

IN-HOUSE COUNSEL DRAFT OPINION

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2
3 **ISSUE:** What conflicts of interest are presented by a stock option agreement between
4 in-house lawyer and the company?

5 In-house lawyers are often offered employee stock options as part of their
6 compensation package. In a typical attorney-client relationship - - which is inherently
7 imbalanced in favor of the attorney - - taking stock in a client requires compliance with
8 CRPC 1.8.1: the transaction must be fair and reasonable; the lawyer's role in the
9 transaction must be fully and plainly disclosed to the client in writing; and the client is
10 advised in writing to consult with independent counsel about the transaction and the
11 client thereafter provides informed written consent to it. In general, this rule applies in
12 the in-house context, even if the new lawyer is offered the same general compensation
13 terms as those offered to other employees and indicia of inequality do not exist.

14 **NM: I'm still having a problem with the framing. This rule doesn't seem to be optional.**
15 **So it is strange to frame this opinion as sort of providing an exception to the rule that**
16 **doesn't exist.**

17 **NM: I feel as a practical matter, most stock option agreements tick the relevant boxes of**
18 **1.8.1. So I would consider narrowing the framing on this.**

19 However, the Committee is cognizant that some in-house lawyers have not strictly
20 followed CRPC 1.8.1 when acquiring own stock or stock options in the companies where
21 they work. These lawyers, and those contemplating new in-house positions where
22 similar types of incentive-based compensation is offered, should assess the risk of
23 noncompliance. Factors to consider include (1) whether the lawyer was involved in
24 advising on the organization's formation; (2) whether the proposed compensation
25 agreement is drafted and proposed by the organization (or its counsel) or the lawyer; (3)
26 whether the organization has independent counsel concerning the compensation
27 agreement; (4) whether the compensation terms offered to the lawyer are substantively
28 similar to those offered to employees at the same level; and (5) whether the
29 compensation is part of the lawyer's initial employment agreement, or modifications
30 thereto, or related to lawyer's work on a specific transaction. These factors are not
31 exhaustive but are intended as an analytical tool.

32 Stock ownership may likewise trigger a material limitation conflict under CRPC 1.7(b) if
33 there is a significant risk that the in-house lawyer's representation will be materially
34 limited by their financial interest in connection with their stock ownership. Such a
35 conflict could arise if the lawyer is asked to advise the company concerning a
36 transaction that affects the character or price of the stock, such as a merger or
37 acquisition. If so, the lawyer must obtain informed written consent from an authorized
38 constituent of the company. If the lawyer does not reasonably believe they can
39 competently represent the company due to the conflict, or if the company refuses to

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40 consent to the conflict, the lawyer must refer the matter to nonconflicted in-house
41 counsel or outside counsel.

42 NM: Again, I don't think we should be encouraging lawyers to forego the requirement.

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44 AUTHORITIES

45 INTERPRETED: Rules of Professional Conduct 1.0.1, 1.7, 1.8.1, 1.13

46

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STATEMENT OF FACTS

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

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

62

63

ISSUE PRESENTED

64 Does the stock option agreement present Lawyer with any conflicts of interest and if so,
65 how and when should such conflicts of interest be addressed with the Company?

66

DISCUSSION AND ANALYSIS

67

I. Overview

68 "[C]ounsel working for a corporation in-house and private counsel engaged with respect to a
69 specific matter or on retainer" are "bound by the same fiduciary and ethical duties to their
70 clients." *PLCM Group, Inc. v. Drexler* (2000) 22 Cal. 4th 1084, 1094. In-house lawyers have
71 attorney-client relationships with the organizations that employ them. *Gutierrez v. G & M Oil*
72 *Co., Inc.* (2010) 184 Cal.App.4th 551, 559. Specifically, an organization's legal department is
73 encompassed within the definition of "law firm." California Rules of Professional Conduct
74 (CRPC) 1.0.1(c) ("Firm' or 'law firm' means . . . lawyers employed in a legal services
75 organization or in the legal department, division or office of a corporation, of a government
76 organization, or of another organization."). A lawyer's duties to an organizational client are the

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77 same whether they are “employed or retained” by the organization. CRPC 1.13(a). In short, the
78 underlying purposes of a lawyer’s fiduciary duties—protecting the public and the integrity of
79 the legal system and promoting the administration of justice and confidence in the legal
80 profession—are not diminished simply because the lawyer is employed rather than retained by
81 an organizational client.

82 These principles similarly apply to the in-house lawyer’s compensation for legal services. Thus,
83 when an in-house lawyer is presented with a stock option agreement or stock as part of their
84 compensation, that lawyer must analyze whether the proposed arrangement triggers any
85 conflicts of interest. This may be difficult if the lawyer serves a dual role of employee (where
86 the balance of power typically favors the employer-client) and attorney (where the balance of
87 power between attorney and client typically favors the attorney) “For example, in-house
88 lawyers may be seen to owe different duties than independent lawyers, perhaps because they
89 are viewed as employees of the client directly rather than indirectly.” *Klein, No Fool for a Client:
90 The Finance and Incentives Behind Stock-Based Compensation for Corporate Attorneys*, 1999
91 Colum. Bus. L. Rev. 330. Accordingly, “[t]he dual status of in-house counsel—acting as both
92 employee and attorney—and the dual status of the company—acting as both employer and
93 client—can pose some challenging questions about when one role takes precedence over
94 another.” *Missakian v. Amusement Industry, Inc.* (2021) 69 Cal.App.5th 630, 652; *see also*,
95 *General Dynamics Corp. v. Superior Court (Rose)* (1994) 7 Cal.4th 1164 (recognizing this dynamic
96 in the employment law context).

97 **II. Does the stock option agreement present Lawyer with any conflicts of interest, and if**
98 **so, how and when should such conflicts of interest be addressed with the Company?**

99

100 **A. Potential Application of CRPC 1.8.1**

101 In the traditional attorney-client relationship, a lawyer’s acceptance of stock or stock options
102 from a client in lieu of or in addition to fees for legal services is subject to CRPC 1.8.1, which
103 governs when a lawyer knowingly acquires an ownership or other pecuniary interest adverse to
104 a client. *See* CRPC 1.8.1, Comment [5] (“This rule does not apply to the agreement by which the
105 lawyer is retained by the client, unless the agreement confers on the lawyer an ownership,
106 possessory, security, or other pecuniary interest adverse to the client.”); ABA Formal Opn. 00-
107 418 (“[A] lawyer who acquires stock in her client corporation in lieu of or in addition to a cash
108 fee for her services enters into a business transaction with a client, such that the requirements
109 of Model Rule 1.8(a) must be satisfied.”). If CRPC 1.8.1 applies, the lawyer must ensure that the
110 following requirements are met:

111 (a) the transaction or acquisition and its terms are fair and
112 reasonable to the client and the terms and the lawyer’s role in the
113 transaction or acquisition are fully disclosed and transmitted in

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114 writing to the client in a manner that should reasonably have
115 been understood by the client;

116 (b) the client either is represented in the transaction or
117 acquisition by an independent lawyer of the client’s choice or the
118 client is advised in writing* to seek the advice of an independent
119 lawyer of the client’s choice and is given a reasonable opportunity
120 to seek that advice; and

121 (c) the client thereafter provides informed written consent to the
122 terms of the transaction or acquisition, and to the lawyer’s role in
123 it.

124 The purpose of the rule is to address the inherently imbalanced relationship between attorney
125 and client. *Beery v. State Bar* (1987) 43 Cal.3d 802, 812-813. “The law accordingly takes a
126 jaundiced view of business transactions between attorneys and their clients.” *Ferguson v.*
127 *Yaspan* (2014) 233 Cal. App. 4th 676, 685. Indeed, “the law presumes” attorneys engaging in
128 such transactions “wear” a “black” hat. *Mayhew v. Benninghoff* (1997) 53 Cal. App.4th 1365,
129 1369.¹

130 Some of these concerns may be less pronounced in the in-house context, where the new lawyer
131 is offered the same general compensation terms, including stock and stock options, as those
132 offered to other employees. Indeed, the power dynamic may be reversed. “[F]rom an economic
133 standpoint, the dependence of in-house counsel is indistinguishable from that of other
134 corporate managers or senior executives who also owe their livelihoods and career goals and
135 satisfaction to a single organizational employer.” *General Dynamics Corp. v. Superior Court,*
136 *supra*, 7 Cal. 4th at 1172. In addition, the in-house lawyer’s employment agreement may be
137 prepared and/or presented by the General Counsel, employment counsel, or other company
138 counsel.

139 No California court has addressed whether CRPC 1.8.1 applies to stock or stock option
140 agreements between in-house counsel and their employer. In the absence of such authority,
141 the Committee cannot opine that it does not apply. At the same time, the Committee is
142 cognizant of the practical reality that many in-house lawyers own stock or stock options in the
143 companies for which they work despite that they have not fully complied with CRPC 1.8.1.

¹ 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 give rise to a cause of action for damages caused by a failure to comply with the rule. . 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. “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.

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144 Out of state authority and the ABA provide some guidance on this issue. The Washington
145 Supreme Court has recognized that compensation agreements for the in-house
146 lawyer/employee, which may include nonmonetary compensation such as computers, cell
147 phones and health benefits, are more akin to standard employment contracts and should not
148 be governed by Washington's version of CRPC 1.8.1, because, typically, "the lawyer has no
149 advantage in dealing with the client." (See, *Chism v. Tri-State Constr., Inc.*, 193 Wn. App. 818,
150 852; quoting, Wa. RPC 1.8(a), Comment [1]. See also Washington State Bar Association Advisory
151 Opinion 1045 (1986) [concluding that in-house lawyer's arms-length negotiation concerning
152 compensation in the form of shares in the employer, a publicly traded corporation, did not
153 violate Washington's version of CRPC 1.8].)²

154

155 The ABA Task Force on the Independent Lawyer ["Task Force"] reached a similar conclusion:

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

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

167 The Task Force noted that the "timing, size and conditions" placed on stock grants are typically
168 the result of unilateral decisions by the corporate employer, in consultation with outside
169 advisors and counsel. In short, the Task Force concluded, such stock grants, under normal
170 circumstances, should not create interests that are "adverse" to the company's interests. In

² Wa. RPC 1.8(a), Comment [1] states that "[RPC 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 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 CRPC 1.8.1 are substantially similar. See CRPC 1.8.1, Comment [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, CRPC 1.8.1, Comment [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."

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171 other words, this type of compensation arrangement would be similar to a “standard
172 commercial transactions for products or services that a lawyer acquires from a client on the
173 same terms that the client generally markets them to others, where the lawyer has no
174 advantage in dealing with the client.” CRPC 1.8.1, Comment [6].

175 However, a distinction must be made between “normal circumstances,” i.e., an employment
176 agreement offered by an established company that contains stock grants or options as a
177 general form of employment compensation, and other types of business transactions in which
178 there is an inherent imbalance of power between attorney and client. For example, CRPC 1.8.1
179 applies to situations where the attorney and an existing or new client form a business together
180 as founders or shareholders, and the attorney provides legal services to the newly-formed
181 business entity.³ See, *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, 1169; see also, *Passante v.*
182 *McWilliam* (1997) 53 Cal.App.4th 1240.

183 Thus, to determine whether the arrangement falls within “normal circumstances,” the in-house
184 lawyer should analyze whether the equity-based compensation arrangement is a “standard”
185 contract that does not involve an imbalance of bargaining power in favor of the lawyer. Factors
186 to consider include (1) whether the lawyer was involved in advising on the organization’s
187 formation; (2) whether the proposed compensation agreement is drafted and proposed by the
188 organization (or its counsel) or the lawyer; (3) whether the organization has independent
189 counsel concerning the compensation agreement; (4) whether the compensation terms offered
190 to the lawyer are substantively similar to those offered to employees at the same level; (5)
191 whether the compensation is part of Lawyer’s initial employment agreement, or modifications
192 thereto, or related to Lawyer’s work on a specific transaction.

193 NM: Maybe we can sort of caveat this at the outset and say that we encourage compliance in
194 all circumstances, BUT at a min, please pay attention to this area...

195 CC: Yes, I think we should discuss revising these sections regarding distinction between
196 “normal” circumstances and instances where the lawyer is a founder as in *Fair*. I’m not sure
197 what we are trying to say if our opinion is that compliance is required in all situations.

198 Again, the Committee cautions that even if these factors weigh against application of CRPC
199 1.8.1, it only lessens the risk of a violation of the rule.

200 Here, Lawyer was not involved in Company’s formation. Lawyer is presented with a stock
201 option agreement that is offered to the Company’s employees as part of the Company’s Stock
202 Incentive Plan. The securities vest incrementally over time. Thus, stock options are offered as a
203 standard form of compensation in the proposed employment agreement and not in connection

³ 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. 1999-154.

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204 with a particular transaction or undertaking. It is an arms-length transaction. Compliance with
205 CRPC 1.8.1 would be superfluous (?) [exhausting form over substance?].

206 However, Lawyer should also consider relatively easy burden of compliance. It is Company's
207 proposal and undoubtedly views the terms fair and reasonable. The additional step of obtaining
208 Company's express acknowledgement of its right to consult with independent counsel and
209 informed written consent to the arrangement would not be burdensome.

210 **NM: This is the key for me. I can't read 1.8.1 any way other than mandating this.**

211 **B. Potential Application of CRPC 1.7**

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

226 In ABA Formal Opn. 00-418 (2000), the committee opined that although issuance of stock to
227 outside counsel in lieu of or in addition to fees mandated compliance with Model Rule 1.8(a)
228 (the equivalent to CRPC 1.8.1), it "creates no inherent conflict of interest" under the "material
229 limitation" conflict provisions of Model Rule 1.7(b). The committee explained: "Indeed,
230 management's role primarily is to enhance the business's value for the stockholders. Thus, the
231 lawyer's legal services in assisting management usually will be consistent with the lawyer's
232 stock ownership. In some circumstances, such as the merger of one corporation in which the
233 lawyer owns stock into a larger entity, the lawyer's economic incentive to complete the
234 transaction may even be enhanced." (*Id.* at p. 9.)

235 However, this does not render CRPC 1.7(b) wholly inapplicable to an in-house lawyer who owns
236 stock or stock options. See *also*, Independent Lawyer Report, p. 56 ("To the extent . . . that the
237 receipt of such compensation or the ownership of equity in the employer company might raise
238 a question as to a potential conflict of interest or impairment of the representation, Rule 1.7
239 would govern.") Indeed, the committee envisions a number of scenarios where a material
240 limitation conflict could arise, such as advising corporate management on the duty to disclose
241 materially adverse financial information. "[T]he lawyer must evaluate her ability to maintain the

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242 requisite professional independence as a lawyer in the corporate client’s best interest by
243 subordinating any economic incentive arising from her stock ownership.” ABA Form. Opn. 00-
244 418 (2000), p. 10. If the lawyer reasonably believes that her representation may be materially
245 limited by her stock ownership she must consult with the client and obtain consent before
246 continuing the representation. *Ibid.* This rule applies with equal force to in-house lawyers
247 regardless of whether the stock option agreement was an arms-length negotiation falling
248 outside the ambit of CRPC 1.8.1, as discussed *supra*.

249

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

259

260 However, the stock option agreement also provides that in the event of a merger with or
261 acquisition by another company, the vesting of the Lawyer’s option will immediately accelerate
262 so as to become fully vested. Given that such a merger is a mere potentiality, and lacking
263 specificity as to any terms and timing, it is unlikely that it presents a significant risk at the outset
264 of Lawyer’s employment that the acceleration provision will materially limit Lawyer’s
265 representation. Lawyer may consider an advance conflict waiver if a reasonably comprehensive
266 explanation of foreseeable scenarios in which Company may be adversely affected by the
267 merger and acceleration of Lawyer’s stock vesting can be provided.. (See *generally*, CRPC 1.7,
268 Comment [9]; *Sheppard, Mullin, Richter & Hampton LLP v. J-M Mfg. Co., Inc.* (2018) 6 Cal.5th 59.)
269 Even if an advance waiver is obtained, in the event of a merger, Lawyer should reassess
270 whether a second “confirming” waiver is required depending on the specificity of the advance
271 waiver and whether it reasonably predicted the materialized conflict. (See, *Visa U.S.A., Inc. v.*
272 *First Data Corp* (N.D. Cal. 2003) 241 F.Supp.2d 1100; *Western Sugar Coop. v. Archer-Daniels-*
273 *Midland Co.* (C.D. 2015) 98 F.Supp.3d 1074 (material change may trigger need for new
274 disclosure and informed written consent.) Independent Lawyer Report, p. 43.)

275

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CONCLUSION

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278 The employer-employee relationship inherent in the role of a corporate in-house lawyer
279 presents unique challenges with respect to the application of the conflicts rules that govern the
280 legal profession as a whole. Nevertheless, in-house lawyers are not exempt from compliance
281 with those rules. If their compensation involves the issuance of stock or stock options, they
282 must comply with CRPC 1.8.1, or otherwise assess the risk of noncompliance. Even if the

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283 assumes the risk of noncompliance, the lawyer has on ongoing obligation to assess whether
284 their stock ownership presents a significant risk that their representation will be materially
285 limited by their financial interests in connection with a particular matter on which the lawyer is
286 asked or expected to provide advice and counsel.

287 CC: Delete, and insert "Further, the lawyer has an ongoing obligation . . . "

288 NM: To discuss

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IN-HOUSE COUNSEL DRAFT OPINION

ISSUE: What conflicts of interest are presented by a stock option agreement between in-house lawyer and the company?

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 CRPC 1.8.1: the transaction must be fair and reasonable; the lawyer's role in the transaction ~~is~~ must be fully and plainly disclosed to the client in writing; and the client is advised in writing to consult with independent counsel about the transaction and the client thereafter provides informed written consent to it. ~~This~~ In general, this rule applies equally in the in-house context, even if the ~~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.

NM: I'm still having a problem with the framing. This rule doesn't seem to be optional. So it is strange to frame this opinion as sort of providing an exception to the rule that doesn't exist.

NM: I feel as a practical matter, most stock option agreements tick the relevant boxes of 1.8.1. So I would consider narrowing the framing on this.

However, the Committee is cognizant of the practical reality that ~~manysome~~ in-house lawyers have not strictly followed CRPC 1.8.1 when acquiring own stock or stock options in the companies ~~for which~~ where they work ~~without having complied with CRPC 1.8.1.~~ These lawyers, and those contemplating new in-house positions where ~~stocks~~ similar types of incentive-based compensation is offered, should assess the risk of noncompliance. ~~compliance with CRPC 1.8.1 would not be required. (See CRPC 1.8.1, Cmt. [6].) Factors to consider in determining whether CRPC 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 indicia of inequality exists. If so, compliance with CRPC 1.8.1 is required.~~~~

Even if the lawyer elects to forgo the requirement of compliance with CRPC 1.8.1 is not required, ~~s~~Stock ownership may ~~still~~ likewise trigger a material limitation conflict under CRPC 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.

41 Such a conflict could arise if the lawyer is asked to advise the company concerning a
42 transaction that affects the character or price of the stock, such as a merger or
43 acquisition. If so, the lawyer must obtain informed written consent from an authorized
44 constituent of the company. If the lawyer does not reasonably believe they can
45 competently represent the company due to the conflict, or if the company refuses to
46 consent to the conflict, the lawyer must refer the matter to nonconflicted in-house
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50 **AUTHORITIES**
51 **INTERPRETED:**

Rules of Professional Conduct 1.0.1, 1.7, 1.8.1, 1.13

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53 **STATEMENT OF FACTS**

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

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63 at an exercise price equal to the fair market value of such shares on the date of the grant, based
64 on the Company's Stock Incentive Plan. The agreement states that the securities will vest at
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75 specific matter or on retainer" are "bound by the same fiduciary and ethical duties to their
76 clients." *PLCM Group, Inc. v. Drexler* (2000) 22 Cal. 4th 1084, 1094. In-house lawyers have
77 attorney-client relationships with the organizations that employ them. *Gutierrez v. G & M Oil*

78 *Co., Inc.* (2010) 184 Cal.App.4th 551, 559. Specifically, An organization’s legal department is
 79 encompassed within the definition of “law firm.” California Rules of Professional Conduct
 80 (CRPC) 1.0.1(c) (“‘Firm’ or ‘law firm’ means . . . lawyers employed in a legal services
 81 organization or in the legal department, division or office of a corporation, of a government
 82 organization, or of another organization.”). A lawyer’s duties to an organizational client are the
 83 same whether they are “employed or retained” by the organization. CRPC 1.13(a). In short, the
 84 underlying purposes of a lawyer’s fiduciary duties—protecting the public and the integrity of
 85 the legal system and promoting the administration of justice and confidence in the legal
 86 profession—are not diminished simply because the lawyer is employed rather than retained
 87 by an organizational client.

88 These principles similarly apply to the in-house lawyer’s compensation for legal services. Thus,
 89 when an in-house lawyer is presented with a stock option agreement or stock as part of their
 90 compensation, that lawyer must analyze whether the proposed arrangement triggers any
 91 conflicts of interest. This may be difficult if the lawyer serves a dual role of employee (where
 92 the balance of power typically favors the employer-client) and attorney (where the balance of
 93 power between attorney and client typically favors the attorney) ~~However, in many~~
 94 ~~circumstances, analysis of an in-house lawyer’s fiduciary and ethical duties must be placed in~~
 95 ~~the context of the employer-employee relationship.~~ “For example, in-house lawyers may be
 96 seen to owe different duties than independent lawyers, perhaps because they are viewed as
 97 employees of the client directly rather than indirectly.” *Klein, No Fool for a Client: The Finance*
 98 *and Incentives Behind Stock-Based Compensation for Corporate Attorneys*, 1999 Colum. Bus. L.
 99 Rev. 330. Accordingly, “[t]he dual status of in-house counsel—acting as both employee and
 100 attorney—and the dual status of the company—acting as both employer and client—can pose
 101 some challenging questions about when one role takes precedence over another.” *Missakian v.*
 102 *Amusement Industry, Inc.* (2021) 69 Cal.App.5th 630, 652; *see also, General Dynamics Corp. v.*
 103 *Superior Court (Rose)* (1994) 7 Cal.4th 1164 (recognizing this dynamic in the employment law
 104 context).

105
 106 **II. Does the stock option agreement present Lawyer with any conflicts of interest, and if**
 107 **so, how and when should such conflicts of interest be addressed with the Company?**

108
 109 **A. Potential Application of CRPC 1.8.1**

110 In the traditional attorney-client relationship, a lawyer’s acceptance of stock or stock options
 111 from a client in lieu of or in addition to fees for legal services is subject to CRPC 1.8.1, which
 112 governs when a lawyer knowingly acquires an ownership or other pecuniary interest adverse to
 113 a client. *See* CRPC 1.8.1, Comment [5] (“This rule does not apply to the agreement by which the
 114 lawyer is retained by the client, unless the agreement confers on the lawyer an ownership,
 115 possessory, security, or other pecuniary interest adverse to the client.”); ABA Formal Opn. 00-

116 418 (“[A] lawyer who acquires stock in her client corporation in lieu of or in addition to a cash
 117 fee for her services enters into a business transaction with a client, such that the requirements
 118 of Model Rule 1.8(a) must be satisfied.”). If CRPC 1.8.1 applies, the lawyer must ensure that the
 119 following requirements are met:

120 (a) the transaction or acquisition and its terms are fair and
 121 reasonable to the client and the terms and the lawyer’s role in the
 122 transaction or acquisition are fully disclosed and transmitted in
 123 writing to the client in a manner that should reasonably have
 124 been understood by the client;

125 (b) the client either is represented in the transaction or
 126 acquisition by an independent lawyer of the client’s choice or the
 127 client is advised in writing* to seek the advice of an independent
 128 lawyer of the client’s choice and is given a reasonable opportunity
 129 to seek that advice; and

130 (c) the client thereafter provides informed written consent to the
 131 terms of the transaction or acquisition, and to the lawyer’s role in
 132 it.

133 The purpose of the rule is to address the inherently imbalanced relationship between attorney
 134 and client. *Beery v. State Bar* (1987) 43 Cal.3d 802, 812-813. “The law accordingly takes a
 135 jaundiced view of business transactions between attorneys and their clients.” *Ferguson v.*
 136 *Yaspan* (2014) 233 Cal. App. 4th 676, 685. Indeed, “the law presumes” attorneys engaging in
 137 such transactions “wear” a “black” hat. *Mayhew v. Benninghoff* (1997) 53 Cal. App. 4th 1365,
 138 1369.¹

139 ~~However, these~~ Some of these concerns may be less pronounced ~~are typically~~ may be absent in
 140 the in-house context, where the new lawyer is offered the same general compensation terms,
 141 including stock and stock options, as those offered to other employees. ~~Indeed, the power~~
 142 ~~dynamic may be reversed.~~ “[F]rom an economic standpoint, the dependence of in-house
 143 counsel is indistinguishable from that of other corporate managers or senior executives who
 144 also owe their livelihoods and career goals and satisfaction to a single organizational
 145 employer.” *General Dynamics Corp. v. Superior Court, supra*, 7 Cal. 4th at 1172. In addition, the

¹ 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 give rise to a cause of action for damages caused by a failure to comply with the rule. ~~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. “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.

146 in-house lawyer’s employment agreement may be prepared and/or presented by the General
147 Counsel, employment counsel, or other company counsel.

148 No California court has addressed whether CRPC 1.8.1 applies to stock or stock option
149 agreements between in-house counsel and their employer. In the absence of such authority,
150 the Committee cannot opine that it does not apply. At the same time, the Committee is
151 cognizant of the practical reality that many in-house lawyers own stock or stock options in the
152 companies for which they work ~~without~~ despite that they have not fully complied with
153 CRPC 1.8.1. ~~These lawyers and those contemplating an in-house position should assess the risk~~
154 of noncompliance.

155 ~~However,~~ Out of state authority and the ABA provide some guidance on this issue. The
156 Washington Supreme Court has recognized that compensation agreements for the in-house
157 lawyer/employee, which may include nonmonetary compensation such as computers, cell
158 phones and health benefits, are more akin to standard employment contracts and should not
159 be governed by Washington’s version of CRPC 1.8.1, because, typically, “‘the lawyer has no
160 advantage in dealing with the client.’ ” (See, *Chism v. Tri-State Constr., Inc.*, 193 Wn. App. 818,
161 852; quoting, Wa. RPC 1.8(a), Comment [1]. See also Washington State Bar Association Advisory
162 Opinion 1045 (1986) [concluding that in-house lawyer’s arms-length negotiation concerning
163 compensation in the form of shares in the employer, a publicly traded corporation, did not
164 violate Washington’s version of CRPC 1.8].)²

165 ~~See also, Washington State Bar Association Advisory Opinion 1045 (1986) (concluding that~~
166 ~~lawyer’s arms-length negotiation concerning in-house lawyer’s compensation in the form of~~
167 ~~shares in the employer, a publicly traded corporation, did not violate RPC 1.8).~~

168 The ABA Task Force on the Independent Lawyer [“Task Force”] reached a similar conclusion:

169 In the usual case, the receipt of equity-based compensation by in-
170 house counsel would not appear to be the type of ‘business
171 transaction with a client’ contemplated by Rule 1.8. Option or
172 restricted stock grants (the usual forms of equity compensation

² Wa. RPC 1.8(a), Comment [1] states that “[RPC 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 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 CRPC 1.8.1 are substantially similar. See CRPC 1.8.1, Comment [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, CRPC 1.8.1, Comment [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.”

173 paid to in-house attorneys) are merely a form of compensation
174 and, like cash, are a facet of the general employment relationship
175 rather than part of or related to any particular transaction or
176 undertaking.

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

180 The Task Force noted that the “timing, size and conditions” placed on stock grants are typically
181 the result of unilateral decisions by the corporate employer, in consultation with outside
182 advisors and counsel. In short, the Task Force concluded, such stock grants, under normal
183 circumstances, should not create interests that are “adverse” to the company’s interests. In
184 other words, this type of compensation arrangement would be similar to a “standard
185 commercial transactions for products or services that a lawyer acquires from a client on the
186 same terms that the client generally markets them to others, where the lawyer has no
187 advantage in dealing with the client.” CRPC 1.8.1, Comment [6].

188 However, a distinction must be made between [“normal circumstances,” i.e.,](#) an employment
189 agreement offered by an established company that contains stock grants or options as a
190 general form of employment compensation, and other types of business transactions in which
191 there is an inherent imbalance of power between attorney and client. For example, [CRPC Rule](#)
192 1.8.1 applies to situations where the attorney and an existing or new client form a business
193 together as [owners-founders](#) or shareholders, and the attorney provides legal services to the
194 newly-formed business entity.³ See, *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, 1169; see
195 also, *Passante v. McWilliam* (1997) 53 Cal.App.4th 1240-

196 Thus, ~~in determining whether CRPC 1.8.1 applies~~ [to determine whether the arrangement falls](#)
197 [within “normal circumstances,”](#) the in-house lawyer should analyze whether the equity-based
198 compensation arrangement is a “standard” contract that does not involve an imbalance of
199 bargaining power in favor of the lawyer. Factors to consider include (1) whether the lawyer was
200 involved in advising on the organization’s formation; (2) whether the proposed compensation
201 agreement is drafted and proposed by the organization (or its counsel) or the lawyer; (3)
202 whether the organization has independent counsel concerning the compensation agreement;
203 (4) whether the compensation terms offered to the lawyer are substantively similar to those
204 offered to employees at the same level; (5) whether the compensation is part of Lawyer’s initial
205 employment agreement, or modifications thereto, or related to Lawyer’s work on a specific
206 transaction.

³ 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. 1999-154.

207 NM: Maybe we can sort of caveat this at the outset and say that we encourage compliance in
 208 all circumstances, BUT at a min, please pay attention to this area...

209 CC: Yes, I think we should discuss revising these sections regarding distinction between
 210 "normal" circumstances and instances where the lawyer is a founder as in Fair. I'm not sure
 211 what we are trying to say if our opinion is that compliance is required in all situations.

212 Again, the Committee cautions that even if these factors weigh against application of CRPC
 213 1.8.1, it only lessens the risk of a violation of the rule. ~~If it is determined that CRPC 1.8.1~~
 214 ~~applies, then the requirements of CRPC 1.5(a), which governs the reasonableness of fees~~
 215 ~~charged by a lawyer, must also be satisfied. However, this analysis is subsumed within the first~~
 216 ~~prong of CRPC 1.8.1. "In determining whether [CRPC 1.8.1's] first requirement of fairness and~~
 217 ~~reasonableness to the client is satisfied, the general standard of [CRPC 1.5(a)] that 'a lawyer's~~
 218 ~~fee shall be reasonable' and the factors enumerated under that Rule are relevant."~~ ABA Form-
 219 ~~Opn. 00-418.⁴~~

220 Here, Lawyer was not involved in Company's formation. Lawyer is presented with a stock
 221 option agreement that is offered to the Company's employees as part of the Company's Stock
 222 Incentive Plan. The securities vest incrementally over time. Thus, stock options are offered as a
 223 standard form of compensation in the proposed employment agreement and not in connection
 224 with a particular transaction or undertaking. It is an arms-length transaction. Compliance with
 225 CRPC 1.8.1 would be superfluous (?) [exhausting form over substance?]. ~~that does not trigger~~
 226 ~~the requirements under CRPC 1.8.1.~~

227 However, Lawyer should also consider relatively easy burden of compliance. It is Company's
 228 proposal and undoubtedly views the terms fair and reasonable. The additional step of obtaining
 229 Company's express acknowledgement of its right to consult with independent counsel and
 230 informed written consent to the arrangement would not be burdensome.

231 NM: This is the key for me. I can't read 1.8.1 any way other than mandating this.

232 **B. Potential Application of CRPC 1.7**

233 Lawyer must separately consider whether the stock option provisions in the employment
 234 agreement present a "material limitation" conflict of interest under rule 1.7(b). Specifically,
 235 CRPC 1.7(b) prohibits representation of a client if there is a significant risk that the
 236 representation "will be materially limited . . . by the lawyer's own interests," without the
 237 informed written consent of the client. Further, the lawyer cannot represent the client even
 238 with the requisite consent from the client if the lawyer does not "reasonably believe[] that the
 239 lawyer will be able to provide competent and diligent representation to each affected client."
 240 CRPC 1.7(d)(1). Thus, where the lawyer has a personal interest in the subject matter of the

⁴ Analysis of CRPC 1.8.1 and 1.5(a) is beyond the scope of this opinion. ABA Form. Opn. 00-418 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.

241 representation, the lawyer must assess whether their independent judgment will be materially
242 impacted to the detriment of the client. See, e.g., ABA Model Rule 1.7, Comment [10]: “For
243 example, if the probity of a lawyer's own conduct in a transaction is in serious question, it may
244 be difficult or impossible for the lawyer to give a client detached advice. . . . See Rule 1.8 for
245 specific Rules pertaining to a number of personal interest conflicts, including business
246 transactions with clients.”

247 In ABA Formal Opn. 00-418 (2000), the committee opined that although issuance of stock to
248 outside counsel in lieu of or in addition to fees mandated compliance with Model Rule 1.8(a)
249 (the equivalent to CRPC 1.8.1), it “creates no inherent conflict of interest” under the “material
250 limitation” conflict provisions of Model Rule 1.7(b). The committee explained: “Indeed,
251 management's role primarily is to enhance the business's value for the stockholders. Thus, the
252 lawyer's legal services in assisting management usually will be consistent with the lawyer's
253 stock ownership. In some circumstances, such as the merger of one corporation in which the
254 lawyer owns stock into a larger entity, the lawyer's economic incentive to complete the
255 transaction may even be enhanced.” (*Id.* at p. 9.)

256 However, this does not render CRPC 1.7(b) wholly inapplicable to an in-house lawyer who owns
257 stock or stock options. See *also*, Independent Lawyer Report, p. 56 (“To the extent . . . that the
258 receipt of such compensation or the ownership of equity in the employer company might raise
259 a question as to a potential conflict of interest or impairment of the representation, Rule 1.7
260 would govern.”) Indeed, the committee envisions a number of scenarios where a material
261 limitation conflict could arise, such as advising corporate management on the duty to disclose
262 materially adverse financial information. “[T]he lawyer must evaluate her ability to maintain the
263 requisite professional independence as a lawyer in the corporate client’s best interest by
264 subordinating any economic incentive arising from her stock ownership.” ABA Form. Opn. 00-
265 418 (2000), p. 10. If the lawyer reasonably believes that her representation may be materially
266 limited by her stock ownership she must consult with the client and obtain consent before
267 continuing the representation. *Ibid.* This rule applies with equal force to in-house lawyers
268 regardless of whether the stock option agreement was an arms-length negotiation falling
269 outside the ambit of CRPC 1.8.1, as discussed *supra*.

270
271 Here, Company offers Lawyer participation in its Stock Incentive Plan, which includes stock
272 options that vest incrementally over time. These are terms offered to other employees. At the
273 outset of the employment relationship, these provisions by themselves do not present a
274 significant risk that Lawyer’s independent judgment will be materially limited to the detriment
275 of the Company. “Given the relatively limited equity stake of corporate counsel in most cases,
276 the lawyer’s ownership interest usually would not materially limit the representation. Indeed,
277 equity-based compensation grants generally are made in small increments over time and, at
278 the time made, are restricted in ways that give them only contingent, future value.”

279 (Independent Lawyer Report, p. 56.)

280

281 However, the stock option agreement also provides that in the event of a merger with or
282 acquisition by another company, the vesting of the Lawyer’s option will immediately accelerate
283 so as to become fully vested. Given that such a merger is a mere potentiality, and lacking
284 specificity as to any terms and timing, it is unlikely that it presents a significant risk at the outset
285 of Lawyer’s employment that the acceleration provision will materially limit Lawyer’s
286 representation. Lawyer may consider an advance conflict waiver if a reasonably comprehensive
287 explanation of foreseeable scenarios in which Company may be adversely affected by the
288 merger and acceleration of Lawyer’s stock vesting can be provided. ~~However, future events~~
289 ~~may require Lawyer to reassess whether a second confirming waiver is required.~~ [See generally,
290 CRPC 1.7, Comment [9]; Sheppard, Mullin, Richter & Hampton LLP v. J-M Mfg. Co., Inc. (2018) 6
291 Cal.5th 59.] Even if an advance waiver is obtained, in the event of a merger, Lawyer should
292 reassess whether a second “confirming” waiver is required depending on the specificity of the
293 advance waiver and whether it reasonably predicted the materialized conflict. [See, Visa U.S.A.,
294 Inc. v. First Data Corp (N.D. Cal. 2003) 241 F.Supp.2d 1100; Western Sugar Coop. v. Archer-
295 Daniels-Midland Co. (C.D. 2015) 98 F.Supp.3d 1074 (material change may trigger need for new
296 disclosure and informed written consent.) Independent Lawyer Report, p. 43.]

297
298 **CONCLUSION**
299

300 The employer-employee relationship inherent in the role of a corporate in-house lawyer
301 presents unique challenges with respect to the application of the conflicts rules that govern the
302 legal profession as a whole. Nevertheless, in-house lawyers are not exempt from compliance
303 with those rules. ~~With respect to movement between companies and compliance with CRPC 1.9~~
304 ~~and 1.10, an in-house lawyer must examine their involvement in matters on which there is or~~
305 ~~may be direct adversity between their former and potential new employers, as well as whether~~
306 ~~they were exposed to confidential information material to an adverse matter.~~ If their
307 compensation involves the issuance of stock or stock options, they must examine [comply with](#)
308 [CRPC 1.8.1, or otherwise assess the risk of noncompliance.](#) ~~the circumstances of the offer, and~~
309 ~~the nature of their relationship with the company to determine if CRPC 1.8.1 applies governs~~
310 ~~the stock transaction.~~ Even if ~~it is determined that~~ the assumes the risk of noncompliance, CRPC
311 1.8.1 does not apply, the lawyer has an ongoing obligation to assess whether their stock
312 ownership presents a significant risk that their representation will be materially limited by their
313 financial interests in connection with a particular matter on which the lawyer is asked or
314 expected to provide advice and counsel.

315 CC: Delete, and insert “Further, the lawyer has an ongoing obligation . . .”
316 NM: To discuss

317
318