

COMMITTEE ON DISCIPLINARY RULES AND REFERENDA PROPOSED RULE CHANGES

Rule 1.08. Conflict of Interest: Prohibited Transactions

The Committee on Disciplinary Rules and Referenda, or CDRR, was created by Government Code section 81.0872 and is responsible for overseeing the initial process for proposing a disciplinary rule. Pursuant to Government Code section 81.0876, the committee publishes the following proposed rule. The committee will accept comments concerning the proposed rule through April 13, 2023. Comments can be submitted at texasbar.com/CDRR or by email to cdrr@texasbar.com. The committee will hold a public hearing on the proposed rule by teleconference on April 12, 2023, at 10 a.m. CDT. For teleconference participation information, please go to texasbar.com/cdrr/participate.

Current sections 1.08(b)-(j) would not be amended and would remain in effect. The CDRR proposes additional comments to Rule 1.08 and proposes renumbering of the current comments.

Proposed Rule (Redline Version)

Rule 1.08. Conflict of Interest: Prohibited Transactions

(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 terms of the transaction or acquisition are fair and reasonable to the client, and are fully disclosed and transmitted to the client in a writing that can be reasonably understood by the client;

(2) the client either is represented in the transaction or acquisition by an independent lawyer of the client's choice or the client is advised in writing to seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(3) the client thereafter provides informed consent in writing to the terms of the transaction or acquisition, and to the lawyer's role in it, including whether the lawyer is representing the client in the transaction.

Comment:

Transactions between Client and Lawyer

Business Transactions between Client and Lawyer

[1] A lawyer's legal skill and training, together with the relationship of trust and confidence between lawyer and client, create the possibility of overreaching when the lawyer participates in a business, property or financial transaction with a client, for example, a loan or sales transaction or a lawyer investment on behalf of a client. The requirements of paragraph (a) must be met even when the transaction is not closely related to the subject matter of the representation, as when a lawyer drafting a will for a client learns that the client needs money for unrelated expenses and offers to make a loan to the client. The Rule applies to lawyers engaged in the sale of goods or services related to the practice of law, for example, the sale of title insurance or investment services to existing clients of the lawyer's legal practice. It also applies to lawyers purchasing property from estates they represent. It does not apply to ordinary fee arrangements between client and

lawyer, which are governed by Rule 1.04, although its requirements must be met when the lawyer accepts an interest in the client's business or other nonmonetary property as payment of all or part of a fee. In addition, the Rule does not apply to 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. In such transactions, the lawyer has no advantage in dealing with the client, and the restrictions in paragraph (a) are unnecessary and impracticable.

[2] Paragraph (a)(1) requires that the transaction itself be fair to the client and that its essential terms be communicated to the client, in writing, in a manner that can be reasonably understood. Paragraph (a)(2) requires that in many cases the client also be advised, in writing, of the desirability of seeking the advice of independent legal counsel. It also requires that the client be given a reasonable opportunity to obtain such advice. Paragraph (a)(3) requires that the lawyer obtain the client's informed consent, in a writing signed by the client, both to the essential terms of the transaction and to the lawyer's role. When necessary, the lawyer should discuss both the material risks of the proposed transaction, including any risk presented by the lawyer's involvement, and the existence of reasonably available alternatives and should explain why the advice of independent legal counsel is desirable. See Rule 1.00(j).¹

[3] The risk to a client is greatest when the client expects the lawyer to represent the client in the transaction itself or when the lawyer's financial interest otherwise poses a significant risk that the lawyer's representation of the client will be materially limited by the lawyer's financial interest in the transaction. Here the lawyer's role requires that the lawyer must comply, not only with the requirements of paragraph (a), but also with the requirements of Rule 1.06. Under that Rule, the lawyer must disclose the risks associated with the lawyer's dual role as both legal adviser and participant in the transaction, such as the risk that the lawyer will structure the transaction or give legal advice in a way that favors the lawyer's interests at the expense of the client. Moreover, the lawyer must obtain the client's informed consent. In some cases, the lawyer's interest may be such that Rule 1.06 will preclude the lawyer from seeking the client's consent to the transaction.

[4] If the client is independently represented in the transaction, paragraph (a)(2) of this Rule is inapplicable, and the paragraph (a)(1) requirement

for full disclosure is satisfied either by a written disclosure by the lawyer involved in the transaction or by the client's independent counsel. The fact that the client was independently represented in the transaction is relevant in determining whether the agreement was fair and reasonable to the client as paragraph (a)(1) further requires.

[No Proposed Changes to Current Comments 4-8, Which Are Proposed to Be Renumbered as Comments 5-9.]

Proposed Rule (Clean Version)

Rule 1.08. Conflict of Interest: Prohibited Transactions

(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:

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(2) the client either is represented in the transaction or acquisition by an independent lawyer of the client's choice or the client is advised in writing to seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(3) the client thereafter provides informed consent in writing to the terms of the transaction or acquisition, and to the lawyer's role in it, including whether the lawyer is representing the client in the transaction.

Comment:

Transactions between Client and Lawyer

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[1] A lawyer's legal skill and training, together with the relationship of trust and confidence between lawyer and client, create the possibility of overreaching when the lawyer participates in a business, property or financial transaction with a client, for example, a loan or sales transaction or a lawyer investment on behalf of a client. The requirements of paragraph (a) must be met even when the transaction is not closely related to the subject matter of the representation, as when a lawyer drafting a will for a client learns that the client needs money for unrelated expenses and offers to make a loan to the client. The Rule applies to lawyers engaged in the sale of goods or services related to the practice of law, for example, the sale of title insurance or investment services to existing clients of the lawyer's legal practice. It also applies to lawyers purchasing property from estates they represent.

It does not apply to ordinary fee arrangements between client and lawyer, which are governed by Rule 1.04, although its requirements must be met when the lawyer accepts an interest in the client's business or other nonmonetary property as payment of all or part of a fee. In addition, the Rule does not apply to 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. In such transactions, the lawyer has no advantage in dealing with the client, and the restrictions in paragraph (a) are unnecessary and impracticable.

[2] Paragraph (a)(1) requires that the transaction itself be fair to the client and that its essential terms be communicated to the client, in writing, in a manner that can be reasonably understood. Paragraph (a)(2) requires that in many cases the client also be advised, in writing, of the desirability of seeking the advice of independent legal counsel. It also requires that the client be given a reasonable opportunity to obtain such advice. Paragraph (a)(3) requires that the lawyer obtain the client's informed consent, in a writing signed by the client, both to the essential terms of the transaction and to the lawyer's role. When necessary, the lawyer should discuss both the material risks of the proposed transaction, including any risk presented by the lawyer's involvement, and the existence of reasonably available alternatives and should explain why the advice of independent legal counsel is desirable. See Rule 1.00(j).¹

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[4] If the client is independently represented in the transaction, paragraph (a)(2) of this Rule is inapplicable, and the paragraph (a)(1) requirement for full disclosure is satisfied either by a written disclosure by the lawyer involved in the transaction or by the client's independent counsel. The fact that the client was independently represented in the transaction is relevant in determining whether the agreement was fair and reasonable to the client as paragraph (a)(1) further requires.

[No Proposed Changes to Current Comments 4-8, Which Are Proposed to Be Renumbered as Comments 5-9.] TBJ

NOTES

1. The Committee on Disciplinary Rules and Referenda recommended proposed Rule 1.00, TDRPC, to the State Bar of Texas Board of Directors for review and consideration. The board approved the proposed rule and shall petition the Texas Supreme Court to order a vote by State Bar members.

