

Business transactions with clients

Lawyers frequently have an opportunity to do business with clients beyond the straightforward monetary payment for legal services rendered. Sometimes clients wish to offer their lawyer an ownership interest in a start-up business as payment for some or all of the legal services provided, or lawyers wish to acquire an interest in property owned by the client to secure payment for future legal fees. Sometimes a client would like to partner with their lawyer to pursue a new business opportunity, or sometimes a client simply cannot pay a bill and wishes to trade property the client owns or barter professional services for payment. Each of these situations is permissible, but all present a potential concurrent conflict of interest with a client. How to ethically navigate these conflicts is specifically regulated by professional responsibility rules.



SUSAN HUMISTON is the director of the Office of Lawyers Professional Responsibility and Client Securities Board. She has more than 20 years of litigation experience, as well as a strong ethics and compliance background. Prior to her appointment, Susan worked in-house at a publicly traded company, and in private practice as a litigation attorney.

The rules

Rule 1.8, Minnesota Rules of Professional Conduct, is helpfully entitled "Conflicts of Interest: Current Clients: Specific Rules." There are 11 main subparts to Rule 1.8 that cover a gamut of situations from business transactions with clients to financial assistance to clients to sex with clients (expressly prohibited unless that relationship predated the lawyer-client relationship). Let's start with the main rule on business transactions: Rule 1.8(a):

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 document signed by the client separate from the transaction documents, 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.¹

As written, the rule is expansive in its application, and applies to everything except standard commercial transactions with clients of the kind and on the same terms as the client markets to the public, and ordinary fee arrangements between a client and lawyer, including applying whenever a "lawyer accepts an interest in the client's business or other nonmonetary property as payment for all or a part of a fee."²

The requirements of the rule are strictly enforced from a disciplinary perspective but more importantly, lawyers should view them as important risk management tools. Because of the trust and confidence that clients place in counsel, business transactions with clients can be easy targets for claims of overreaching and breach of fiduciary duty. Taking pains to comply with the requirements of the rule provides an effective counter to such claims.

What does compliance look like?

First, remember Rule 1.8(a) is conjunctive—all three prongs must be satisfied. Second, note that each prong contains additional requirements. Specifically, Rule 1.8(a)(1) requires that the terms of the transaction be (i) "fair and reasonable," and (ii) requires that the terms be disclosed in writing and (iii) disclosed in a manner that can be reasonably understood by the client. Accordingly, depending on the sophistication level of your client, the written agreement effectuating the transaction may need to be separately summarized in an understandable manner. You should also spend time establishing for yourself how the terms are "fair and reasonable" to the client. What factors are available to show the current value of the transaction? If the transaction is in lieu of payment of fees, how is the value "reasonable" in light of Rule 1.5(a), which requires that lawyers charge fees that are reasonable under the circumstances? As with much in the law, what these elements look like will depend on the particular facts and circumstances presented.

The second prong, Rule 1.8(a)(2), contains two requirements: The client is advised in writing of the desirability of seeking counsel and the client is given a reasonable opportunity to obtain such advice. Again, what is reasonable will depend on the particular facts and circumstances. Requiring the client to execute the documents on the same day they are given to the client, or shortly thereafter, is likely unreasonable. Providing the client with several weeks to seek separate counsel and to consult with same is likely reasonable.

The third prong, Rule 1.8(a)(3), incorporates one of the most important aspects of conflict law—informed consent. Rule 1.0(f) defines "informed consent" as an "agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternative to the proposed course of conduct."³

In addition, the informed consent must be in a document separate from the transaction, must be signed by the client, must discuss the essential terms of the transaction, and must disclose the lawyer's role in the transaction *vis-à-vis* the client.

Remember, it is generally insufficient just to use the words "informed consent." Rather, as the definition states, you must give your client information about the material risks and alternatives available in order for the consent to the transaction to actually be informed. Think about this from your client's perspective—if someone asks them, "What were the risks of the transaction," what do you think they will say? What about, "What were the alternatives available to you?" Having a written document that sets forth this information, signed by the client, demonstrates compliance with the rule and is a good risk management strategy.

Other things to keep in mind

In addition to the black-letter law required to do business with clients, Rule 1.8 contains a lot of other rules on specific client conflicts, such as specific restrictions that usually cannot be papered over, including that a "lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent."⁴ This rule generally prohibits lawyers from usurping client opportunities. Lawyers cannot draft an instrument that gives the lawyer or a member of the lawyer's family a substantial gift unless the lawyer is related to the donee.⁵

This rule would, for example, prohibit a lawyer from drafting sale documents for a below-market transaction with a client meant as a gift to the lawyer for exceptional services. While a lawyer can accept a gift from a client, neither the lawyer, nor the lawyer's law firm, can draft the transaction documents.⁶ Lawyers cannot provide financial assistance to clients in connection with pending or contemplated litigation except in limited, specified circumstances.⁷ This prohibition applies to loan advances against settlement proceeds. Further, lawyers cannot acquire a proprietary interest in the cause of action or subject matter of the litigation, except by statutory lien or reasonable contingency fee agreement.⁸ Accordingly, for example, while you can

have a contingency fee agreement on damages arising from a patent infringement case, you cannot acquire an ownership interest in the patent that is the subject of the infringement case.

Conclusion

Clients often look to us as trusted business advisors in addition to legal advisors, and it may make perfect sense to do business with clients. Before engaging in business with a client (beyond standard commercial transactions with your client of the kind your client markets to the general public),⁹ however, please review the rules so that you are familiar with the conflicts of interest that such transactions create, the specific steps needed to address those conflicts, and times when there is a *per se* prohibition on the type of transaction you are contemplating. As always, you can call our ethics hotline for advice on how to

ethically do business with your client, 651-296-2963 or 1-800-657-3601. ▲

Notes

¹ Rule 1.8(a), MRPC.

² Rule 1.8, MRPC, Comment [1].

³ Rule 1.0(f), MRPC.

⁴ Rule 1.8(b), MRPC.

⁵ Rule 1.8(c), MRPC.

⁶ Rule 1.8(k), MRPC, "While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them."

⁷ Rule 1.8(e), MRPC.

⁸ Rule 1.8(i), MRPC.

⁹ See Rule 1.8, MRPC, Comment [1], excluding from Rule 1.8(a) "standard commercial transactions between the lawyer and the client for products or services that the client generally markets to others, for example, banking or brokerage services, medical services, products manufactured or distributed by the client, and utilities services."