# MCLE Article: Ethical Issues for the In-House Transactional Lawyer

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*This article is the third in a series by the authors that focuses on ethical issues of particular interest to transactional attorneys in California.*

Since you took an in-house attorney position and no longer work for a law firm, you don't have to worry about the nuances and application of all of California's ethical rules, right? Ok, fine, there's still the general duty of loyalty to consider and of course confidentiality and attorney-client privilege,[1] but most of the other ethical rules—just like time sheets and billings—no longer apply, right? Sorry, but that's just not the case. In fact, you might be surprised to learn which ethical rules apply to you in your new position, as well as how they apply.

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## The Broad Reach of California's Ethical Rules

### California's Ethical Rules Apply to In-House Attorneys

The ethical rules that govern lawyers in the State of California are the California Rules of Professional Conduct (or the CRPC).[2] The CRPC are binding on all members of the California State Bar, whether in-house or at a law firm, whether active or inactive, and whether performing services in a legal or business capacity.[3] The California State Bar has disciplinary authority over all California State Bar members, and yet in-house attorneys are often surprised at how many of the rules are applicable to their duties.

### California's Ethical Rules Apply to Certain Attorneys Who Aren't Even Members of the California State Bar

Even in-house attorneys who are not members of the California State Bar but who practice in California may be subject to the CRPC. The California State Bar permits foreign lawyers to practice as in-house counsel in the state under certain circumstances. An attorney who resides in California and who is licensed to practice law in another U.S. jurisdiction may register to provide legal services as in-house counsel for a single "qualifying institution" in California without becoming a member of the California State Bar.[4] To be eligible to do so, an in-house attorney who is not a member of the California State Bar must meet the eligibility requirements of California Rules of Court (or CRC) Rule 9.46,which includes the requirement to abide by all laws and rules governing California State Bar members—e.g., the CRPC. [5] In-house attorneys resident in California, including those who are not admitted to practice in California, must therefore abide by the ethical rules applicable to all members of the California State Bar.

### California's Ethical Rules Apply to "Inactive" Attorneys and Those Who No Longer Practice Law

A member of the California State Bar in good standing (i.e., a member who does not have any disciplinary charges pending) may request voluntary inactive membership at any time or upon retirement. Voluntarily inactive members may return to active status by applying to the California State Bar and paying any required fees. However, changing a lawyer's status as a member of the California Bar from "active" to "inactive" doesn't alter the fact that the CRPC apply to such lawyer. The CRPC govern "members" and do not distinguish its application between "active" and "inactive" members.

Further, the CRPC do not only apply to practicing California attorneys and in-house attorneys that have availed themselves of CRC Rule 9.46 (discussed above); it likely applies to non-practicing lawyers as well. The American Bar Association (or the ABA) has recently opined that lawyers who no longer practice law because they have taken a business role may be subject to discipline for misconduct.[6] Because of the CRPC's expansive definition and use of the term "member," the California State Bar could possibly take a similar view, should it learn of a non-practicing lawyer's misconduct.

### The Application of Certain California Rules to the In-House Transactional Attorney

While it is clear that the CRPC apply to in-house transactional attorneys, how certain of the rules apply to such attorneys is far less clear. Attorneys are relatively familiar with the application of the ethical rules to their practices when they work for law firms or as sole

practitioners.[7] In fact, many of the rules contemplate the attorney as an outside legal advisor with multiple clients—not an employee (or part) of a single client. But by their own terms, and as explained above, the CRPC are meant to govern the professional conduct of California lawyers regardless of whether such lawyers work at law firms, work in-house or don't even work as lawyers anymore. Not only does the CRPC have an expansive definition of "member," which would pick up in-house attorneys, the term "law firm" is broadly defined in the CRPC to include in-house legal departments.[8] As a result, to the extent the CRPC reference law firms, such rules apply to your in-house legal department as well.

How well, then, do the CRPC apply to in-house transactional attorneys? Some of the rules are obvious in their application to in-house attorneys (such as the duty of confidentiality mentioned above).[9] Some of the rules don't really apply to the in-house attorney as a practical matter (such as the obligation to maintain trust accounts).[10] But the application of some of the rules may come as a surprise to many in-house attorneys. The remainder of this article focuses on five familiar topics of California legal ethics and how they apply to the in-house lawyer.

## Conflicts of Interest:[11]

### Avoiding the Representation of Adverse Interests

Rule 3-310(E) of the CRPC requires, among other things, that attorneys not accept employment on a matter that is adverse to a client where, by reason of the representation of that client, the attorney has obtained confidential information material to such employment (at least not without the informed written consent of the affected client). The rule also applies where the affected client is a former client of the attorney—the attorney is prohibited from taking on the new adverse matter absent informed written consent from the former client.[12]

Perhaps you were familiar with this rule while at your prior job working at a law firm. Suppose while at your firm you frequently represented client A in a variety of corporate transactions, including working to prepare disclosure schedules and other documentation for a major financing transaction where client A was the borrower. To make sure no one in the firm took on a representation adverse to client A, conflict checks were run every time a new matter came to your firm. If, for example, client B sought to engage you or your law firm in a new matter adverse to client A where certain confidential information pertaining to client A (such as the information you gathered in preparing disclosure schedules) would be material to the new engagement, the informed written consent of client A (and perhaps of client B as well) would need to be obtained prior to taking on the engagement. Such consent would be required even if client A were no longer a client of your law firm. This is (or should be) standard operating procedure for law firms in order to assure their adherence to the duty of loyalty and the ethical rules applicable to conflicts of interest.

That was then; this is now. You now work in-house, for a large company. And wouldn't you know it, today you learn that your boss is negotiating a deal pursuant to which your employer would acquire substantially all of the assets of your former law firm client, client A. Can you work on this transaction, or are you conflicted? Do the ethical rules applicable to conflicts of interest even apply? Is this an area of concern for the in-house attorney? The answer may surprise both you *and* your boss: You may have a conflict of interest. The confidential information about client A you learned from your work for client A may be very material now that your current employer wants to be sure it understands, and properly prepares for the acquisition of, the assets of client A. In fact, such information may even be material to your employer's determination of whether it will proceed with the transaction and/or the purchase price it is willing to pay to acquire the assets. Unless client A provides its informed written consent, your conflict of interest may prevent you from working on this transaction.[13]

In addition, Rule 3-310(B) of the CRPC may require that you provide written disclosure to your employer of the fact that you had previously represented client A, especially if your previous relationship with client A would "substantially affect" the work you might be asked to do on behalf of your employer in connection with the transaction involving your former client.[14] This rule (unlike Rule 3-310(E)) applies even if you had not obtained confidential information pertaining to client A while at your law firm. However, while you may have to provide written disclosure to your current employer, if the work you will be doing on behalf of your employer does not bear a "substantial relationship" to the prior work you did on behalf of client A and client A has no reasonable expectation of confidentiality, you may proceed to do the work *without* the consent client A.[15]

### Imputation of Conflicts Within the Legal Department

So, if you personally can't work on the acquisition of client A's assets, what about the other attorneys who work for your employer? Can they work on this transaction that involves client A, or is your conflict attributable to them as well?

The provisions of Rule 3-310 of the CRPC referenced above speak in terms of prohibitions on members of the State Bar (i.e., individual attorneys), rather than on law firms or legal depart-

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ments. Attorneys at law firms are well advised, however, to analyze conflicts of interest on the basis that the rules apply to current, prospective and former clients of the attorney's law firm.[16] As a general rule, the attorney's duty of loyalty extends to all clients of his or her firm, and the client's attorney-client relationship extends to all members of the firm, regardless of which attorney performs services on behalf of such client.[17] While the CRPC do not address when one attorney's conflict is imputed to the law firm,[18] case law in California has adopted a rule of attribution (also known as vicarious disqualification).[19] Simply described, the rule of attribution imputes the conflict of interest of one attorney within a law firm to the rest of the attorneys in the firm, thereby resulting in the disqualification of the entire law firm.[20] It is important to note, however, that an attorney can be disciplined only for a willful violation of an ethical rule.[21] Because imputation is a creature of case law in California, law firms and other attorneys within a firm might not be subject to discipline, but an imputed conflict of interest may result in a court disqualifying the firm or other attorney from the conflicted representation.[22]

As noted above, your work for client A might result in a conflict of interest if client B sought to engage you while still at your law firm in a new matter adverse to client A, even if client A were no longer a client of your firm. By virtue of the rule of attribution, your conflict might result in the firm and other attorneys at the firm being disqualified from the representation of client B. Again, standard operating procedure in the law firm context. But, does the same rule apply to legal departments?

As previously mentioned, since the CRPC's definition of a "law firm" includes legal departments within a business entity, the rule of attribution may well apply to in-house attorneys.[23] While the rule of attribution is not contained in the CRPC and therefore the CRPC's definition of "law firm" is not necessarily dispositive, case law takes a broader view. For example, in its 2006 decision of *City & County of San Francisco v. Cobra Solutions, Inc.*, the California Supreme Court extended the rule of vicarious disqualification to all attorneys in a city attorney's office due to the personal conflict of interest of the city attorney.[24] Attributing the conflicts of one in-house attorney to other attorneys in the same legal department seems consistent with the intent of the ethical rule: namely, to avoid the situation "where a client would be materially and adversely affected by . . . the lawyer's duties to . . . a former client . . . ."[25] The case law states that the rule is intended to vicariously disqualify attorneys "working together and practicing law in a professional association."[26] In an in-house legal department, just like in a law office, attorneys collaborate with one another, discuss client confidences, and work together to achieve the goals of their client (i.e., their common employer).

Because the ethical considerations for attorneys in a law firm and for attorneys in an in-house legal department are the same, the potential disqualification of entire legal departments should be the same as would be the result for law firms. In other words, because of the rule of attribution, your personal conflict with respect to client A might not only prevent you from working on the acquisition transaction on behalf of your employer, it may also preclude some or all of your in-house colleagues as well.

In California, until case law determines otherwise, prudent in-house attorneys should consider their personal conflicts of interest as well as the possible application of the rule of attribution to their in-house legal departments. While few (if any) legal departments utilize a system for checking conflicts and approving new engagements—let alone maintaining a list of former clients of each in-house attorney—such a system might be advisable to avoid potential violations. Further, whenever a conflict becomes apparent, the in-house attorney may need to consider some form of prophylactic or remedial action, such as securing the informed written consent of the affected former client or having a non-lawyer colleague interface with outside counsel on the matter (thereby avoiding the need for in-house attorneys on such matter).[27]

### Your Salary and Bonuses

So, now that you've successfully navigated the rules relating to conflicts of interest (perhaps by securing the requisite informed written consent) and impressed your boss with your competence on the acquisition of the assets of client A, you're thinking you might be entitled to a raise or a bonus. Perhaps even use of the corporate jet for your next vacation. No harm in asking, right? Surely there can't be ethical rules that pertain to your compensation and employment relationship with your employer, are there? Once again, you might be in for a surprise.

Rule 4-200 of the CRPC prohibits attorneys from, among other things, collecting an unconscionable fee.[28] As stated in the rule, "unconscionability" is determined on the basis of facts and circumstances, and the rule enumerates certain factors to be considered.[29] In addition, rule 4-400 prohibits attorneys from inducing a client (other than a relative) to make a substantial gift.[30] As discussed earlier in this article, these rules should apply equally to in-house and outside counsel. But how do they apply to the in-house attorney who is in an employer-employee relationship with the client?

Once again, the application is a little awkward, and we have found no case law or interpretive opinions to provide any guidance here. However, there appears to be no precedential basis to conclude that the compensation arrangement for the in-house attorney is not the equivalent of a fee arrangement between the employee-attorney and the employer-client. As a result, such compensation (taking into account any raise, bonus and/or other perquisites) might be subject to review under the "unconscionability" standard set forth in Rule 4-200. Additionally, the request for a bonus or perquisite might constitute the inducement of a substantial gift in violation of Rule 4-400. If the bonus or perquisite you've requested is substantial, or if your total compensation is so high as to be considered unconscionable, you may have overstepped and violated the CRPC.

### Sexual Relations with Client

Rule 3-120 of the CRPC prohibits attorneys from having sexual relations with clients in certain circumstances. Specifically, under Rule 3-120 and subject to limited exceptions, attorneys in California are barred from, among other things, requiring or demanding sexual relations (as defined in Rule 3-120[31]) with a client incident to or as a condition of any professional representation. They are also prohibited from employing coercion, intimidation, or undue influence in entering into sexual relations with a client.[32] The rule is not just applicable to individual clients: where the client is an organization, any individual "overseeing the representation" is deemed to be the client for purposes of the rule.[33] While you may not have been familiar with the specifics of this rule, you most likely were aware of the existence of such a rule. So, if the situation were to arise while at your law firm job, you might have thought to consult the rule before asking out your contact at the corporate client.

Now that you are in-house, need you concern yourself with the specifics of Rule 3-120? As noted above, the same rules apply to attorneys whether in private practice or in-house. So, if an in-house attorney's colleague, who may work just down the hall from the attorney, "oversees" (or acts as client with respect to) any aspect of the in-house attorney's work, then the in-house attorney should be mindful of this rule before initiating sexual relations with the colleague.

### Failing to Act Competently

Of course, failing to act competently could be grounds for dismissal for the in-house attorney. But did you know it could subject the in-house attorney to discipline as well? Rule 3-110(A) of the CRPC provides that a member of the California State Bar "shall not intentionally, recklessly, or repeatedly fail to perform legal services with competence."[34] Because the rule does not distinguish between in-house attorneys and those in private practice, termination of employment may not be the only result for failing to act competently.

### A Duty to Resign (or Not Resign)?

Finally, there are circumstances under which attorneys must withdraw from a representation.[35] There are also ethical limitations on when and how attorneys may withdraw from a representation.[36] Do these rules apply to the in-house attorney? In other words, do California's ethical rules dictate when the in-house attorney must—or must not—quit his or her job?

Rule 3-700(B) of the CRPC mandates withdrawal of the attorney under certain circumstances. For example, the attorney must withdraw if the attorney knows either that the client is asserting a position in litigation for the sole purpose of harassing or maliciously injuring another person, or that continued employment will result in a violation of the CRPC.[37] Further, Rule 3-600, which defines certain ethical obligations where the client is an organization, contemplates that the attorney may have a duty to resign (e.g., where "up the ladder" reporting fails to prevent a violation of law that is likely to result in substantial injury to the organization).[38] But, whether or not withdrawal is mandatory, an attorney cannot simply withdraw from employment at the discretion of the attorney: Rule 3-700(A)(2) provides that an attorney "shall not withdraw from employment until the [attorney] has taken reasonable steps to avoid reasonably foreseeable prejudice to the rights of the client, including giving due notice to the client, [and] allowing time for employment of other counsel . . . ."[39]

Again, the same rules apply to attorneys whether in-house or in private practice—the only difference for the in-house attorney is that the client is the employer. As a result, you should not only be aware that there are circumstances that might mandate resigning your in-house position, but you might also not have the right to resign your position upon the timing of your choice.

## Conclusion

In-house attorneys in California, including those who are inactive or not even qualified in California, are required to abide by the ethical rules set forth in the California Rules of Professional Conduct. While the ethical rules by their own terms apply to all attorneys, whether at a law firm or in-house, the application of the rules to in-house attorneys can be awkward in many instances. To avoid a violation of the ethical rules, in-house attorneys—just like attorneys at law firms—must be mindful of the rules and the

policies that underlie them, even though the application of some of the rules may be surprising. ■

## Endnotes

1 *See* Cal. Rules of Prof. Conduct [hereinafter CRPC] R. 3-100 (2009); Cal. Bus. & Prof. Code § 6068(e)(1) (West 2003). While the attorney-client privilege is a substantial concern for in-house attorneys, a discussion of the attorney-client privilege is outside the scope of this article. However, *see, e.g.,* Michael A. Lampert, *In House Counsel and the Attorney Client Privilege*, *available at* http://library.findlaw.com/2000/Oct/1/128767.html (2000).

2 The current Rules of Professional Conduct (including those discussed herein) are under review by the California State Bar. Information concerning the review process can be found online at: http://calbar.ca.gov/state/calbar/calbar_generic.jsp?cid=10129&id=1100.

3 CRPC R. 1-100(A) & B(2) (definition of "member").

4 California Rules of Court [hereinafter CRC] R. 9.46 (2009). A "qualifying institution" is a corporation, partnership, association or other legal entity (including subsidiaries and organizational affiliates) that (i) employs at least 10 employees full-time in California or (ii) employs in California an attorney who is an active member in good standing of the California State Bar. However, neither a governmental entity nor an entity that provides legal services to others can be a "qualifying institution" for purposes of the rule. CRC R. 9.46(a)(1).

5 For an attorney to practice law under CRC R. 9.46, the attorney must: (a) be an active member in good standing of the bar of a U.S. state, jurisdiction, possession, territory or dependency; (b) register with the California State Bar and file an Application for Determination of Moral Character with the Committee of Bar Examiners; (c) meet all requirements for admission to the California State Bar (except that such attorney need not take the California bar exam or the MPRE); (d) comply with rules adopted by the Board of Governors relating to the Registered In-House Counsel Program; (e) practice law exclusively for a single qualifying institution (with a limited exception for certain *pro bono* services); (f) *abide by all laws and rules governing California State Bar members,* (including MCLE requirements); (g) satisfy in his or her first year of practice under CRC R. 9.46 all of the MCLE requirements, including ethics education, that California State Bar members must complete every three years; and (h) reside in California. CRC R. 9.46(c) (emphasis added).

6 *See* ABA Form. Op. 04-433 (2004). *See also* Kansas City Daily Record Staff, *ABA committee determines lawyers must report non-practicing lawyer misconduct*, Daily Journal Of Commerce (2004) ("Lawyers have an ethical obligation to report misconduct by other lawyers, if the misconduct raises a substantial question about the offending lawyer's honesty, trustworthiness or fitness to practice law. They must report the misconduct even if it occurs totally removed from legal practice, and even if the misbehaving lawyer does not practice law….").

7 For a discussion of certain rules of the CRPC, *see, e.g.,* the first two articles in this series, Neil J Wertlieb and Nancy T. Avedissian, *Addressing Conflicts of Interest in a Transactional Practice*, 4 Bus. L. News 7 (2008) *and* Neil J Wertlieb and Nancy T. Avedissian, *Ex Parte Communications in a Transactional Practice*, 1 Bus. L. News 3 (2009).

8 "Law Firm" is defined in Rule 1-100(B) of the CRPC to include, among other things, "a division, department, office, or group within a business entity, which includes more than one lawyer who performs legal services for the business entity." *See* Rule 1.0 of the ABA Model Rules, which defines "firm" or "law firm" to include "lawyers employed in a legal services organization or *the legal department of a corporation or other organization.*" ABA Model Rules, R. 1.0(c) (2009) (emphasis added).

9 CRPC R. 3-100 (2009); *see also* Cal. Bus. & Prof. Code § 6068(e)(1).

10 Under CRPC R. 4-100, attorneys must hold funds received by them or their law firms for the benefit of a client in identifiable bank accounts labeled "Trust Account," "Client's Funds Account" or words of similar import. Requiring a law firm with multiple clients to segregate the accounts of clients makes sense: by keeping client accounts separate, it's easy to identify which money belongs to which client, as well as that none of it belongs to the firm. Applying this rule to an in-house legal department (which is also a "law firm" under the CRPC) appears strange. Legal departments typically do not receive funds on behalf of their clients – the company or business itself. And even in those rare instances when a legal department might receive funds on behalf of the company, it doesn't really make sense to require a legal department that has received such funds to segregate the company's money (into a labeled account) from money that otherwise belongs to the company anyway.

11 *See generally* Wertlieb and Avedissian, *Addressing Conflicts of Interest in a Transactional Practice*, supra note 7.

12 "A member shall not, without the informed written consent of the client or former client, accept employment adverse to the client or former client where, by reason of the representation of the client or former client, the member has obtained confidential information material to the employment." CRPC R. 3-310(E).

13 *Id.*

14 "A member shall not accept or continue representation of a client without providing written disclosure to the client where: . . . (2) The member knows or reasonably should know that: (a) the member previously had a legal . . . relationship with a party . . . in the same matter; and (b) the previous relationship would substantially affect the member's representation . . . ." CRPC R. 3-310(B).

15 *See Flatt v. Super. Ct.*, 9 Cal. 4th 275, 283 (Cal. 1994); *Cornish v. Super. Ct.* (Capital Bond & Ins. Co.), 209 Cal. App. 3d 467, 475-477 (1989).

16 *See William H. Raley v. Super. Ct.* (Carroll), 149 Cal. App. 3d 1042, 1049-1050 (1983).

17 *Blackmon v. Hale*, 1 Cal. 3d 548, 558 (1970). *See, also*, Cal. Bar Form. Op. 1981-64 (1981) (stating that attorneys of a private law firm share responsibilities with their firm for representation of their clients).

18 Unlike the CRPC, the ABA Model Rules do contain a rule of attribution: "While 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 . . . ." ABA Model Rules, R. 1.10(a).

19 *See, e.g.,* Cal. Bar, Form. Op. 1998-152 (1998).

20 *See, e.g.*, *City & County of San Francisco v. Cobra Solutions, Inc.,* 38 Cal. 4th 839, 847-848 (2006) (holding that the rule requiring vicarious disqualification of an entire law firm applies to a government law office when the head of that office has a conflict because that attorney previously, while in private practice, represented a client that is now being sued by the government entity in a matter substantially related to the attorney's prior representation).

21 Cal. Bus. & Prof. Code §§ 6076, 6068.5 (West 2003).

22 *Cobra Solutions*, supra note 20 at 847.

23 *See* supra note 8.

24 *Cobra Solutions*, supra note 20.

25 *See* Restatement of the Law Third - The Law Governing Lawyers § 121 (2000) (A conflict of interest exists where there is a "substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another client, a former client, or a third person").

26 *Cobra Solutions*, supra note 20 at 848 (*citing People ex rel. Dep't of Corps. v. SpeeDee Oil Change Sys., Inc.* 20 Cal. 4th 1135, 1153-1154 (1999)).

27 Note that the ABA Model Rules additionally permit screening of the personally conflicted lawyer. ABA Model Rules, R. 1.10(b)(2). Currently, there is no comparable exception to the rule of attribution under California law.

28 "A member shall not enter into an agreement for, charge, or collect an illegal or unconscionable fee." CRPC R. 4-200(A).

29 According to Rule 4-200(B), factors to be considered in determining the conscionability of a fee include the following: "(1) the amount of the fee in proportion to the value of the services performed; (2) the relative sophistication of the member [of the California State Bar] and the client; (3) the novelty and difficulty of the questions involved and the skill requisite to perform the legal service properly; (4) [not applicable to in-house]; (5) the amount involved and the results obtained; (6) the time limitations imposed by the client or by the circumstances; (7) the nature and length of the professional relationship with the client; (8) the experience, reputation, and ability of the member or members performing the services; (9) whether the fee is fixed or contingent; (10) the time and labor required; and (11) the informed consent of the client to the fee." CRPC R. 4-200(B).

30 CRPC R. 4-400.

31 "For purposes of this rule, 'sexual relations' means sexual intercourse or the touching of an intimate part of another person for the purpose of sexual arousal, gratification, or abuse." CRPC R. 3-120(A).

32 CRPC R. 3-120(B). As stated in the Discussion to the rule: "Rule 3-120 is intended to prohibit sexual exploitation by a lawyer in the course of a professional representation."

33 CRPC R. 3-120 and Discussion.

34 CRPC R. 3-110(A). "For purposes of this rule, 'competence' in any legal service shall mean to apply the 1) diligence, 2) learning and skill, and 3) mental, emotional, and physical ability reasonably necessary for the performance of such service." CRPC R. 3-110(B).

35 *See* CRPC R. 3-700(B).

36 *See, e.g.,* CRPC R. 3-700(A)(2) & (C).

37 "A member representing a client . . . shall withdraw from employment, if: (1) The member knows or should know that the client is bringing an action, conducting a defense, asserting a position in litigation, or taking an appeal without probable cause and for the purpose of harassing or maliciously injuring any person; or (2) The member knows or should know that continued employment will result in violation of these rules or of the State Bar Act . . . " CRPC R. 3-700(B).

38 CRPC R. 3-600(C).

39 CRPC R. 3-700(A)(2).