AHERN Update

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Comprehensive Changes to Rules of Professional Conduct Become Operative Next Month

By Douglas A. Pettit, Shareholder and Vice President of Pettit Kohn Ingrassia Lutz & Dolin PC

On May 10, 2018, the California Supreme Court approved the first comprehensive changes to the Rules of Professional Conduct since 1989. The new or amended rules are completely renumbered, a number of past rules have been changed, and there are new rules. Previously, there were 46 rules. There will now be 69 new or amended rules, which will become operative in November 2018, bringing the California rules into closer alignment with the ABA's Model Rules. We refer to the Rules being replaced as the "Past Rule" even though they are effective through October 31, 2018.

Here are some of the more significant differences as of November 1, 2018.

Communication with Clients (Rule 1.4)

Past Rule 3-500, "Communication," required that a lawyer shall keep a client reasonably informed about "significant developments" relating to the employment or representation. Otherwise, the Rule was fairly non-specific.

New Rule 1.4 is more specific and in line with the Model Rule. In addition to requiring lawyers to keep the client reasonably informed about significant developments, the lawyer must also:

- Promptly inform the client of any decision or circumstance requiring either disclosure or the client's informed consent;
- Reasonably consult with the client about the client's objectives and the manner of achieving them; and
- Advise the client of relevant limitations on the lawyer's conduct, such as those methods of assistance requested by the client which are prohibited by the rules.

The most significant difference is the need to consult with the client about objectives and how to achieve them. The new Rules place an emphasis on allowing the client to make informed decisions with an understanding of the costs involved. While we always have encouraged attorneys to clearly communicate with their clients, this now makes it unethical not to have discussions with the client about objectives and how to manage them. In litigation cases this practically mandates some form of a litigation management plan.

Scope of Representation and Allocation of Authority (Rule 1.2)

This new Rule, without a prior counterpart, follows the theme of allowing clients to take control of litigation objectives and costs in two ways. First, it expressly permits a limited scope of retention if it is reasonable under the circumstances, not otherwise prohibited, and informed consent is obtained. Identifying the scope of the representation has long been recommended as a way to avoid exposure when clients make claims that they expected advice beyond that which the attorney felt he/she agreed to provide. An example is tax advice in a personal injury matter. The new rule however, also allows the client to authorize the attorney to take specific actions on the client's behalf without taking on general retention. This allows a client to keep litigation costs controlled.

Second, this Rule also states that a lawyer shall aide by a client's decisions concerning the objectives or representation and shall consult with the client as to the means by which they are to be pursued. Again, the Rules are emphasizing that decision making rests with the clients and that attorneys discuss not only the objective, but the means.

Unconscionable Fees (Rule 1.5)

Past Rule 4-200 states that an attorney may not charge or collect an unconscionable fee. The past rule lists factors that may be considered in determining whether a fee is unconscionable. Establishing that fees were unconscionable under the prior factors was fairly difficult. (While disputes that fees were not earned because of negligent conduct and/or alleged ethical breaches were common, it was rare to have successful arguments that fees were unconscionable under Rule 4-200).

New Rules 1.5(b)(1) and 1.5(b)(2) add the following factors to the list: (1) whether the lawyer engaged in "fraud or overreaching" in negotiating or setting the fee; and (2) whether the lawyer has failed to disclose material facts.

These changes would appear to make it easier to argue unconscionability. The "overreaching" and failure to disclose "material" facts may allow for a variety of arguments claiming a fee to be unconscionable. The first factor may allow for arguments as to whether the fee "over reaches" in relation to the amount at issue in the engagement or other reasons. The second factor could allow for arguments about whether the attorney disclosed all facts material to the representation. This could include facts regarding the attorneys' experience in the area of retention, trial experience, or anticipated or estimated fees.

Fee Sharing (Rule 1.5.1)

Fee sharing and referral fees are still permitted under new Rule 1.5.1. However, to divide fees for shared work or responsibility, attorneys need to obtain informed written consent from the client at the time of the agreement or as soon as reasonably practicable after full disclosure of the fact a division of fees will be made, the identity of the lawyers or firm, and the terms of the division. The lawyers also need to enter into a written agreement to divide the fee and the fee cannot be increased as a result of the division.

There are three differences from past Rule 2-200. First, there now must be a written agreement between the attorneys. Second, the written consent must be obtained at the beginning of the agreement or as soon as reasonably practicable. Third, the new Rule omits language about "gifts" for the referral of cases. This would seem to confirm that gifts are still permitted but if there is a firm agreement for a referral fee, that the requirements above must be met.

Conflicts of Interest

Past Rules implement a "checklist" approach to conflicts, listing the instances in which informed written consent is required to accept or continue representation and/or when written disclosure of a potential conflict is required.

The new rules take a similar approach to conflicts but add some twists. Preliminarily, they are organized differently, drawing distinctions between current and former clients. Here is a listing of the new applicable Rules:

- Rule 1.7: Current Clients
- Rule 1.8.1: Business Transactions with Clients

- Rule 1.8.6: Payment of Fees by Third Party
- Rule 1.8.7: Aggregate Settlements
- Rule 1.8.10: Sexual Relations with a Client
- Rule 1.9: Duties to Former Clients
- Rule 1.10: Imputation of Conflicts
- Rule 1.18: Duties to Prospective Clients

For current clients (where the duty of loyalty is typically at issue) new **Rule 1.7** requires the attorney to consider first whether the representation is "directly adverse to another client in the same or a separate matter." Comment [2] expands the definition of "matter" to encompass "any judicial or other proceeding, application, request for ruling or other determination, contract, transaction, claim, controversy, investigation, charge, accusation, arrest, or other deliberation, decision, or action that is focused on the interests of specific persons, or a discrete and identifiable class of persons." The new conflict rule therefore prohibits representation of a client if that client's interests are adverse to those of another client the lawyer has counseled or represented in almost *any* capacity.

Additionally, a lawyer may not accept representation without obtaining informed written consent where "there is a significant risk the lawyer's representation of the client will be materially limited by the lawyer's responsibilities to or relationships with another client, a former client or a third person, or by the lawyer's own interests." (For an example of where an attorney has conflicts with representation of a current client due to relationships with non-clients, review the recent case of *Knutson v. Foster* (2018)).

Rule 1.7 also continues to cast a wide net on when written disclosures are required. The Rule reiterates the requirements of past Rule 3-310 in noting that written disclosures are required when:

1) The lawyer has, or knows that another lawyer in the lawyer's firm has, a legal, business, financial, professional, or personal relationship with or responsibility to a party or witness in the same matter or;

2) The lawyer knows or reasonably should know that another party's lawyer is a spouse, parent, child, or sibling of the lawyer, lives with the lawyer, is a client of the lawyer or another lawyer in the lawyer's firm, or has an intimate personal relationship with the lawyer

Further, Rule 1.7 adds a "catch all" provision. If any scenarios are covered by the rule, representation is only permitted if:

1) The lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

2) The representation is not prohibited by law; and

3) The representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal.

Thus, even if the client is willing to sign a conflict waiver, an attorney is under a duty to independently consider, and confirm, that the lawyer will be able to provide competent and diligent representation in light of the potential or actual conflicts. Use of the term "reasonable" also implies that this analysis will be judged on an objective and subjective basis.

Rule 1.8.10 is slightly different than its past counterpart, Rule 3-120. Previous Rule 3-120 allowed an attorney to continue representation of a client with whom he/she had developed sexual relations if the attorney felt he/she could continue to act competently. (Sexual relations is defined as intercourse or the touching of an intimate part of another person for the purpose of sexual arousal. Rule 1.8.10 expressly prohibits an attorney from a sexual relationship with a client unless the consensual sexual relationship preexisted the attorney-client relationship.

Rule 1.9 addresses duties to former clients where the duty of confidentiality is the concern. It contains the similar language to that as contained in past Rule 3-310.

Rule 1.18 is a new Rule and significant addition. It spells out the duties that an attorney owes to a prospective client even if the attorney and/or client decline the representation. Notably, information obtained by a prospective client may result in a conflict and bar retention or continued representation for another client. Rule 1.18 designates any person who consults a lawyer for the purpose of retaining a lawyer or securing legal advice as a "prospective" client.

Lawyers are prohibited from disclosing or using confidential information obtained from the prospective client. Lawyers are also prohibited from accepting representation of a client with interests materially adverse to those of a prospective client, even if the lawyer does not actually accept representation of the prospective client unless all affected parties have given informed written consent, or if the lawyer took reasonable measures to avoid obtaining more information than necessary from the prospective client, is timely screened from the matter, and written notice is provided.

Safekeeping of Client Property (Rule 1.15)

Past Rule 4-100, which governed the safekeeping of client property, required that funds received or held for the benefit of the client be segregated in a client trust account. However, the past rule did *not* require that advance deposits on fees be held in a client trust account. The flexible nature of the past rule meant that firms could deposit advance fee payments into the firm's operating accounts.

As of November 1, 2018, this practice would violate the Rules: new Rule 1.15 explicitly adds "advances for fees" as client property that must be held in trust, thus requiring that essentially *all* funds received from a client be maintained in a client trust account in California. The only exceptions are flat fees (if disclosed in writing that the client has the right to have the flat fee deposited in a trust account) and true retainers, which are classified not as funds belonging to the client but rather funds belonging to the lawyer because the retainer is earned upon receipt.

The new rule also keeps the language regarding funds "received **or held** for the benefit of the client." This suggests that when the new rules go into effect, client funds already held in a firm's operating account and not yet earned, will likely need to be identified, segregated, and moved to a trust account maintained in California.

Delay of Litigation (Rule 3.2)

A Rule with no prior counterpart, Rule 3.2 sets forth that an attorney shall not use means that have no substantial purpose other than to delay proceedings or cause needless expense.

Truthfulness to Others (Rules 4.1 and 4.3)

Two new Rules without prior counterparts, both Rules emphasize an attorney's need to be honest with third parties and move beyond an attorney's duty of candor to a tribunal and/or client. Rule 4.1 sets forth that an attorney shall not make false statements of material fact or law to a third person or fail to disclose a material fact to a third person where disclosure is necessary to avoid assisting a criminal or fraudulent act by a client unless disclosure is prohibited by the Business and Professions Code.

Notably, case law has typically restricted claims by third parties based on the failure of attorneys to disclose information to nonclients. The new Rules reiterate the same provision contained in the previous Rules that they are not intended to create private causes of action. But it still leaves a much broader range for nonclients to submit complaints to the State Bar based on alleged violations of this section.

Rule 4.3 states that an attorney, speaking on behalf of a client to a third party, may not state or imply that he or she is disinterested. Further, if the attorney believes that the third party believes the attorney is disinterested, the attorney must take reasonable steps to correct the misunderstanding.

Inadvertent Emails (Rule 4.4)

Rule 4.4, without a prior counterpart, sets forth an ethical obligation that echoes duties previously established by case law. When it is reasonably apparent to a lawyer that a privileged communication was inadvertently sent, the lawyer shall refrain from examining the writing any more than is necessary to determine that it is privileged or subject to the work product doctrine and shall promptly notify the sender.

Responsibilities of Managerial and Supervisory Lawyers (Rule 5.1)

Another new Rule without a prior counterpart, Rule 5.1 requires that an attorney who has managerial authority in a law firm shall make reasonable efforts to ensure the firm has procedures in effect giving reasonable assurances that all lawyers comply with the Rules of Professional Conduct and State Bar Act. The Rule also requires that direct supervisors make reasonable efforts to ensure lawyers they supervise comply with both. Supervising attorneys are responsible if they ratify conduct or know of the conduct at a time when its consequences could have been avoided or mitigated and failed to take reasonable remedial action.

Prohibition on Discrimination (Rule 8.4.1)

Past Rule 2-400 prohibited discrimination in the management or operation of a law practice, and required a prior adjudication of unlawful conduct by a tribunal of competent jurisdiction before a lawyer could be subject to discipline by the State Bar. The past rule provided a due process 'buffer' between attorneys and disgruntled employees or clients alleging discrimination.

New Rule 8.4.1 dramatically expands the scope of the rule and eliminates the requirement that there be a final determination of unlawful discrimination before the State Bar can impose discipline. Rule 8.4.1 prohibits unlawful discrimination, harassment, and retaliation in connection with the representation of a client, the refusal to accept a client, termination of a client, and in law firm operations.

Under the new rule, there is no need for a prior adjudication before a State Bar complaint is filed or investigated. Moreover, the alleged discrimination need not be just in the operation of a law practice; it could arise from the choice to represent or not represent a client as well. Rule 8.4.1 also recognizes a much wider range of "protected characteristics" than are recognized by Rule 2-400.

This Rule is likely the one that could have the most profound impact on the State Bar Staff. It essentially puts the State Bar Attorneys and Investigators in the position of investigating a broad range of potential accusations that until November 1 have never been part of their purview and were typically in the hands of investigators trained specifically to deal with harassment and discrimination claims. The new Rule also likely emphasizes the need for attorneys to retain files for potential clients who are turned away with notes setting forth the reasons. Otherwise, the attorney could be faced with trying to explain to the State Bar a reason for rejecting a potential client where the attorney may not even recall the client and has no means of refreshing his/her memory.

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