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Taking Stock: Investing in Clients Under the New Rules

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Investing in clients has long been a dicey prospect. The disciplinary reporters are filled with cases that illustrate the conflicts—whether the lawyer handled the transaction involved for the client (*see, e.g.*, *In re Brown*, 277 Or 121, 559 P2d 884 (1977)) or simply engaged in a business deal with a client where the client relied on the lawyer for legal advice (*see, e.g.*, *In re Montgomery*, 292 Or 796, 643 P2d 338 (1982)). And because conflicts in this setting easily translate into breaches of the fiduciary duty of loyalty, unwaived conflicts can also easily translate into claims and fee forfeiture. *See generally Kidney Association of Oregon v. Ferguson*, 315 Or 135, 843 P2d 442 (1992) (discussing the relationship between violations of the professional rules and breaches of lawyers' fiduciary duties).

Neither the old rules nor the new ones *prohibit* a lawyer from investing in a client—either directly or in lieu of a fee. Rather, they both require clear disclosure and client consent. The new rules, however, express their wariness by making the consent requirements more exacting.

The old rule, DR 5-104(A), was comparatively general:

> "A lawyer shall not enter into a business transaction with a client if they have differing interests therein and if the client expects the lawyer to

exercise the lawyer's professional judgment therein for the protection of the client, unless the client has consented after full disclosure."

The new rule, RPC 1.8(a), by contrast, is quite specific:

"A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

"(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

"(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

"(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction."

The new Oregon provision is patterned on the corresponding ABA model rule. For lawyers or law firms considering business deals with a client, the ABA's ethics opinion on investing in clients—00-418—should be required reading. The opinion discusses in detail the concept of what's "fair and reasonable" to the client and when that's measured. On this last point, the ABA's ethics committee concluded that the reasonableness of an investment should be measured when the deal is done. But that's not a uniform view. The Washington Court of Appeals, for example, found last year in *Holmes v. Loveless*, 122 Wn App 470, 94 P3d 338 (2004), that the "reasonableness" requirement for an investment in lieu of a fee extends over the life of the fee agreement—even after the underlying legal services have been completed.

Although not a matter of ethics, the Professional Liability Fund also has rigorous coverage requirements when lawyers are considering a business transaction with a client. Exclusion V.8 to the PLF's basic plan excludes coverage for claims arising from business transactions falling within RPC 1.8(a) unless very detailed disclosure in a form specifically developed by the PLF is executed by the client. Exclusion V.8 also includes requirements for giving the PLF notice of the deal and the accompanying disclosure within 10 days of when the disclosure form has been signed by the client. Exclusion V.8, the PLF's model disclosure form and accompanying comments by the PLF are all available on the PLF's web site at www.osbplf.org.

The cases involving lawyer investments in clients display motives ranging from the best to the worst on the part of the lawyer-investors. What they all share, though, is the theme that this is an area fraught with potential conflicts and that lawyers' motives will be subject to microscopic scrutiny after the fact. In that context, a lawyer making an investment in a client needs to put a premium on clear and complete disclosure to the client up front.

ABOUT THE AUTHOR

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