

Ethics Corner: Doing Business with Clients; Taking Securities in Lieu of Fees

Suppose a lawyer wishes to purchase a house from a client or wants to start a non-law business in partnership with a client – a saloon, perhaps. Or, suppose a lawyer wants to take securities from a client in lieu of fees. The analysis starts with ABA Model Rule 1.8(a), of which every state has a version. That rule has three important provisions. First, it provides that the transaction must be “fair and reasonable” to the client. Second, the lawyer must tell the client in writing that it would be a good idea for the client to check with another lawyer on the advisability of the transaction. Third, the client must sign a written consent containing the essential terms of the transaction and the lawyer’s role in it.

Probably the most dramatic illustration of a lawyer’s failure to follow Rule 1.8(a) was in *Passante v. McWilliams*, 62 Cal. Rptr. 2d 298 (Cal. App. 1997). A corporate client promised to give a lawyer a small percentage of its stock in return for the lawyer having just found badly-needed financing for the corporation. At that time the stock was worth very little. Several years later, when the lawyer attempted to obtain the stock, it had become worth some \$32 million. The California Court of Appeals ruled that the lawyer was not entitled to the stock because of, in part, the lawyer’s violation of California’s version of Model Rule 1.8(a) (Cal. Rule 3-300). (We say “in part” because there were also contract law issues that seemed to bother the court as much as the 1.8(a) issue.)

More recently, in *Goldston v. Bandwidth Tech. Corp.*, 2008 WL 2445496 (N.Y. App. June 19, 2008), the lawyer fared better. He had a retainer agreement to provide corporate services to a high tech company in exchange for 2% of the company’s stock, then worth, perhaps, some \$40,000. According to press reports, one of the appellate briefs disclosed that the 2% had become worth more than \$7 million. In the opinion, the Appellate Division affirmed the trial court’s finding that the lawyer was entitled to the stock. A principal issue was whether the company’s president had authority to make the agreement (he did). There were other issues as well. There was no discussion whatever of New York’s version of Model Rule 1.8(a) (N.Y. DR 5-104).

Note that in *Passante* the promise of stock came during the lawyer-client relationship. In *Goldston* the retainer agreement was negotiated at the outset of the representation. While the court in *Goldston* did not discuss that distinction, the different treatment in the two cases comports with those cases that deal with fee changes that occur after the representation has commenced (sometimes referred to as “mid-stream fee changes”). Courts are generally hostile to mid-stream fee changes, and they increasingly invoke Model Rule 1.8(a) specifically in evaluating whether such changes are enforceable. *See, e.g., Valley/50th Ave., L.L.C. v. Stewart*, 153 P.3d 186 (Wash. 2007).

What about taking securities from clients in lieu of fees? The ABA Standing Committee on Ethics and Professional Responsibility has addressed this issue in its Formal Opinion 00-418 (2000), “Acquiring Ownership in a Client in Connection with Performing Legal Services” (“ABA Op. 00-418”). It says that such arrangements are not per se unethical, but says that lawyers taking client securities must comply with Model Rule 1.8(a). That means the arrangement must be in writing, the client be afforded a reasonable opportunity to consult with other counsel, the client’s consent to the arrangement be in writing, and the terms be “fair and reasonable” to the client. The opinion discusses the interplay of the

"fair and reasonable" requirement of Rule 1.8(a) and the requirement of Model Rule 1.5(a) that fees be "reasonable." It also deals with the need to disclose possible conflicts to the client and the role of Model Rule 1.7(b) (now 1.7(a)(2)), which relates to conflicts of interest and the lawyer's interests.

Opinion 2000-3 (2000) of the Committee on Professional and Judicial Ethics of the Association of the Bar of the City of New York ("N.Y. City Bar Op. 2000-3), which was rendered soon after ABA Op. 00-418, basically tracks that opinion. In brief summary, it is slightly more lenient than ABA Op. 00-418. It says that the lawyer does not have to comply with N.Y. DR 5-104(A) (N.Y.'s version of Model Rule 1.8(a)), unless the client is relying upon the advice of the lawyer with respect to the fee transaction itself. Thus, the Committee concludes, there may be instances in which a lawyer takes stock in lieu of fees where it would be appropriate to treat the arrangement as any other fee arrangement. The sophistication of the client and complexity of the transaction will obviously play a role in whether this is the case. In other respects, N.Y. City Bar Op. 2000-3 is comparable to ABA Op. 00-418.

The District of Columbia Bar Legal Ethics Committee Opinion 300 (2000) ("Op. 300") mentions ABA Op. 00-418 and N.Y. City Bar Op. 2000-3, only in a footnote, but states that Op. 300 reaches the same conclusions as those two opinions. Actually, unlike N.Y. City Bar Op. 2000-3, Op. 300 does not discuss situations in which such an arrangement might not be subject to Rule 1.8(a) or its New York counterpart, DR 5-104.

The lesson? When considering a "one-off" fee or business arrangement with a client, be wary of your state's version of Model Rule 1.8(a).
