Co., LLC* (2019) 38 Cal.App.5th 1069, 1083 [251 Cal.Rptr.3d 573].)[6] Here, Lawyer's work on employment law matters, in and of itself, would not normally impart to Lawyer information relating to Old Company's patent applications and technology. Therefore, no facts

[6] "[N]ot every civil standard stated in the case law subjects a lawyer to discipline." Cal. Formal Opn. No. 1998-152. The Rules of Professional Conduct and State Bar Act regulate lawyer conduct through discipline to protect the public; disqualification rules are intended to preserve confidentiality and the integrity of judicial proceedings. Disqualification does not require proof of a disciplinary rule violation or disclosure of confidential information. Thus, disqualification standards do not automatically establish a violation of the Rules of Professional Conduct, so a lawyer may be disqualified but not subject to discipline for the same conduct. See Cal. Formal Opn. No. 1998-152; rule 1.0 and Cmt. [6].

suggest that Lawyer gleaned information from Old Company's "playbook" regarding its technology or patent applications that would rise to the level of material importance to Lawyer's new legal matters. Thus, the competing nature of the two companies and the similarity of Lawyer's roles at the two companies does not mean that Lawyer currently possesses, or previously had access to, confidential information which is material to Lawyer's anticipated new role as Company's general counsel.

ii. "Same or Substantially Related" Matters

Under rule 1.9(a) and (b), two matters are "the same or substantially related" if they involve a substantial risk of a violation of the duty of loyalty or the duty of confidentiality. (Rule 1.9, Cmt. [3].) The duty of loyalty to a former client means that the lawyer must refrain from doing "anything that will injuriously affect the former client in any matter in which the lawyer represented the former client." (Rule 1.9, Cmt. [3].) The duty of confidentiality to a former client means that the lawyer must refrain from using against the former client "knowledge or information acquired by virtue of the previous relationship." (Rule 1.9, Cmt. [1] [citing *Oasis West Realty, LLC v. Goldman* (2011) 51 Cal.4th 811 [124 Cal.Rptr.3d 256]; *Wutchumna Water Co. v. Bailey* (1932) 216 Cal. 564 [15 P.2d 505]].)

Examples of matters that are the same or substantially related include: "(i) if the matters involve the same transaction or legal dispute or other work performed by the lawyer for the former client; or (ii) if the lawyer normally would have obtained information in the prior representation that is protected by Business and Professions Code section 6068, subdivision (e) and rule 1.6, and the lawyer would be expected to use or disclose that information in the subsequent representation because it is material to the subsequent representation." (Rule 1.9, Cmt. [3].)

Again, the fact that Old Company and Company are competitors with similar technologies and patents is insufficient alone to establish that Lawyer represented Old Company in the same or substantially related matter to the matter or matters that Lawyer is expected to handle at Company. The inquiry involves a comparison of the specific facts and legal issues in the two matters. (ABA Form. Opn. No. 99-415 (1999); *Farris v. Fireman's Fund Ins. Co.* (2004) 119 Cal.App.4th 671, 681 [14 Cal.Rptr.3d 618] [hereafter *Farris*].) Thus, for example, the "same or substantially related" standard may be met where the two representations involve competing patents. (See generally *Nasdaq, Inc. v. Miami Int'l Holdings, Inc.* (2018) 2018 U.S. Dist. LEXIS 151813 [law firm disqualified from representing new client against former client in patent infringement case because "[a]ll of the patents at issue in this case relate to 'methods and systems for automated securities trading, including options trading,' and the accused technology is the same for all asserted patents"] (unpub. opn.).)

Here, based on the facts presented, Lawyer's role in the labor and employment department at Old Company is similar to their anticipated role as general counsel for Company only to the extent that both companies are economic competitors in the same technology space; and not because of any actual work performed or knowledge gained while working for Old Company.

This similarity alone, is insufficient to render the representations the same or substantially similar enough to trigger a conflict under rule 1.9(a) or (b).

In this instance, prior to accepting employment with Old Company's economic competitor, Lawyer would be required to perform an analysis under *Farris, supra,* 119 Cal.App.4th 671, by comparing the specific facts and legal issues in the above-described hypothetical dispute, with the type of work Lawyer expects to handle for Company. This is because Lawyer may be disqualified from representing Company if Lawyer acquired protected information that is material to any new matter Lawyer wishes to undertake on behalf of Company in Lawyer's new position. (ABA Form. Opn. No. 99-415 (1999).)

While Company may not be able to predict every future case or matter that it will need Lawyer to handle, the discussion below addresses circumstances where a conflict may arise post-employment. For example, a legal dispute or issue may arise between the two companies concerning intellectual property rights, or other proprietary interests, and about which Lawyer possesses material confidential information from Lawyer's time at Old Company.

iii. Material Adversity

Rule 1.9(a) and (b) both require material adversity. Ethics scholars "have generally concluded that 'material adverseness' includes, but is not limited to, matters where the lawyer is directly adverse on the same or a substantially related matter. While material adverseness is present when a current client and former client are directly adverse, material adverseness can also be present where direct adverseness is not." (ABA Form. Opn. No. 497 (2021).) "However, 'material adverseness' does not reach situations in which the representation of a current client is simply harmful to a former client's economic or financial interests, without some specific tangible direct harm." (*Ibid.*)

Material adverseness may arise in the future to the extent Lawyer is required to attack the work they performed on behalf of Old Company. (ABA Form. Opn. No. 497 (2021).) "Another type of 'material adverseness' exists when a lawyer attempts to attack her own prior work. For example, one court held that a lawyer cannot challenge a patent that the lawyer previously obtained for a former client." (*Id.* at p. 5 and fn. 17 [citing *Sun Studs, Inc. v. Applied Theory Associates, Inc.* (Fed.Cir. (Or.) 1985) 772 F.2d 1557, 1566–68; see also, *Oasis West Realty, supra*, 51 Cal.4th 811 [lawyer should not have lobbied against project that he earlier worked on].)

For example, in *Asyst Technologies, Inc. v. Empack, Inc.* (N.D.Cal. 1997) 962 F.Supp. 1241, two attorneys, while partners at one law firm, represented Asyst Techs, Inc. in prosecuting and obtaining several patents. The attorneys then moved to another law firm, which represented Empack against Asyst in an infringement lawsuit over the same patents and asserting a counterclaim challenging the validity of the patents. (*Ibid.*) Counsel for Asyst moved to disqualify the law firm representing Empack. The court granted the motion, reasoning that "[f]ew people are more likely to have confidential information with which to attack the validity of a patent than the lawyers who prosecuted it." (*Id.* at 1242.)

Here, Lawyer was not responsible for prosecuting patents on behalf of Old Company. However, to the extent Lawyer was involved in, or gained material knowledge of, such activity as labor and employment counsel, a conflict may arise to the extent Old Company and Company assert patent infringement and/or validity claims arising from that activity.

C. Rule 1.9(c)—Duty of Confidentiality Even Absent Conflict of Interest

Even if Lawyer determines that no conflict of interest exists under rule 1.9(a) or (b), Lawyer must still maintain inviolate Old Company's confidential information under rule 1.9(c). Nevertheless, rule 1.9(c) does not prohibit using information obtained through a prior representation where the information has become "generally known" (or where disclosure is otherwise authorized by the rules). (Rule 1.9, Cmt. [5] [citing, *In the Matter of Johnson* (Review Dept. 2000) 4 Cal. State Bar Ct. Rptr. 179].)

D. Rule 1.10—Screening

Based on the facts presented, Lawyer may determine that there is no initial conflict of interest for Lawyer under rule 1.9(a) or (b), and therefore no informed written consent from Old Company is required before Lawyer agrees to accept the general counsel position with Company. However, given that Old Company and Company are competitors, with similar technology and patents, a conflict of interest may arise in the future. For example, Company may elect to pursue a patent that directly challenges a patent held by Old Company for technology developed by its employees. If Lawyer acquired material, confidential information concerning the technology through handling labor and employment matters at Old Company, then a conflict of interest may arise under rule 1.9(b), which may be imputed to Company's legal department.

Rule 1.10 provides that "[w]hile lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by rules 1.7 or 1.9" unless the following conditions are satisfied:

> (1) The prohibited lawyer did not substantially participate in the same or substantially related matter;
>
> (2) The prohibited lawyer is timely screened from any participation in the matter and is apportioned no part of the fee therefrom; and
>
> (3) Written notice is promptly given to the affected former client to enable it to ascertain compliance with the provisions of the rule, which shall include a description of the screening; procedures employed; and an agreement by the firm to respond promptly to any written inquiries or objections by the former client about the screening procedures. (Rule 1.10(a)(2).)

Although Lawyer may have acquired material confidential information, it is unlikely that Lawyer substantially participated in matters involving Old Company's patents and technology because

Lawyer's work was limited to labor and employment.[7] Therefore, screening may be appropriate assuming it is timely implemented with the requisite notice to Old Company.[8] If an effective screening cannot be implemented, Company may instead need to refer the matter to outside counsel for handling. Outside counsel should report to one of Company's constituents other than Lawyer and other screening measures should be implemented to "wall off" Lawyer from the infringement matter.

2. Does a Stock Option Agreement Present a Lawyer with Any Conflicts of Interest and, If So, How and When Should Such Conflicts of Interest Be Addressed with the Employer?

A. Potential Application of Rule 1.8.1

In the traditional attorney-client relationship, a lawyer's acceptance of stock or stock options from a client in lieu of, or in addition to, fees for legal services is subject to rule 1.8.1, which governs when a lawyer knowingly acquires an ownership or other pecuniary interest adverse to a client. (See rule 1.8.1, Cmt. [5] ["This rule does not apply to the agreement by which the lawyer is retained by the client, unless the agreement confers on the lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client."]; ABA Formal Opn. No. 00-418 (2000) ["[A] lawyer who acquires stock in her client corporation in lieu of or in addition to a cash fee for her services enters into a business transaction with a client, such that the requirements of Model Rule 1.8(a) must be satisfied."].) If rule 1.8.1 applies, the lawyer must ensure that the following requirements are met:

(1) The transaction or acquisition and its terms are fair and reasonable to the client and the terms and the lawyer's role in the transaction or acquisition are fully disclosed and transmitted in writing to the client in a manner that should reasonably have been understood by the client;

(2) The client either is represented in the transaction or acquisition by an independent lawyer of the client's choice or the client is advised in writing* to seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(3) The client thereafter provides informed written consent to the terms of the transaction or acquisition, and to the lawyer's role in it.

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[7] Cf. *Take2 Techs. Ltd. v. Pac. Biosciences of Cal. Inc.* (2023) 2023 WL 4930359, 2023 U.S. Dist. LEXIS 199138 (conflict arising from lawyer's movement from law firm to in-house position was imputed to entire legal department in litigation between lawyer's former client and new employer because lawyer substantially participated in the matter prior to leaving the law firm by billing over 65 hours in preparing the lawsuit against her current employer, and had evaluated the specific patent and claim of infringement at issue in the litigation).

[8] See rule 1.10(a)(2)(iii).

The purpose of the rule is to address the inherently imbalanced relationship between attorney and client. (*Beery v. State Bar* (1987) 43 Cal.3d 802, 812–813 [239 Cal.Rptr. 121].) "The law accordingly takes da jaundiced view of business transactions between attorneys and their clients." (*Ferguson v. Yaspan* (2014) 233 Cal.App.4th 676, 684 [183 Cal.Rptr.3d 83].) Indeed, "the law presumes" attorneys engaging in such transactions "wear" a "black" hat. (*Mayhew v. Benninghoff* (1997) 53 Cal.App.4th 1365, 1369 [62 Cal.Rptr.2d 27].)[9]

However, these concerns are typically absent in the in-house context where the new lawyer is offered the same general compensation terms, including stock and stock options, as those offered to other employees. Indeed, the power dynamic may be reversed. "[F]rom an economic standpoint, the dependence of in-house counsel is indistinguishable from that of other corporate managers or senior executives who also owe their livelihoods, career goals and satisfaction to a single organizational employer." (*General Dynamics Corp. v. Superior Court, supra*, 7 Cal.4th at 1172.) In addition, the in-house lawyer's employment agreement may be prepared and/or presented by the general counsel, employment counsel, or other company counsel.

No California court has addressed whether rule 1.8.1 applies to stock or stock option agreements between in-house counsel and their employer. However, the Washington Supreme Court has recognized that compensation agreements for the in-house lawyer/employee, which may include nonmonetary compensation such as computers, cell phones, and health benefits, are more akin to standard employment contracts and should not be governed by Washington's version of rule 1.8.1 because, typically, "the lawyer has no advantage in dealing with the client." (See *Chism v. Tri-State Constr., Inc.* (Wash.App. 2016) 193 Wash.App. 818, 852 [374 P.3d 193]; [quoting Wa. Rule 1.8(a), Cmt. [1]]. See also Washington State Bar Association Advisory Opinion 1045 (1986) [concluding that lawyer's arms-length negotiation concerning in-house lawyer's compensation in the form of shares in the employer, a publicly traded corporation, did not violate Rule 1.8].)[10]

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[9] A lawyer's failure to satisfy the requirements of rule 1.8.1 subjects a lawyer to discipline. However, a violation of the rule does not by itself provide a basis for civil liability. Rather, the rule's "statutory counterpart—Probate Code section 16004—erects a presumption that transactions between an attorney and client 'by which the [attorney] obtains an advantage' are a breach of the attorney's fiduciary duty and are the product of undue influence." *Ferguson v. Yaspan, supra,* at 684–685; see also *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, 1140 [125 Cal.Rptr.3d 765]. "The presumption is rebuttable, and the attorney's inability to do so renders the transaction voidable at the client's option." *Ferguson v. Yaspan, supra,* at 685.

[10] Wa. Rule 1.8(a), Cmt. [1] states that: "[Rule 1.8(a)] does not apply to ordinary fee arrangements between client and lawyer, which are governed by Rule 1.5, although its requirements must be met when the lawyer accepts an interest in the client's business or other nonmonetary property as payment of all or part of a fee. In addition, the Rule does not apply to standard commercial transactions between the lawyer and the client for products or services that the client generally markets to others, for example, banking or brokerage services, medical services, products manufactured or distributed by the

The ABA Task Force on the Independent Lawyer (Task Force) reached a similar conclusion:

> In the usual case, the receipt of equity-based compensation by in-house counsel would not appear to be the type of 'business transaction with a client' contemplated by Rule 1.8. Option or restricted stock grants (the usual forms of equity compensation paid to in-house attorneys) are merely a form of compensation and, like cash, are a facet of the general employment relationship rather than part of or related to any particular transaction or undertaking.

(Litigation Section of the American Bar Association, *Lawyers Doing Business with Their Clients: Identifying and Avoiding Legal and Ethical Dangers, A Report of the Task Force on the Independent Lawyer* (2001) [hereafter Independent Lawyer Report].)

The Task Force noted that the timing, size and conditions placed on stock grants are typically the result of unilateral decisions by the corporate employer, in consultation with outside advisors and counsel. In short, the Task Force concluded, such stock grants, under normal circumstances, should not create interests that are adverse to the company's interests. In other words, this type of compensation arrangement is similar to "standard commercial transactions for products or services that a lawyer acquires from a client on the same terms that the client generally markets them to others, where the lawyer has no advantage in dealing with the client." (Rule 1.8.1, Cmt. [6].)

However, a distinction must be made between an employment agreement offered by an established company that contains stock grants or options as a general form of employment compensation, and other types of business transactions in which there is an inherent imbalance of power between attorney and client. For example, rule 1.8.1 applies to situations where the attorney and an existing or new client form a business together as owners or shareholders, and the attorney provides legal services to the newly formed business entity.[11] (See *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, 1169 [125 Cal.Rptr.3d 765]; see also, *Passante v. McWilliam* (1997) 53 Cal.App.4th 1240 [62 Cal.Rptr.2d 298].)

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client, and utilities' services. In such transactions, the lawyer has no advantage in dealing with the client, and the restrictions in paragraph (a) are unnecessary and impracticable." The Comments to rule 1.8.1 are substantially similar. See rule 1.8.1, Cmt. [5]: "This rule does not apply to the agreement by which the lawyer is retained by the client, unless the agreement confers on the lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client." See also, rule 1.8.1, Cmt. [6] "This rule does not apply . . . to standard commercial transactions for products or services that a lawyer acquires from a client on the same terms that the client generally markets them to others, where the lawyer has no advantage in dealing with the client."

[11] It is irrelevant that the lawyer is not formally designated as "general counsel" or "in-house counsel" for the business entity, or whether the lawyer provides both legal and nonlegal services. "When a member performs both legal and non-legal professional services for a client, the member is subject to the California Rules of Professional Conduct with respect to all of those services." Cal. Form. Opn. No. 1999-154.

Thus, in determining whether rule 1.8.1 applies, the in-house lawyer should analyze whether the equity-based compensation arrangement involves an imbalance of bargaining power as a result of the attorney-client relationship. Factors to consider include: (1) whether the lawyer was involved in advising on the organization's formation; (2) whether the proposed compensation agreement is drafted and proposed by the organization (or its counsel) or the lawyer; (3) whether the organization has independent counsel concerning the compensation agreement; (4) whether the compensation terms offered to the lawyer are substantively similar to those offered to employees at the same level; (5) whether the compensation is part of the lawyer's initial employment agreement, or modifications thereto, or related to the lawyer's work on a specific transaction.

If it is determined that rule 1.8.1 applies, then the requirements of rule 1.5(a), which governs the reasonableness of fees charged by a lawyer, must also be satisfied. However, this analysis is subsumed within the first prong of rule 1.8.1. "In determining whether [rule 1.8.1's] first requirement of fairness and reasonableness to the client is satisfied, the general standard of [rule 1.5(a)] that 'a lawyer's fee shall be reasonable' and the factors enumerated under that Rule are relevant." (ABA Formal Opn. No. 00-418 (2000).)[12]

Here, Lawyer is presented with a stock option agreement that is offered to Company's employees as part of Company's Stock Incentive Plan. The securities vest incrementally over time. Thus, stock options are offered as a standard form of compensation in the proposed employment agreement and not in connection with a particular transaction or undertaking. It is an arms-length transaction that does not trigger the requirements under rule 1.8.1.

B. Potential Application of Rule 1.7

Lawyer must separately consider whether the stock option provisions in the employment agreement present a material limitation conflict of interest under rule 1.7(b). Specifically, rule 1.7(b) prohibits representation of a client if there is a significant risk that the representation "will be materially limited . . . by the lawyer's own interests," without the informed written consent of the client. Further, the lawyer cannot represent the client even with the requisite consent from the client if the lawyer does not "reasonably believe that the lawyer will be able to provide competent and diligent representation to each affected client." (Rule 1.7(d)(1).) Thus, where the lawyer has a personal interest in the subject matter of the representation, the lawyer must assess whether their independent judgment will be materially impacted to the detriment of the client. (See ABA Model Rule 1.7, Cmt. [10] ["For example, if the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give a client detached advice . . . . See Rule 1.8 for specific Rules pertaining to a number of personal interest conflicts, including business transactions with clients."].)

[12] Analysis of rules 1.8.1 and 1.5(a) is beyond the scope of this opinion. ABA Form. Opn. No. 00-418 (2000) provides helpful guidance in determining compliance with both Rules in the context of a lawyer's stock ownership in a client corporation in lieu of or in addition to cash fee for services.

In ABA Formal Opn. No. 00-418 (20000), the committee opined that although the issuance of stock to outside counsel in lieu of or in addition to fees mandated compliance with Model Rule 1.8(a) (the equivalent to rule 1.8.1), it "creates no inherent conflict of interest" under the "material limitation" conflict provisions of Model Rule 1.7(b). The committee explained: "Indeed, management's role primarily is to enhance the business's value for the stockholders. Thus, the lawyer's legal services in assisting management usually will be consistent with the lawyer's stock ownership. In some circumstances, such as the merger of one corporation in which the lawyer owns stock into a larger entity, the lawyer's economic incentive to complete the transaction may even be enhanced." (*Id*. at p. 9.)

However, this does not render rule 1.7(b) wholly inapplicable to an in-house lawyer who owns stock or stock options. (See also Independent Lawyer Report, p. 56 ["To the extent . . . that the receipt of such compensation or the ownership of equity in the employer company might raise a question as to a potential conflict of interest or impairment of the representation, Rule 1.7 would govern."].) Indeed, the committee envisions a number of scenarios where a material limitation conflict could arise, such as advising corporate management on the duty to disclose materially adverse financial information. "[T]he lawyer must evaluate her ability to maintain the requisite professional independence as a lawyer in the corporate client's best interest by subordinating any economic incentive arising from her stock ownership." (ABA Form. Opn. No. 00-418 (2000) p. 10.) If the lawyer reasonably believes that the representation may be materially limited by stock ownership, the lawyer must consult with the client and obtain consent before continuing the representation. (*Ibid.*) This rule applies with equal force to in-house lawyers regardless of whether the stock option agreement was an arms-length negotiation falling outside the ambit of rule 1.8.1, as discussed *supra.*

Here, Company offers Lawyer participation in its Stock Incentive Plan, which includes stock options that vest incrementally over time. These are terms offered to other employees. At the outset of the employment relationship, these provisions by themselves do not present a significant risk that Lawyer's independent judgment will be materially limited to the detriment of Company. "Given the relatively limited equity stake of corporate counsel in most cases, the lawyer's ownership interest usually would not materially limit the representation. Indeed, equity-based compensation grants generally are made in small increments over time and, at the time made, are restricted in ways that give them only contingent, future value." (Independent Lawyer Report, p. 56.)

However, the stock option agreement also provides that in the event of a merger with or acquisition by another company, the vesting of Lawyer's option will immediately accelerate so as to become fully vested. Given that such a merger is a mere potentiality and lacking specificity as to any terms and timing, it is unlikely that it presents a significant risk at the outset of Lawyer's employment that the acceleration provision will materially limit Lawyer's representation. Lawyer may consider an advance conflict waiver if a reasonably comprehensive explanation of foreseeable scenarios in which Company may be adversely affected by the merger and acceleration of Lawyer's stock vesting can be provided. However, future events may require Lawyer to reassess whether a second confirming waiver is required. (See generally

rule 1.7, Cmt. [9]; *Sheppard, Mullin, Richter & Hampton LLP v. J-M Manufacturing Co., Inc.* (2018) 6 Cal.5th 59 [237 Cal.Rptr.3d 424].) Even if an advance waiver is obtained, in the event of a merger, Lawyer should reassess whether a second confirming waiver is required depending on the specificity of the advance waiver and whether it reasonably predicted the materialized conflict. (See *Visa U.S.A., Inc. v. First Data Corp* (N.D.Cal. 2003) 241 F.Supp.2d 1100; *Western Sugar Coop. v. Archer-Daniels-Midland Co.* (C.D.Cal. 2015) 98 F.Supp.3d 1074 [material change may trigger need for new disclosure and informed written consent]; Independent Lawyer Report, p. 43.)

CONCLUSION

The employer-employee relationship inherent in the role of a corporate in-house lawyer presents unique challenges with respect to the application of the conflicts rules that govern the legal profession as a whole. Nevertheless, in-house lawyers are not exempt from compliance with those rules. With respect to movement between companies and compliance with rules 1.9 and 1.10, an in-house lawyer must examine their involvement in matters on which there is or may be direct adversity between their former and potential new employers, as well as whether they were exposed to confidential information material to an adverse matter. If their compensation involves the issuance of stock or stock options, they must examine the circumstances of the offer, and the nature of their relationship with the company to determine if rule 1.8.1 applies and governs the stock transaction. Even if it is determined that rule 1.8.1 does not apply, the lawyer has an ongoing obligation to assess whether their stock ownership presents a significant risk that their representation will be materially limited by their financial interests in connection with a particular matter on which the lawyer is asked or expected to provide advice and counsel.