



The State Bar of California

Rule 1.8.1 Business Transactions with a Client and Pecuniary Interests Adverse to a Client (Rule Approved by the Supreme Court, Effective November 1, 2018)

A lawyer shall not enter into a business transaction with a client, or knowingly* acquire an ownership, possessory, security or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

- (a) 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;
- (b) 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
- (c) the client thereafter provides informed written consent* to the terms of the transaction or acquisition, and to the lawyer's role in it.

Comment

[1] A lawyer has an "other pecuniary interest adverse to a client" within the meaning of this rule when the lawyer possesses a legal right to significantly impair or prejudice the client's rights or interests without court action. (See *Fletcher v. Davis* (2004) 33 Cal.4th 61, 68 [14 Cal.Rptr.3d 58]; see also Bus. & Prof. Code, § 6175.3 [Sale of financial products to elder or dependent adult clients; Disclosure]; Fam. Code, §§ 2033-2034 [Attorney lien on community real property].) However, this rule does not apply to a charging lien given to secure payment of a contingency fee. (See *Plummer v. Day/Eisenberg, LLP* (2010) 184 Cal.App.4th 38 [108 Cal.Rptr.3d 455].)

[2] For purposes of this rule, factors that can be considered in determining whether a lawyer is independent include whether the lawyer: (i) has a financial interest in the transaction or acquisition; and (ii) has a close legal, business, financial, professional or personal relationship with the lawyer seeking the client's consent.

[3] Fairness and reasonableness under paragraph (a) are measured at the time of the transaction or acquisition based on the facts that then exist.

[4] In some circumstances, this rule may apply to a transaction entered into with a former client. (Compare *Hunnicutt v. State Bar* (1988) 44 Cal.3d 362, 370-71 ["[W]hen an attorney enters into a transaction with a former client regarding a fund which resulted from the attorney's representation, it is reasonable to examine the relationship between the parties for indications of special trust resulting therefrom. We conclude that if there is evidence that the client placed his trust in the attorney because of the representation, an attorney-client relationship exists for the purposes of [the predecessor rule] even if the representation has otherwise ended [and] It appears that [the client] became a

target of [the lawyer's] solicitation because he knew, through his representation of her, that she had recently received the settlement fund [and the court also found the client to be unsophisticated].”] with *Wallis v. State Bar* (1942) 21 Cal.2d 322 [finding lawyer not subject to discipline for entering into business transaction with a former client where the former client was a sophisticated businesswoman who had actively negotiated for terms she thought desirable, and the transaction was not connected with the matter on which the lawyer previously represented her].)

[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. Such an agreement is governed, in part, by rule 1.5. This rule also does not apply to an agreement to advance to or deposit with a lawyer a sum to be applied to fees, or costs or other expenses, to be incurred in the future. Such agreements are governed, in part, by rules 1.5 and 1.15.

[6] This rule does not apply: (i) where a lawyer and client each make an investment on terms offered by a third person* to the general public or a significant portion thereof; or (ii) 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.

**NEW RULE OF PROFESSIONAL CONDUCT 1.8.1
(Former Rule 3-300)
Business Transactions with a Client and Pecuniary Interests Adverse to a Client**

EXECUTIVE SUMMARY

The Commission for the Revision of the Rules of Professional Conduct (“Commission”) evaluated current rule 3-300 (Avoiding Interests Adverse to a Client) in accordance with the Commission Charter. In addition, the Commission considered the national standard of ABA Model Rule 1.8(a). The result of the Commission’s evaluation is proposed rule 1.8(a) (Conflicts of Interest: Current Clients: Specific Rules).

Rule As Issued For 90-day Public Comment

Proposed rule 1.8.1 states a lawyer’s duties when entering into a business transaction with a client or acquiring an adverse pecuniary interest. In general, a transaction between a fiduciary and a beneficiary gives rise to a presumption of self-dealing.¹ Two main issues were considered in drafting proposed rule 1.8.1. The first issue pertains to the current rule’s requirement that an attorney advise clients that they may seek independent counsel. The Commission considered whether there should be an exception to this requirement in the limited circumstance where a client is already represented by another lawyer in the specific transaction. The second issue was whether the rule should be clarified as to its applicability to a modification of a lawyer-client fee agreement.² In the current rule’s Discussion section, there is only limited guidance on the applicability of the rule to fee agreements. That guidance states that: “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.”

Regarding circumstances where the client is already represented by another lawyer in the transaction, the Commission recommends adding the exception to the requirement that an attorney advise clients that they may seek independent counsel (see proposed paragraph (b)). The Commission reasoned that the client protection intended by this requirement is not furthered by requiring an advisement in such circumstances because the objective of the requirement is already met, namely the client has retained a lawyer to advise the client on the transaction. In addition, the Commission was concerned that the lawyer’s act of giving advisement notwithstanding that the client is already represented by another lawyer might be

¹ See Probate Code § 16004(c) which provides that:

A transaction between the trustee and a beneficiary which occurs during the existence of the trust or while the trustee's influence with the beneficiary remains and by which the trustee obtains an advantage from the beneficiary is presumed to be a violation of the trustee's fiduciary duties. This presumption is a presumption affecting the burden of proof. This subdivision does not apply to the provisions of an agreement between a trustee and a beneficiary relating to the hiring or compensation of the trustee.

² This ambiguity in the current rule is discussed in an ethics alert article by the Committee on Professional Responsibility and Conduct (“COPRAC”) entitled: “Uncertain Ethics Requirements for Attorney Fee Modifications Counsel Compliance with Rule 3-300 when Modifying a Fee Agreement.” The article includes a comment from the Office of the Chief Trial Counsel arguing that all modifications should be regarded as transactions because a current client’s trust and confidence is implicated. The article is posted at: http://ethics.calbar.ca.gov/Portals/9/documents/Publications/EthicsHotliner/Ethics_Hotliner-Fee_Modification_Rule_3-300-Summer_09.pdf.

perceived by the client as denigrating the independent lawyer that the client has already chosen and therefore could interfere with the client's confidence in that lawyer's advice.

Regarding the issue of whether the rule should be clarified as to its applicability to a modification of a lawyer-client fee agreement, the Commission recommends amending the existing Discussion guidance to state that the rule "does not apply to the provisions of an agreement between a lawyer and client relating to the lawyer's hiring or compensation unless the agreement confers on the lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client." The Commission viewed this clarification as preferable to the alternative of an amendment stating, as an absolute proposition, that rule applies to any and all modifications of a fee arrangement that arise during the lawyer-client relationship. The Commission was concerned that if the rule were to apply to all fee agreement modifications, it might require compliance each time a lawyer: (i) agrees to represent a current client in a new matter; (ii) agrees to a change in the billing rate (including workouts or changes reducing a client's fee obligations); and (iii) agrees to alter the scope of a current representation (including expanding the scope of services in flat or fixed fee arrangements even if there is no concomitant agreement for an additional fee or fee increase). The Commission also observed that discipline already is available when a lawyer utilizes the lawyer-client relationship to manipulate a client (see *In the Matter of Shalant* (2006) 4 Cal. State Bar Ct. Rptr. 829) and for a situation where a fee arrangement is unconscionable (see rule 4-200).³

In addition to these two main issues, other proposed amendments include the following.

- In paragraph (a), adding to the existing client disclosure requirement that the lawyer must disclose "the lawyer's role in the transaction or acquisition."
- In paragraph (c), restating the existing requirement to obtain client consent in writing after disclosure as a requirement to obtain a client's "informed written consent to the terms of the transaction or the terms of the acquisition."
- In Comment [1], providing cross references to related statutory provisions concerning the sale of financial products to an elder (Business and Professions Code § 6175.3) and attorney liens on community real property (Family Code §§ 2033 - 2034).
- In Comment [2], adding new guidance on factors that may be considered for determining whether an attorney is an "independent lawyer" under paragraph (b) of the proposed rule.

Related Model Rule concepts considered in connection with Model Rule 1.8(a).

In studying Model Rule 1.8(a), the Commission also considered Model Rules 1.8(d) and (i). The Commission is not recommending adoption of these rules. Model Rule 1.8(d) provides that: "Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation." Model Rule 1.8(i) provides that: "A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may: (1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and (2) contract with a client for a reasonable contingent fee in a civil case."

³ Under rule 4-200(B)(11), a factor for determining the conscionability of a fee is: "The informed consent of the client to the fee."

The Commission construes both of these rules as imposing absolute prohibitions on lawyer conduct. As absolute prohibitions carrying a penalty of State Bar discipline, they are inconsistent with existing California law or policy. The Commission finds that the essential conduct addressed in these Model Rules properly falls under current rule 3-300 and that the public protection afforded by rule 3-300 is more consistent with existing California law than the absolute prohibitions in the Model Rules. Regarding acquisition of literary or media rights, see: *Maxwell v. Superior Court* (1982) 30 Cal.3d 606; and *People v. Doolin* (2009) 45 Cal.4th 390, 391. See also: *Haraguchi v. Superior Court* (2008) 43 Cal.4th 706, 719 at n. 16. Regarding the acquisition of a property interest in the cause of action or subject matter of a client's litigation, see *Mathewson v. Fitch* (1863) 22 Cal. 86 and *Estate of Cohen* (1944) 66 Cal.App.2d 450, 458. As explained in the Model Rule comments, Model Rule 1.8(i) is a regulatory concept based on common law prohibitions on champerty and maintenance, but California has never included the concept of maintenance and champerty in a rule of professional conduct. For both of these Model Rules, the Commission believes that if ultimately adopted proposed rule 1.8.1 should serve as the applicable disciplinary standard.

Revisions Following 90-Day Public Comment Period

Rule Text. After consideration of comments received in response to the initial 90-day public comment period, the Commission largely confirmed its initial recommendations regarding proposed amendments to the rule. However, it implemented a non-substantive revision in paragraph (a) to use the active voice in stating a lawyer's duty of client disclosure. For brevity and clarity, non-substantive revisions also were made in paragraph (c), in part, to remove repeated references to "the terms of" a business transaction or an acquisition of an adverse interest.

Comments. Substantive changes were made to the Comments regarding the applicability of the rule to: (1) a modification of a fee agreement; and (2) dealings with a former client.

Fee modifications. In Comment [1] of the public comment version of the proposed rule, the Commission attempted to clarify to what extent, if any, the proposed rule applied to a modification of a fee agreement but public comments received questioned the clarity and policy of this change. In response to the public comments, the Commission determined to delete the language in Comment [1] concerning modification of fee agreements. Rather than attempting to clarify this issue, the Commission decided to maintain the status quo and restored the language of the current rule's Discussion section. That language has been added at the start of Comment [5].

Business dealings with former clients. Regarding a lawyer's dealings with a former client, the Commission added a new Comment [4] in response to a public comment from the State Bar's Office of the Chief Trial Counsel. The new comment cites to case law holding that the current rule may in some circumstances apply to a transaction entered into with a former client. This new comment promotes compliance by putting lawyers on notice that the rule may apply even in dealings with a person who technically is not a current client of the lawyer at the time of the business transaction or the acquisition of an adverse interest.

With these changes, the Board authorized an additional 45-day public comment period on the revised proposed rule.

Final Commission Action on the Proposed Rule Following 45-Day Public Comment Period

After consideration of comments received in response to the additional 45-day public comment period, the Commission made no changes to the proposed rule and voted to recommend that the Board adopt the proposed rule. A member of the Commission submitted a dissent to this rule that can be found following the Report and Recommendation.

The Board adopted proposed rule 1.8.1 at its March 9, 2017 meeting.

Supreme Court Action (May 10, 2018)

The Supreme Court approved the rule as modified by the Court to be effective November 1, 2018. The Supreme Court modified paragraph (a) as follows:

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

In Comments [1] and [4], citation style was revised to conform to the California Style Manual. In Comment [2], a semicolon was substituted for a comma after the word "acquisition."

Rule 1.8.1 Business Transactions with a Client and
Rule 3-300 Avoiding Pecuniary Interests Adverse to a Client
(Redline Comparison to the California Rule Operative Until October 31, 2018)

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

- (A)(a) ~~The~~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 ~~which~~that should reasonably~~;~~* have been understood by the client; ~~and~~
- (B)(b) ~~The client~~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~~;~~* ~~that the client may~~to seek the advice of an independent lawyer of the client's choice and is given a reasonable~~;~~* opportunity to seek that advice; and
- (C)(c) ~~The~~the client thereafter ~~consents in writing~~provides informed written consent* to the terms of the transaction or ~~the terms of the~~acquisition, ~~and to the lawyer's role in it.~~

Comment**Discussion**

[1] A lawyer has an "other pecuniary interest adverse to a client" within the meaning of this rule when the lawyer possesses a legal right to significantly impair or prejudice the client's rights or interests without court action. (See *Fletcher v. Davis* (2004) 33 Cal.4th 61, 68 [14 Cal.Rptr.3d 58]; see also Bus. & Prof. Code, § 6175.3 [Sale of financial products to elder or dependent adult clients; Disclosure]; Fam. Code, §§ 2033-2034 [Attorney lien on community real property].) However, this rule does not apply to a charging lien given to secure payment of a contingency fee. (See *Plummer v. Day/Eisenberg, LLP* (2010) 184 Cal.App.4th 38 [108 Cal.Rptr.3d 455].)

[2] For purposes of this rule, factors that can be considered in determining whether a lawyer is independent include whether the lawyer: (i) has a financial interest in the transaction or acquisition; and (ii) has a close legal, business, financial, professional or personal relationship with the lawyer seeking the client's consent.

[3] Fairness and reasonableness under paragraph (a) are measured at the time of the transaction or acquisition based on the facts that then exist.

[4] In some circumstances, this rule may apply to a transaction entered into with a former client. (Compare *Hunnecutt v. State Bar* (1988) 44 Cal.3d 362, 370-71 ["[W]hen an attorney enters into a transaction with a former client regarding a fund which resulted from the attorney's representation, it is reasonable to examine the relationship between the parties for indications of special trust resulting therefrom. We conclude that if there is evidence that the client placed his trust in the attorney because of the representation, an attorney-client relationship exists for the purposes of [the predecessor rule] even if

the representation has otherwise ended [and] It appears that [the client] became a target of [the lawyer's] solicitation because he knew, through his representation of her, that she had recently received the settlement fund [and the court also found the client to be unsophisticated].”] with *Wallis v. State Bar* (1942) 21 Cal.2d 322 [finding lawyer not subject to discipline for entering into business transaction with a former client where the former client was a sophisticated businesswoman who had actively negotiated for terms she thought desirable, and the transaction was not connected with the matter on which the lawyer previously represented her].)

~~Rule 3-300 is~~^[5] This rule does not intended to apply to the agreement by which the ~~member~~^{lawyer} is retained by the client, unless the agreement confers on the ~~member~~^{lawyer} an ownership, possessory, security, or other pecuniary interest adverse to the client. Such an agreement is governed, in part, by rule ~~4-200.1.5~~. This rule also does not apply to an agreement to advance to or deposit with a lawyer a sum to be applied to fees, or costs or other expenses, to be incurred in the future. Such agreements are governed, in part, by rules 1.5 and 1.15.

[6] This rule does not apply: (i) where a lawyer and client each make an investment on terms offered by a third person* to the general public or a significant portion thereof; or (ii) 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 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.~~