# 109 ACQUIRING AN OWNERSHIP INTEREST IN A CLIENT

**Adopted May 19, 2001.**

## *Introduction and Scope*

For many years, some lawyers have acquired an ownership interest in certain of their clients in connection with performing legal services,[1] either by taking equity in lieu of cash fees or simply by investing money in return for equity.[2] There is an increasing number of start-up companies in need of legal services, often with little or no money to do anything but develop their core product. In addition, there is a concomitantly increasing number of published reports of law firms making large amounts of money on their client-investment portfolios. The result is that, despite the ebb and flow of the equity markets, more lawyers and law firms are open to, or actively seeking, investment in their clients, either through direct equity ownership or by options or warrants to acquire equity. Indeed, at least one law firm representing exclusively start-up companies reportedly insists on being allowed to participate in the company's early-stage equity growth.[3]

Members of the bar and bar organizations have raised questions about the legal and ethical implications of a lawyer investing in a client. In 1986, the ABA Commission on Professionalism, in identifying potential problem areas in lawyer professionalism, voiced concern that while lawyers investing in clients, "may make the client's financing efforts easier, it creates a potential or actual conflict of interest, changing the lawyer-client relationship in a very fundamental way."[4] More currently, and more bluntly, the ABA/BNA Lawyer's *Manual on Professional Conduct* identifies as the primary risk in this practice the conflict that the business relationship creates due to "the position of influence that lawyers have over their clients, and the possibility that lawyers could use their position to take advantage of their clients in business dealings."[5]

Those who insure lawyers against malpractice claims have joined in the concern. The Attorneys Liability Assurance Society ("ALAS") in its *Loss Prevention Manual* cautions: "[I]t is not an overstatement to say that lawyers' increasing involvement in client-related . . . activities [those arising out of some form of transaction with a client of the lawyer] is threatening to become an unmanageable crisis within the legal profession. . . . The fundamental problem with lawyers' client-related activities is the risk that the lawyer's independence, objectivity and judgment will be—or will be perceived to be—compromised."[6]

Nevertheless, the ABA Standing Committee on Ethics and Professional Responsibility, in Formal Opinion 00-418,[7] has concluded that the Model Rules of Professional Conduct do not prohibit a lawyer from acquiring an ownership interest in a client, either in lieu of a cash fee for providing legal services or as an investment opportunity in connection with such services, as long as the lawyer complies with applicable ethical rules (ABA Formal Opinion 00-418 is attached to this Opinion as Appendix A).

In Colorado, consideration also must be given to the implications of *In the Matter of Larry D. Sather*, 3 P.3d 403 (Colo. 2000) regarding the circumstances under which a fee paid in advance may be considered earned and the reasonableness of that fee.

## *Syllabus*

Subject to the limitations and additions comprising the balance of this Opinion, the Ethics Committee of the Colorado Bar Association endorses ABA Formal Opinion 00-418 as the correct statement of the ethical considerations applicable to a lawyer or law firm acquiring an ownership interest in a client.

The Colorado Rules of Professional Conduct do not prohibit a lawyer from acquiring an ownership interest in a client, either in lieu of a cash fee for providing legal services or other benefit to the client or by accepting an investment opportunity, as long as the lawyer complies with Colo. RPC 1.7(b) and (c) regarding representation that may be materially limited by the lawyer's own interests, Colo. RPC 1.8(a)

governing business transactions with clients[8] and, where the lawyer acquires the interest in lieu of cash fees, Colo. RPC 1.5(a) requiring that a fee for legal services be reasonable. The investing lawyer also must comply with other applicable rules discussed in this Opinion.

### *Discussion*

Despite the potential conflicts that inevitably are present when a lawyer owns an equity interest in a client, such investments under some circumstances may have merit in promoting access to legal services. A lawyer's willingness to accept an equity interest in lieu of a cash fee may be the only way for a client with minimal uncommitted cash resources to obtain competent legal advice.

The Committee perceives no significant difference in the treatment under the Rules of Professional Conduct of the acquisition by a lawyer of an ownership interest in the lawyer's client, whether the lawyer receives direct payment of fees through receipt of an ownership interest in the client entity or receives the opportunity to acquire such interest for cash if that opportunity would not have been offered had the lawyer not also undertaken to perform legal services for the entity. Further, the same ethical issues must be addressed whether the ownership interest is acquired directly by the lawyer, by the lawyer's firm, or (in taking advantage of an investment opportunity offered to the lawyer) by an investment partnership controlled by the lawyer or by members of the lawyer's firm.[9]

### *Conflicts of Interest*

To comply with Colo. RPC 1.8(a), the transaction by which the lawyer acquires the interest and its terms must be fair and reasonable to the client and fully disclosed, and the terms of the transaction must be transmitted to the client in writing in a manner that reasonably can be understood by the client. The client must also be informed that the use of independent counsel is advisable[10] and must be given a reasonable opportunity to seek the advice of such independent counsel in the transaction. The client must consent to the transaction in writing.

In determining the effect of such an investment on the lawyer's representation of the client in which the lawyer invests, the lawyer must comply with Colo. RPC 1.7(b) and (c) governing situations in which the representation of a client may be materially limited by the lawyer's own interests. The lawyer must also comply with Colo. RPC 2.1 requiring that a lawyer exercise independent professional judgment and render candid advice in representing a client. If such an investment is made, the lawyer should give careful attention to Colo. RPC 1.13 regarding representation of an organization as the client. In addition, the lawyer must consider potential circumstances that might result in the lawyer using information relating to representation of a client to the disadvantage of the client in violation of Colo. RPC 1.8(b).

The potential conflicts of interest between a lawyer who is both counsel to and an equity owner in a client are myriad. As one example, a lawyer advising the board of directors of an acquisition target may find a direct conflict between her or his desire to maximize the present value of the client company's stock (and the lawyer's investment) as represented by the would-be acquirer's offer and the board's desire to maximize longer term value by remaining independent. This is a classic example of a situation in which the "business judgment rule" may apply to protect directors acting in accordance with the rule from liability to the company's owners, even though their actions do not result in immediately maximized value to those owners. In another example, a lawyer advising the board of directors of a company on disclosure issues in connection with a public offering of securities may be influenced by her or his desire to maximize the return on the lawyer's investment in the company. In each case, the question remains whether the board is receiving objective advice from counsel. That is, is the lawyer's own interest in her or his equity investment so in conflict with the interests of the client as to make it unreasonable to believe that "the representation will not be adversely affected" (Colo. RPC 1.7(b)(1)) or that the lawyer can "exercise independent professional judgment and render candid advice" (Colo. RPC 2.1)?

There are no bright line guides to answering these questions, and the examples above (and, in the Committee's opinion, examples contained in ABA Formal Opinion 00-418) are not meant to establish such bright lines. Each set of facts must be analyzed on its own merit. Among the many things a lawyer must

take into consideration in attempting to answer these questions are the amount of the lawyer's investment relative to his or her net worth and the amount of the investment relative to the capitalization of the client. How much financial pressure is on the lawyer with respect to the investment? How much control or influence can the lawyer exert by virtue of his or her equity interest relative to the total outstanding (or voting) equity?

A separate concern in this analysis is whether or not the investing lawyer is free to vote that equity interest in the lawyer's own self-interest under any or all circumstances, even if, under the particular circumstances at the time of the vote, the lawyer's vote may defeat the purposes of the client. Here again, there are no bright line guides to addressing this concern. However, the lawyer must constantly reanalyze the changing circumstances in the course of the representation for potential conflicts of interest that may adversely affect the representation (Colo. RPC 1.7(b)(1)), or impair his or her ability to exercise independent professional judgment and render candid advice (Colo. RPC 2.1).

The Committee believes that it is strongly advisable that the lawyer include in the disclosure made to the client prior to consummation of the investment transaction the following:

- that there are potential conflicts of interest that may arise resulting from the lawyer's investment and/or actions as an equity owner;
- that such conflicts may under certain circumstances require the lawyer to withdraw from the representation if those conflicts rise to the level that continued representation would violate the Rules of Professional Conduct (Colo. RPC 1.16(a)); and
- that as an equity owner, the lawyer may in the future vote her or his equity interest as she or he sees fit in the lawyer's own self-interest, regardless of the wishes of the management of the client.[11]

The rules regarding conflicts of interest apply equally to all clients, regardless of their level of sophistication. It is the lawyer's duty to recognize the conflict of interest and comply with the rule.

> No matter what the sophistication level of a client, it is never the client's duty to recognize the conflicts of interest nor is it the client's duty to seek out such information. No matter what the education level or the sophistication of a client, it is always the attorney's duty to fully disclose the existence or potential for conflict of interest, to avoid such conflicts, and to obtain, if necessary, a full waiver of such conflict.

*In the Matter of Breen*, 830 P.2d 462 (Ariz. 1992).

### *Reasonableness of Fees; Valuation*

"Attorney fees are always subject to refund if they are excessive or unearned." *In the Matter of Larry D. Sather,* 3 P.3d 403 at 413 (Colo. 2000).

Compliance with Colo. RPC 1.5 requires that the fees paid by means of equity be of reasonable value in light of the legal services or other benefit to the client for which they are charged. The comment to that rule acknowledges that a lawyer may accept property, such as an equity interest, in payment of fees.[12] Although there is no clear guidance on the subject in Colorado case law, ABA Formal Opinion 00-418,[13] and other authorities suggest that the circumstances to be considered in determining the value of the equity received and the reasonableness of that value as a fee for legal services or other benefit to the client are those circumstances reasonably ascertainable at the time of the transaction (the time at which a definitive agreement is made with the client regarding the lawyer's investment).[14]

The circumstances of each case should be judged under an objective standard of reasonableness. *See* Colo. RPC 1.5(a); *Feiger, Collison & Killmer v. Jones*, 926 P.2d 1244, 1252 (Colo. 1996) (client's sophistication a factor); *Beeson v. Industrial Claim Appeals Office of the State of Colorado*, 942 P.2d 1314, 1316 (Colo.App. 1997) (various factors should be employed to measure the reasonableness of the attorney fee, and the weight given to any factor depends on the circumstances of each case.) A lawyer taking equity in lieu of fees would be well advised to obtain, if possible, an objective valuation of the equity interest at the time it is received to demonstrate that the fee is reasonable in light of the benefit conferred or services rendered or to be rendered to the client in return.

### *The Issue of Advance Fees*

Receipt by a lawyer of an ownership interest in a client in lieu of cash fees is equivalent to receipt of advance fees, in whole or in part, if the services for which the ownership interest is given have not yet been performed or the client does not receive some benefit in return for the ownership interest at the time the interest is received. Under Colo. RPC 1.15 and the Colorado Supreme Court's holding in *In the Matter of Larry D. Sather*, 3 P.3d 403 (Colo. 2000), advance fees remain property of the client until earned.

In structuring an arrangement under which a lawyer receives an ownership interest in a client before performing the legal services for which the ownership interest is given, the lawyer must determine, with the client's consent, whether some portion or all of the equity interest has been earned at the time the engagement is entered into. The justification for such a decision and the manner in which it is memorialized should comply with the requirements in *Sather* for dealing with a cash payment that qualifies as an "earned retainer." If the equity interest is not intended as an earned retainer and does not meet the test under *Sather*, it remains the property of the client. In that case, if the equity interest takes the form of, for example, certificated securities, the lawyer must keep them in a safe deposit box or another appropriate location of safekeeping (*see* Colo. RPC 1.15(a) and Comment to Colo. RPC 1.15.[15]

If the investment in the client is not intended or does not qualify as an "earned retainer," as described in *Sather*, the lawyer must consider the additional complications that result from determining the time period over which, and the legal services to be rendered for which, the equity investment is earned by the lawyer and the manner in which all or a portion of the equity investment will be returned to the client if the representation is terminated prior to completion of the representation, whether by the client or the attorney. There is a dearth of case law in this area, but the Committee believes that the writing called for under Colo. RPC 1.8(a) should describe how the equity interest will be earned, *e.g.*, by valuing the ownership interest at the time it is granted and considering it earned in proportion to the hourly rate the lawyer charges or to specific legal services to be provided by the lawyer, and the conditions under which it could be returned to the client.

### *Related Non-Ethical Issues*

Apart from the ethical implications of investing in a client, a lawyer contemplating such an investment should give serious consideration to other significant implications of such action. The burden of proof is on the lawyer to show that the terms of both a business transaction and a compensation agreement with a client were fair and reasonable and that the client was fully informed.[16]

Issues deserving of scrutiny include potential civil liability claims based in securities law (*e.g.*, shareholder derivative suits), compliance with applicable securities laws (*e.g.*, insider trading rules), in what circumstances should a lawyer disclose her or his equity interest in a client to others involved in a transaction with the client, the fiduciary duties the lawyer may owe to the client, the lawyer's duty of loyalty under the law of agency,[17] the extent of and relevant exclusions from the lawyer's or firm's professional liability insurance, and the need for clear, thorough firm policies regarding investing in clients. These implications are beyond the scope of this Opinion, but are of substantial importance to a lawyer dealing with the question of whether or how to invest in a client.[18]

## NOTES

1. Baker, "Who Wants to be a Millionaire?," *ABA J.* (Feb. 2000) at 36.

2. For purposes of this opinion, "equity" and "an ownership interest" are used synonymously and include the right to receive future equity, *e.g.*, options or warrants. For ease of reference, we refer to this practice as "investing in clients."

3. Schmitt, "Little Law Firm Scores Big by Taking Stake in Clients," *The Wall Street J.* (March 22, 2000) at B1.

4. ABA Commission on Professionalism, *In the Spirit of Public Service: A Blueprint for the Rekindling of Lawyer Professionalism* (1986).

5. *Lawyer's Manual on Professional Conduct*, 51:502 (ABA/BNA).

6. ALAS, *1999 Loss Prevention Manual*, Tab III.A at 3.

7. *Lawyer's Manual, supra*, note 5 at 1101:207.

8. ABA Formal Opinion 00-418, *supra*, note 5 at Section A, *Compliance with Rules 1.8(a) and 1.5(a) When Acquiring Ownership in a Client*. "In our opinion, a lawyer who acquires stock in her client corporation in lieu of or in addition to a cash fee for her services enters into a business transaction with a client such that the requirements of Model Rule 1.8(a) must be satisfied." Citing, *inter alia*, Restatement (Third) of the Law Governing Lawyers, § 126, comment, and Hazard and Hodes, *The Law of Lawyering* (2d ed. 1998) §§ 1.8:202 *et seq.*, and noting that Rule 1.8(a) does not apply to open market purchases or in other circumstances not involving direct intervention by the client.

9. Colo. RPC 5.4(d) requires lawyers who practice with or in the form of a for-profit professional corporation or association or limited liability company to comply with C.R.C.P. 265. C.R.C.P. 265, in turn, provides that professional companies may be established, and may exercise their powers and privileges, solely for the purpose of conducting the practice of law. C.R.C.P. 265(I)(A)(2) and (3). In *Network Affiliates, Inc. v. Robert E. Schack, P.A.,* 682 P.2d 1244 (Colo.App. 1984), the Colorado Court of Appeals held that a Colorado law firm's contract to sell advertising materials to a Florida law firm exceeded the Colorado law firm's powers and privileges under C.R.C.P. 265, thus rendering the contract void. No published Colorado case has determined whether mere ownership of stock by a C.R.C.P. 265 entity exceeds that entity's powers and privileges. However, most jurisdictions regulate law firm professional corporations under variations of the American Bar Association's *Model Professional Corporation Supplement*, which, in relevant part, "permits a professional corporation to invest in real estate or make other investments that are incidental to the rendering of the professional service for which it was formed, and which do not rise to the level of an independent business purpose." Official Comment, Section 14, *Model Professional Corporation Supplement* (1984).

10. In reading ABA Formal Opinion 00-418, Colorado lawyers should note that Colo. RPC 1.8(a)(2) requires that the client be informed that the use of independent counsel "*may be advisable.*" This differs from the Model Rules of Professional Conduct, cited in the ABA Opinion, that require only "*a reasonable opportunity to seek the advice of independent counsel*," and also differs from the recommendation under Restatement (Third) of the Law Governing Lawyers, § 126 (2000) that the client consent "*after being encouraged*" to seek independent legal advice.

11. Even with this disclosure, the lawyer should proceed cautiously in exercising her or his right to vote the equity interest in a manner that could be adverse to the best interest of the client or the wishes of client's governing body (*e.g.*, board of directors). Such action could lead to allegations of a violation of Rule 1.7(b) regarding the representation itself.

12. Colo. RPC 1.5, Comment, *Terms of Payment*, states, "A lawyer may accept property in payment for services, such as an ownership interest in an enterprise, providing this does not involve acquisition of a proprietary interest in the cause of action or subject matter of the litigation contrary to Rule 1.8(j). However, a fee paid in property instead of money may be subject to special scrutiny because it involves questions concerning both the value of the services and the lawyer's special knowledge of the value of the property."

13. ABA Formal Opinion 00-418, n. 9.

14. Restatement (Third), The Law of Lawyering, § 126 Comment e ("The requirement that the transaction be fair from the perspective of an objective observer derives from the general fiduciary requirement of fair dealing with a client [*citation omitted*]. Unintended overreaching is a possibility in transactions involving lawyers and their clients. Accordingly, a lawyer must overcome a presumption that overreaching has occurred by demonstrating the fairness of the transaction. Fairness is determined based on the facts that reasonably could be known at the time of the transaction, not as the facts later develop. The relative ability of the lawyer and client to foresee how the facts might develop, however, is relevant in determining fairness. An appropriate test is whether a disinterested lawyer would have advised the client not to enter the transaction with some other party.").

15. The lawyer also must deal with questions regarding the extent to which, if at all, the lawyer may exercise the rights of ownership of the equity interest, *e.g.*, voting rights, the right to receive dividends or liquidation distributions, and the right as an equity owner to corporate information.

16. *See Howard v. Hester,* 338 P.2d 106 (Colo. 1958) ("Lawyers and real estate men stand in a confidential relation to their clients and principals, and extreme care must be exercised by them to see that their

transactions bear the searching light of fair and above-board dealing."). *Bryant v. Hand,* 404 P.2d 521 (Colo. 1965), *citing Rupp v. Cool*, 362 P.2d 396 (Colo. 1961), *quoting from* 7 C.J.S., Attorney and Client § 204 a (2): "Where after the relationship has been established, an attorney and client enter into an agreement in reference to the attorney's compensation, . . . the burden is on him to prove that the agreement was fairly and openly made, was supported by adequate consideration, and that he gave the client full knowledge of the facts and of his legal rights, when he entered into the agreement, and that the services to be performed were reasonably worth the amount stated in the agreement. . . ." *See also Cleery v. Cleery*, 692 N.E.2d 955 (Mass. 1998); *Cupeiro v. Baron*, 555 So.2d 370 (Fla.App., 3rd Dist. 1989) (burden of proof clear and convincing evidence) (accord *The Florida Bar v. Simonds*, 376 So.2d 853 (Fla. 1979); *Bauermeister v. McReynolds*, 575 N.W.2d 354 (Neb. 1998)).

17. The duties of loyalty in general prohibit the lawyer from harming the client. *Restatement (Third), The Law Governing Lawyers* § 16, Comment e (2000).

18. For additional guidance in identifying and dealing with some of these areas of concern, see the report of the American Bar Association's Litigation Task Force on the Independent Lawyer, *Lawyers Doing Business With Their Clients: Identifying and Avoiding Legal and Ethical Dangers* (ABA 2001).

## FORMAL OPINION 109

## APPENDIX A

## American Bar Association Formal Opinion 00-418
## July 7, 2000

### *Acquiring Ownership in a Client in Connection with Performing Legal Services*

*The Model Rules of Professional Conduct do not prohibit a lawyer from acquiring an ownership interest in a client, either in lieu of a cash fee for providing legal services or as an investment opportunity in connection with such services, as long as the lawyer complies with Rule 1.8(a) governing business transactions with clients, and, when applicable, with Rule 1.5 requiring that a fee for legal services be reasonable. To comply with Rule 1.8(a), the transaction by which the lawyer acquires the interest and its terms must be fair and reasonable to the client, and fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client. The client also must be given a reasonable opportunity to seek the advice of independent counsel in the transaction and must consent to the transaction in writing. In providing legal services to the client's business while owning its stock, the lawyer must take care to avoid conflicts between the client's interests and the lawyer's personal economic interests as an owner, as required by Rule 1.7(b), and must exercise independent professional judgment in advising the client concerning legal matters as required by Rule 2.1.*

### *Background*

With growing frequency, lawyers who provide legal services to start-up businesses are investing in their clients, sometimes accepting an ownership interest as a part or all of the fee.[1] Some representatives of the organized bar have questioned this practice.[2] Many lawyers nevertheless believe that acquiring ownership interests in start-up business clients is desirable in order to satisfy client needs and also, because of growing competition with higher paying venture capital and investment firms, to attract and retain partners and associates.[3] From the client's perspective, the lawyer's willingness to invest with entrepreneurs in a start-up company frequently is viewed as a vote of confidence in the enterprise's prospects. Moreover, a lawyer's willingness to accept stock instead of a cash fee may be the only way for a cash-poor client to obtain competent legal advice. Frequently, this may be the determining factor in the client's selection of a lawyer.[4]

The Committee in this Opinion examines the issues that must be addressed under the ABA Model Rules of Professional Conduct when a lawyer or law firm acquires an ownership interest in a client in connection with performing legal services.[5] A typical situation might be one in which the client business is a corporation that the law firm is organizing at the request of the founding entrepreneurs. The latter already have a few friends and family members who are eager to invest funds to start up the corporation. The founders may allow the lawyer working with them to invest the firm's fee for legal services in stock of the corporation. The organizers expect the law firm to introduce them to the firm's venture capital contacts and to continue representing the corporation, eventually performing the services necessary to take it public.[6]

### *A. Compliance with Rules 1.8(a) and 1.5(a) When Acquiring Ownership in a Client*

In our opinion, a lawyer who acquires stock in her client corporation in lieu of or in addition to a cash fee for her services enters into a business transaction with a client, such that the requirements of Model Rule 1.8(a) must be satisfied.[7] In determining whether Rule 1.8(a)'s first requirement of fairness and reasonableness to the client is satisfied, the general standard of Rule 1.5(a) that "[a] lawyer's fee shall be reasonable" and the factors enumerated under that Rule are relevant.[8]

For purposes of judging the fairness and reasonableness of the transaction and its terms, the Committee's opinion is that, as when assessing the reasonableness of a contingent fee, only the circumstances reasonably ascertainable at the time of the transaction should be considered.[9] It seems clear that "[i]n a discipline case, once proof has been introduced that the lawyer entered into a business transaction with a client, the burden of persuasion is on the lawyer to show that the transaction was fair and reasonable and that the client was adequately informed."[10] Accordingly, it is incumbent upon the lawyer to take account of all information reasonably ascertainable at the time when the agreement for stock acquisition is made.[11]

Determining that the fee is reasonable in terms of the enumerated factors under Rule 1.5(a) does not resolve whether the requirement of Rule 1.8(a) that the transaction and terms be "fair and reasonable to the client" has been met. Determining "reasonableness" under both rules also involves making the often difficult determination of the market value of the stock at the time of the transaction. As Professors Hazard and Hodes state, "[o]ne danger [to the lawyer who accepts stock as a fee] is that the business will so prosper that the fee will later appear unreasonably high."[12] Of course, instead of increasing in value, the stock may become worthless, as occurs frequently with start-up enterprises.[13] The risk of failure and the stock's nonmarketability are important factors that the lawyer must consider, along with all other information bearing on value that is reasonably ascertainable at the time when the agreement is made.[14]

One way for the lawyer to minimize the risk noted by Professors Hazard and Hodes is to establish a reasonable fee for her services based on the factors enumerated under Rule 1.5(a)[15] and then accept stock that at the time of the transaction is worth the reasonable fee. Of course, the stock should, if feasible, be valued at the amount per share that cash investors, knowledgeable about its value, have agreed to pay for their stock about the same time.

A reasonable fee also may include an agreed percentage of the stock issued or to be issued when the value of the shares is not reasonably ascertainable. For example, if the lawyer is engaged by two founders who are contributing intellectual property for their stock, it may not be possible to establish with reasonable certainty the cash value of their contribution. If so, it also would not be possible to establish with reasonable certainty the value of the shares to be issued to the lawyer retained to perform initial services for the corporation. In such cases, the percentage of stock agreed upon should reflect the value, as perceived by the client and the lawyer at the time of the transaction, that the legal services will contribute to the potential success of the enterprise. The value of the stock received by the lawyer will, like a contingent fee permitted under Rule 1.5(c), depend upon the success of the undertaking.[16]

In addition to assuring that the stock transaction and its terms are fair and reasonable to the client, compliance with Rule 1.8(a) also requires that the transaction and its terms must be fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client.[17] Thus, the lawyer must be careful not only to set forth the terms in writing, but also to explain the transaction and its potential

effects on the client-lawyer relationship in a way that the client can understand it. For example, if the acquisition of stock by the lawyer will create rights under corporate by-laws or other agreements that will limit the client's control of the corporation, the lawyer should discuss with the client the possible consequences of such an arrangement.[18]

At the outset, the lawyer also should inform the client that events following the stock acquisition could create a conflict between the lawyer's exercise of her independent professional judgment as a lawyer on behalf of the corporation and her desire to protect the value of her stock.[19] She also should advise the client that as a consequence of such a conflict, she might feel constrained to withdraw as counsel for the corporation, or at least to recommend that another lawyer advise the client on the matter regarding which she has a personal conflict of interest.[20]

Full disclosure also includes specifying in writing the scope of the services to be performed in return for receipt of the stock or the opportunity to invest. The scope of services should be covered in the written transmission to the client even though the stock is acquired by the firm's investment partnership as an opportunity rather than by the firm directly as a part of the fee in lieu of cash. If the client's understanding is that the lawyer keeps the stock interest regardless of the amount of legal services performed by the lawyer and solely to assure the lawyer's availability, it is important to set forth this aspect of the transaction in clear terms.[21] Otherwise, a court might regard the stock acquisition as being in the nature of an advance fee for services and require part of the stock to be returned if all the work originally contemplated as part of the services for which the stock was given has not been performed.[22]

Although it is better practice to set forth all the salient features of the transaction in a written document, compliance with Rule 1.8(a) does not require reiteration of details that the client already knows from other sources. Indeed, too much detail may tend to distract attention from the material terms. Nonetheless, the lawyer bears the risk of omitting a term that seems unimportant at the time, but later becomes significant because she has the burden of showing reasonable compliance with Rule 1.8(a)(1). A good faith effort to explain in understandable language the important features of the particular arrangement and its material consequences as far as reasonably can be ascertained at the time of the stock acquisition should satisfy the full disclosure requirements of Rule 1.8(a).[23]

The client also must have a reasonable opportunity to seek the advice of independent counsel in the transaction and must consent in writing to the transaction and its terms. In addition, although not required by the Model Rules, the written documentation of the transaction should include the lawyer's recommendation to obtain such advice. This serves to emphasize the importance to the client of obtaining independent advice. The client's failure to do so then is his own deliberate choice. The lawyer has complied with Rule 1.8(a) in this respect because actual consultation is *not* required.[24]

The best way to comply with the requirements of Rule 1.8(a) is to set forth the salient terms of the transaction in a document written in language that the client can understand and, after the client has had an opportunity to consult with independent counsel, to have the document signed by both client and lawyer.

### *B. Conflicts Between the Lawyer's Interests and Those of the Client*

On rare occasions the acquisition of stock in a client corporation will amount to acquiring, in the language of Rule 1.8(j), "a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting."[25] As Comment [7] under Rule 1.8 explains, the prohibition "has its basis in common law champerty and maintenance [and] is subject to specific exceptions developed in decisional law and continued in these Rules, such as the exception for reasonable contingent fees set forth in Rule 1.5. . . ." The modern rationale for the rule is the concern that a lawyer acquiring less than all of a client's cause of action creates so severe a conflict between the lawyer's interest and the client's interest that it is nonconsentable.[26]

In our view, when the corporation has as its only substantial asset a claim or property right (such as a license), title to which is contested in a pending or impending lawsuit in which the lawyer represents the corporation, Rule 1.8(j) might be applicable to the acquisition of the corporation's stock in connection with the provision of legal services. If the acquisition of the stock constitutes a reasonable contingent fee, however, Rule 1.8(j) would not prohibit acquisition of the stock.[27]

Rule 1.7(b) prohibits representation of a client if the representation "may be materially limited . . . by the lawyer's own interests," unless two requirements are met. The lawyer must reasonably believe that "the representation will not be adversely affected," and the client must consent to the representation after consultation.[28]

A lawyer's representation of a corporation in which she owns stock creates no inherent conflict of interest under Rule 1.7. Indeed, management's role primarily is to enhance the business's value for the stockholders. Thus, the lawyer's legal services in assisting management usually will be consistent with the lawyer's stock ownership. In some circumstances, such as the merger of one corporation in which the lawyer owns stock into a larger entity, the lawyer's economic incentive to complete the transaction may even be enhanced.[29]

There may, however, be other circumstances in which the lawyer's ownership of stock in her corporate client conflicts with her responsibilities as the corporation's lawyer. For example, the lawyer might have a duty when rendering an opinion on behalf of the corporation in a venture capital transaction to call upon corporate management to reveal material adverse financial information that is being withheld, even though the revelation might cause the venture capital investor to withdraw.[30] In that circumstance, the lawyer must evaluate her ability to maintain the requisite professional independence as a lawyer in the corporate client's best interest by subordinating any economic incentive arising from her stock ownership. The lawyer also must consider whether her stock ownership might create questions concerning the objectivity of her opinion. She must consult with her client and obtain consent if the representation may be materially limited by her stock ownership.

The conflict could be more severe. For example, the stock of the client might be the lawyer's major asset so that the failure of the venture capital opportunity could create a serious financial loss to her. The lawyer's self-interest in such a case probably justifies a reasonable belief that her representation of the corporation would be affected adversely. This would disqualify her under Rule 1.7(b) from providing the opinion even were the client to consent.[31]

In order to minimize conflicts with the interests of the clients such as those described, some law firms have adopted policies governing investments in clients. These policies may include limiting the investment to an insubstantial percentage of stock and the amount invested in any single client to a non-material sum. The policies also may require that decisions regarding a firm lawyer's potential client conflict be made by someone other than the lawyer with the principal client contact (who also may have a larger stock interest in the corporate client) and may also transfer billing or supervisory responsibility to a partner with no stock ownership in the client.[32]

Even though a lawyer owns stock in a corporation, she, of course, has no right to continue to represent it as a lawyer if the corporate client discharges her.[33] Were the lawyer to challenge the decision duly made by the authorized corporate constituents to discharge her, she would violate Rule 1.7(b) because it is clear that her own interests adversely affect the representation of the corporation.[34]

## *Conclusion*

When a lawyer accepts stock or options to acquire stock in a client corporation in connection with providing legal services to it, she must comply with the requirements of Rule 1.8(a) because the stock acquisition constitutes a business transaction with a client and. if applicable, with the requirement of Rule 1.5(a) that the lawyer's fee shall be reasonable. Under Rule 1.8(a), the stock transaction and its terms must be fair and reasonable to the client. This is satisfied if the fee, including receipt of the stock, is reasonable applying the enumerated factors under Rule 1.5(a), and if the transaction and its terms in other respects are fair and reasonable to the client under the circumstances that are reasonably ascertainable at the time the arrangement is made.

The terms of the transaction also must be fully disclosed in writing to the client in a manner that can be reasonably understood by the client. Full disclosure includes, for example, discussions of the consequences of any rights by virtue of the lawyer's stock ownership that may limit the client's control of the corporation under special corporate by-laws or other agreements and the possibility that the lawyer's eco-

nomic interests as a stockholder could create a conflict with the client's interest that might necessitate the lawyer's withdrawal from representation in a matter. The client also must be afforded a reasonable opportunity to consult independent counsel concerning the transaction and its terms. Finally, the client's consent must be in writing.

Although a lawyer's representation of a corporation in which the lawyer owns stock creates no inherent conflict of interest, circumstances may arise that create a conflict between the corporation's interests and the lawyer's economic interest as a stockholder. In such event, the lawyer must consult with the client and obtain client consent if, as a result of her ownership interest, the representation of the corporation in a particular matter may be materially limited. The lawyer may in some circumstances be required under Rule 1.7(b) to withdraw from representing the client in a matter if her financial interest in the client is such that she cannot reasonably conclude that the representation would not be adversely affected.

## NOTES

1. *See, e.g.,* Jason M. Klein, *No Fool for a Client: The Finance and Incentives Behind Stock-Based Compensation for Corporate Lawyers*, 1999 COLUM. BUS. L. REV. 329, 330-31; Debra Baker, *Who Wants to be a Millionaire?*, 86 A.B.A. JOURNAL, February 2000, at 36, 37. Although the interest the lawyer acquires usually is in the form of stock or warrants or options to buy stock of a corporation, this Opinion applies equally to ownership in any form of business entity, such as a limited liability company, limited partnership, or business trust that is the client of the lawyer. For convenience, this Opinion assumes the ownership interest is comprised of corporate stock.

2. *See, e.g.,* ABA Commission on Professionalism, *In the Spirit of Public Service: A Blueprint for the Rekindling of Lawyer Professionalism* (1986), in which the Commission identified lawyers investing in the activities of clients as one of several problem areas. The Commission expressed the view that lawyers investing in clients "may make the client's financing efforts easier, [but that] it creates a potential or actual conflict of interest, changing the lawyer-client relationship in a very fundamental way." *Id.* at 31 (footnotes omitted). *See also* ABA Section of Litigation Task Force on the Independent Lawyer, *Taking an Interest in the Client's Business in Lieu of a Fee* (Draft August 1999); Baker, *supra* note 1, at 39-40.

3. *See, e.g.,* Sean Somerville, *Lawyers Stocking Up on Payday*, BALTIMORE SUN, November 7, 1999, at D-1. *See also* Shawn Neidorf, *Silicon Valley Lawyers Embrace VC-Like Role*, VENTURE CAPITAL J., Oct. 1, 1999, at 1, 2 ("Most Silicon Valley attorneys defer billing, with many offering discounts for the opportunity to invest in a client's company through a law firm's fund.").

4. Klein, *supra* note 1, at 351, also argues that compensating lawyers with equity interests finds support in public policy. Similar to contingent fees, permitting clients to pay with stock or options creates a financing device that allows clients broader access to legal services by providing an alternative currency to pay for those services.

5. The Committee notes that a lawyer considering the acquisition of ownership in a client should address practical issues as well as legal issues that arise under law other than the Model Rules when a lawyer owns an interest in a client. Among these issues are: (1) extent of coverage under lawyer professional responsibility policies when the lawyer also is a stockholder; (2) possibility of civil liability claims, including stockholder derivative actions resulting from the lawyer representing the client in certain types of matters; (3) desirability of adopting clear policies on investing in clients in order to minimize liability risks and to avoid internal disharmony among lawyers in the firm regarding investment opportunities individual lawyers may be offered by clients; and (4) need for assuring compliance by all firm personnel with securities law and regulations.

6. We see no substantial difference under the Model Rules between direct payment to the lawyer of her fee by way of an interest in the business entity in lieu of cash and the opportunity to purchase an interest for cash, if the opportunity to acquire the stock would not have been offered had the lawyer not also undertaken to perform legal services. The same ethical issues also must be addressed whether the ownership interest is acquired directly by the lawyer or by an investment partnership controlled by the lawyer or members of her firm.

7. Rule 1.8(a) states in pertinent part:

> (a) A lawyer shall not enter into a business transaction with 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 to the client in a manner which can be reasonably understood by the client;
> (2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and
> (3) the client consents in writing thereto.

Authorities are in agreement that Rule 1.8(a) applies when a lawyer accepts an interest in the client in connection with a fee for legal services. *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (Proposed Official Draft 1998) § 126 cmt. a (requirements of § 126 apply when lawyer takes interest in client's business as fee); *see also* G. C. HAZARD AND W.W. HODES, THE LAW OF LAWYERING (2d ed. 1998) § 1.8:202 *et seq.*; C. WOLFRAM, MODERN LEGAL ETHICS (1986) § 8.11.2 (Model Rule 1.8(a) or former Model Code of Professional Responsibility DR 5-104(A) apply to the transaction). Rule 1.8(a) does not, however, apply when the lawyer acquires the stock in an open market purchase or in other circumstances not involving direct intervention by the client.

8. Rule 1.5(a) states that:

> The factors to be considered in determining the reasonableness of a fee include the following:
> (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
> (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
> (3) the fee customarily charged in the locality for similar legal services;
> (4) the amount involved and the results obtained;
> (5) the time limitations imposed by the client or by the circumstances;
> (6) the nature and length of the professional relationship with the client;
> (7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
> (8) whether the fee is fixed or contingent.

Rule 1.5 would not apply if the opportunity to invest was not offered in connection with undertaking to provide legal services.

9. *See* RESTATEMENT, *supra* note 7, § 207 Comment e ("Fairness is determined based on facts that reasonably could be known at the time of the transaction, not as facts later develop."). *See also* ABA Formal Op. 94-389 (1994) (Contingent Fees), note 21 (finding various aspects of contingent fee arrangements to be ethical. The note cites Lester Brickman, *Contingent Fees Without Contingencies*, 37 U.C.L.A. L. REV. 29, 87 (1989), to the effect that the legitimacy of a contingency fee is to be judged by the effort expected "prior to the commencement of representation," not by the actual effort expended.) (Emphasis supplied); Klein, *supra* note 1, at 336 ("[R]eview of the fee is only appropriate at the time the fee is granted, for the lawyer has undertaken 100% of the risk associated with the value of that fee in the future.").

10. RESTATEMENT, *supra* note 7, § 207 at 639; *see also* Comment e at 641-42. The transaction also remains voidable in a civil suit, and the lawyer investor, as a fiduciary, has the burden of proving its fairness. *See* RESTATEMENT § 207 cmt. a; *see also Passanate v. McWilliams*, 53 Cal. App. 4th 1240, 1248, 62 Cal. Rptr.2d 298, 302 (Cal. Ct. App. 1997) (lawyer for corporation denied recovery of $32 million for stock of corporation that its board previously had authorized to be issued him in connection with his legal services because the lawyer failed to advise board to consult independent counsel about the transaction); *Matthews v. Spears*, 24 So.2d 195 (La. App. 1945) (court cancelled contract transferring to lawyer undivided one-fourth interest in mineral rights in land owned by clients on the grounds that the lawyer did not fully disclose the nature of the transaction and because consideration for the conveyance was lacking).

11. *See also* Comment [2] to Rule 1.5(a) stating that a fee paid in property (such as corporate stock) "may be subject to special scrutiny because it involves questions concerning both the value of the services and the lawyer's special knowledge of the value of the property." Though the Comment is applicable here, meeting the requirements of Rule 1.8(a) serves to satisfy the special scrutiny standard applicable to the receipt of property in exchange for services.

12. HAZARD & HODES, *supra* note 7, §1.8:202 at 264.

13. In comparing cash to stock compensation, Klein points out that "[w]hen a lawyer is compensated with stock or options rather than with cash, the lawyer accepts the risk or uncertainty in the value of the stock or options . . . . The risk in the future value of the stock or options is significant, because there is no downside protection." *Supra* note 1, at 339-40.

14. *See* Utah Ethics Adv. Op. Comm Op. 98-13, 1998 WL 863904 * 1 (Dec. 4, 1998) (in addition to factors enumerated under Rule 1.5(a), the lawyer also should consider in determining reasonableness of a fee when accepting client stock: (i) the liquidity of the stock, (ii) whether and when it can be expected to be publicly traded, (iii) any restrictions on its transfer, and (iv) its presently anticipated value, including the risks that a proposed patent or trademark may not be granted or necessary government approvals may not be received).

15. *Supra* note 8 and accompanying text.

16. The Committee is aware that sometimes the lawyer will ask the corporation to issue her a percentage of the shares initially issued to the founders as a condition to the lawyer agreeing to become counsel to the new enterprise. We take no position on the ethical propriety of this practice. We caution, however, that in this circumstance, and especially if the cash value of the shares is not reasonably ascertainable, the lawyer should take special care to be in a position to justify the reasonableness of the total fee should it later be questioned as a violation of Rule 1.5(a).

17. As Professor Wolfram notes, "the fact that a transaction is arguably fair and reasonable does not mean that MR 1.8(a) has been complied with if the other requirements of the rule are not satisfied." WOLFRAM, *supra* note 7, § 8.11.4 at 480 (even though contract between client and lawyer was sufficiently fair and reasonable to decree specific performance, lawyer's failure to make full disclosure of the transaction to client referred to disciplinary authority) (citing *Ruth v. Crane*, 392 F. Supp. 724, 731 (E.D. Pa. 1975), *aff'd*, 564 F.2d 90 (3d Cir. 1977)); Comm. on Prof. Ethics and *Conduct of Iowa State Bar Ass'n v. Mershon*, 316 N.W.2d 895, 900 (Iowa 1982) (violation of DR 5-104(A) established "even though respondent did not act dishonestly or make a profit on the transaction").

18. If the lawyer is acquiring a percentage of the equity or a class of securities that entitles her to exercise rights not shared by stockholders generally, then specific disclosure might be required. *See, e.g., Comm. on Prof. Ethics and Conduct of Iowa State Bar Ass'n v. Humphreys*, 524 N.W.2d 396, 399 (Iowa 1994) (lawyer disbarred when, *inter alia*, without advising client-majority stockholder of the potential conflict of interest, he acquired stock and prepared corporate documents that prevented the lawyer's termination as a director and required the lawyer's approval to reduce his compensation as an officer or to take certain other corporate actions). As to the absolute right of a client to discharge the lawyer and the conflict created by differences over business decisions, *see infra* notes 33 and 34 and accompanying text.

19. Rule 2.1 admonishes: "In representing a client, a lawyer shall exercise independent judgment and render candid advice." *See also* Comment [6] under Rule 1.7 ("lawyer's own interests should not be permitted to have an adverse effect on representation of a client"); HAZARD & HODES, *supra* note 7, § 1.8:202 at 264 ("Another danger is that the business will falter, and that [the lawyer], worried about recovering her fee [stock rather than cash] for work already performed, will not be able to advise the client dispassionately.").

20. *See infra* note 31 and accompanying text regarding actions the lawyer must take should a conflict later arise.

21. *See* Pennsylvania Bar Ass'n Comm. on Legal Ethics and Prof. Resp. Formal Op. 95-100, 1995 WL 902545 *3 (August 1, 1995) (non-refundable retainers permissible so long as confirmed by "clear and unambiguous language of a written statement provided to the client or a written agreement between the attorney and client").

22. Even though in such a case a court might not order disgorgement of the fee in a civil action if the client ends the relationship without cause, *see, e.g., Ryan v. Butera et al.*, 193 F.3d 210, 218 (3rd Cir. 1999), the lawyer's ethics might be questioned for failure to return the "unearned" portion of the stock acquired by the lawyer. *See also* Oregon State Bar Ass'n Bd. of Gov. Formal Op. 1998-151, 1998 WL 717731 *2 (July 1998) (lawyer must return pro rata portion of fixed fee, even though specified as "earned on receipt," if representation ends before lawyer performs all the work); District of Columbia Bar Op. 264 (1996) ("special retainers or fee advances in this jurisdiction must be refundable," at least where "tied directly to provision of legal services, rather than designed solely to ensure availability"); *In re Cooperman*, 83 N.Y.2d 465, 475, 633 N.E.2d 1069, 1073, 611 N.Y.S.2d 465, 469 (N.Y. 1994) ("non-refundable retainer fee agreement clashes with public policy because it inappropriately compromises the right to sever the fiduciary services relationship with the lawyer").

23. Professor Wolfram describes the elements constituting full disclosure applicable generally to business dealings with clients as follows:

> (1) the nature of the transaction and each of its terms; (2) the nature and extent of the lawyer's interest in the transaction; (3) the ways in which the lawyer's participation in the transaction might affect the lawyer's exercise of professional judgment in concurrent legal work for the client, if any; (4) the desirability of the client's seeking independent legal advice if the client is not already independently represented; and (5) the nature of the respective risks and advantages to each of the parties to the transaction. WOLFRAM, *supra* note 7, § 8.11.4 at 485 (footnotes omitted).

24. When a client declines to obtain the advice of independent counsel or chooses to seek financial advice instead, the lawyer also may wish to confirm this in writing.

25. Rule 1.8(j) states:

> A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:
> (1) acquire a lien granted by law to secure the lawyer's fee or expenses; and
> (2) contract with a client for a reasonable contingent fee in a civil case.

26. Professor Wolfram, in condemning Rule 1.8(j) as unnecessary, nevertheless notes: "[a] purchase of a partial interest, of course, does present the possibility that the lawyer will not seek and accept client guidance on major decisions in the lawsuit because of the lawyer's own economic interest in the outcome." WOLFRAM, *supra* note 7, § 8.13 at 492. The Committee believes that the failure to consult with the client and accept the client's decision as posited by Professor Wolfram would violate Rule 1.2(a) and Rule 1.7(b), discussed in the next part of this Opinion. As Professor Wolfram suggests, no flat prohibition against a lawyer's purchase of an interest in a client's cause of action is needed "so long as the client consents and the transaction is fair and reasonable." *Id*. Of course, because this constitutes a business transaction with a client, the lawyer also must fully comply with all the other requirements of Rule 1.8(a) as discussed earlier in this Opinion.

27. *See* District of Columbia Bar Op. 179 (1987) (under DR 5-103(A), though acquiring stock in a corporation the lawyer represented in an FCC license application amounted to acquiring an interest in the client's license proceeding, no disciplinary rule is violated by the lawyer in "accepting a reasonable contingent fee that takes the form of a small and noncontrolling equity interest in the client"). The District of Columbia's Rules of Professional Conduct, later adopted, do not contain Rule 1.8(j) or any other specific prohibition against acquiring an interest in litigation. Of course, Rule 1.8(j) also would apply were the stock itself subject to a claim in which the lawyer represents the corporation or other stockholders. *See* Kansas Bar Assn. Op. 98-06 (Sept. 15, 1998) (contracts regarding corporate stock that is the subject of litigation are not per se unethical, depending on the circumstances in the case).

28. Rule 1.7(b) states:

> . . . (b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:
> (1) the lawyer reasonably believes the representation will not be adversely affected: and
> (2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

29. *See* Klein, *supra* note 1, at 355-56 suggesting stock ownership as an incentive that is in furtherance of the lawyer's fiduciary duties to her corporate client. Ownership of corporate client stock should not create a conflict with the corporate client's interests because the lawyer's duty of loyalty is to the corporation. Rule 1.13(a) states: "A lawyer employed or retained by an organization represents the organization acting through its duly authorized representatives."

30. Rule 2.3 applies to legal evaluations made for the use of others and states:

> . . . (a) A lawyer may undertake an evaluation of a matter affecting a client for the use of someone other than the client if:
> (1) the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client; and
> (2) the client consents after consultation.

> (b) Except as disclosure is required in connection with a report of an evaluation, information relating to the evaluation is otherwise protected by Rule 1.6.

As Comment [4] cautions: "The lawyer must be satisfied as a matter of professional judgment that making the evaluation is compatible with other functions undertaken in behalf of the client." When making an evaluation under Rule 2.3, the lawyer should establish with the client in the beginning the types of information that will be revealed and any information that must be withheld. *See* Comment [5] ("The quality of an evaluation depends on the freedom and extent of the investigation upon which it is based.").

31. *See* Rule 1.7, Comment [4] ("Loyalty to a client is . . . impaired when a lawyer cannot consider, recommend or carry out an appropriate course of action for the client because of the lawyer's other . . . interests. The conflict in effect forecloses alternatives that would otherwise be available to the client."). *See also* Utah Ethics Adv. Op. Comm Op. 98-13, *supra* note 14 (quoting Comment [4]). A lawyer who owns stock in a client corporation may, in circumstances where her disagreement with some transaction approved by the corporation's board limits her ability to provide independent professional advice to management, call upon another firm lawyer who is not so limited to advise the client respecting the transaction. In such a circumstance, the lawyer-stockholder must obtain consent of the client pursuant to Rule 1.7(b) to avoid imputed disqualification of other lawyers in the firm under Rule 1.10(a). When the probity of the lawyer's own conduct is questioned, however, better practice calls for independent counsel to advise the client. *See* Comment [6] under Rule 1.7 ("The lawyer's own interests should not be permitted to have an adverse effect on representation of a client."). *See also* ABA Formal Op. 98-410 (1998) (Lawyer Serving as Director of Client Corporation) at 9-10; Peter Geraghty, *ASK ETHICSearch*, in THE PROFESSIONAL LAWYER 21 (Fall 1999) (citing other examples of conflicts between a lawyer's interest as owner of client property and the interests of the client).

32. Other law firm policies regarding investments in clients also include some of the following: (1) No lawyer may invest in or with any firm client without prior executive committee approval, sometimes excepting purchases in *de minimis* amounts in a private placement or open market purchase; and (2) Investments in non-public clients offered firm lawyers are to be allotted among partners (or all firm lawyers) as investment opportunities, or may be placed in a pooled investment fund or allocated to a bonus plan. Reminders to avoid securities violations, including Section 10-b-5 (anti-fraud) and Section 16 (short swing profits), and mechanisms to avoid insider trading also are frequently included.

33. Rule 1.16(a)(3) states in pertinent part that "a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if . . . the lawyer is discharged." *See also* Comment [4]. The decision to discharge the lawyer is made by the corporation "acting through its duly authorized constituents," usually its chief executive or more likely the Board of Directors in this circumstance. *See* Rule 1.13(a), *supra* note 29. Sometimes authority to discharge counsel is vested in the stockholders giving rise to the question whether a lawyer who is a stockholder may ethically vote as a stockholder to retain her firm. Once the decision is duly made, however, the client's right to discharge a lawyer is absolute. Whether because of contract the lawyer may recover damages for her discharge is a matter of law beyond the scope of an ethics opinion.

34. *See, e.g., Comm. on Prof. Ethics and Conduct of Iowa State Bar Ass'n v. Humphreys*, 524 N.W.2d at 398, *supra* note 18. A lawyer who no longer represents a client whose stock she owns must remember that a conflict of interest under Rule 1.7(b) may arise if another client seeks representation on a matter adverse to the former client. The law firm in seeking the new client's consent may need to disclose not only the earlier client-lawyer relationship, but also the investment relationship if it is material. Of course, if the stock value is so high or subject to such risk from the second client's matter that it would not be reasonable to conclude that the representation would not be affected adversely, the lawyer must decline the representation.