OPINION NO. 353
(February 12, 1976)

ATTORNEY AND CLIENT - CONFIDENTIAL COMMUNICATIONS - CONFLICTING INTERESTS - DISCLOSURE. It is improper for an attorney to continue to represent a client where the transaction involves the illegal issuance of securities, and a merger between the client and an affiliated corporation of which the attorney is an officer, director, and house counsel for its parent; the attorney should attempt to persuade the officers of his client that the proposed action is ill-advised, explaining the consequences, and should if necessary report the matter to the board of directors; he should avoid disclosure outside the client corporation, however, unless he is satisfied that a serious crime, in the sense of one likely to seriously damage members of the public, is imminent.

Rules interpreted: Rules of Professional Conduct,
2-111 (A)(2)
2-111 (C)
6-101
5-102 (B)

ABA Code of Professional Responsibility,
DR 4-101 (C)(3)
DR 4-101 (C)(4)
DR 5-101 (A)
DR 7-102 (A)(7)
DR 7-102 (B)
EC 5-15
EC 5-18
EC 7-5

Statutes: Business & Professional Code Section,
6068 (e)

Evidence Code Sections,
958
962

An attorney has inquired about the propriety of his continuing to document a transaction involving the merger of a real estate company ("Company") and a 20% owned affiliate ("Affiliate") which is also a real estate company. The management of Affiliate insists that the securities proposed to be issued in the merger will not be "registered", presumably under the Securities Act

of 1933, despite the advice of the attorney that registration is necessary.

The attorney is secretary and director of Company, and is also house counsel and assistant secretary of its parent ("Parent"), a publicly owned finance and real estate company. The attorney has been asked by the management of Affiliate "to investigate the legal ramifications and applicable securities laws pertinent to the merger" of Affiliate and Company. In view of the positions taken by the attorney and by the management of Affiliate described above, the attorney requests advice as to his responsibilities and duties in his legal capacity, and in particular whether he must discontinue providing legal services in connection with this transaction or whether he may continue to provide such services so long as he discloses fully to such management the unlawful nature of the transaction.

The following observations and conclusions of the Committee are made with respect to, and are limited to the facts of this inquiry only.

1. The Lawyer Should Make All Practical Efforts to Persuade his Clients to Avoid the Violation. These Efforts Should Include, if Necessary, Notification of the Proposed Violation and its Consequences to the Board of Directors of Client Corporations.

The general duty of a lawyer to act competently and diligently set forth in California Rule 6-101 requires that all possible efforts be made to deter the client from an illegal and ill-advised course of action. (It is assumed that the lawyer is clearly satisfied that registration under the Securities Act of 1933 is required,

and that there is no other reasonable interpretation of the law. See ABA Code EC7-5). Initially, the lawyer should attempt to persuade the executives of his client corporations that the proposed course of action is illegal, constitutes a crime (as appears to be the case), and is ill-advised in that damaging consequences would seem to be highly likely. The damaging consequences would presumably be specified as including, at the least: (i) possible future involvement of one or more of the companies and their management in damaging administrative, litigation and even criminal proceedings; (ii) the existence of probable rights of rescission and damages against Affiliate and Company in persons acquiring the unregistered securities which would render it likely that future financial statements and reports of the issuing corporation will be defective unless the existence of these rescission rights are disclosed, with additional resulting liabilities and violations; (iii) the possibility that failure to make the disclosures required by registration would be deemed fraudulent under securities acts with additional resulting liabilities; (iv) the probable existence of rights by Affiliate and Company against their respective management personnel (which rights might be derivatively assertable by Affiliate's, Company's or Parent's stockholders) in respect of damages to those companies resulting from the knowing and willful violations of securities laws; (v) the duty of the attorney, as indicated below, to report the proposed violation to the boards of directors of the corporations involved, and to specify the consequences of violation; (vi) the inability of the attorney, as indicated below, to continue to participate in the transaction in

any capacity; and (vii) the possible duty of the attorney, if he concludes that the intended violation constitutes a serious crime and immenence of which he has no doubt, to take other action necessary to prevent the crime. See item 3 hereinafter.

ABA Code EC 5-18 states that "a lawyer employed or retained by a corporation owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative or other person connected with the entity." ABA Opinion 202 states that: "Since, however, the board of directors of the ... . company is its governing body, we think (the lawyer), with propriety, may and should make disclosures to the board of directors in order that they may take such action as they deem necessary to protect the . . . company from the wrongful acts of its executive officers. Such a disclosure would be to the client itself and not to a third person." The Committee believes, if the attempts of the lawyer to persuade the the executive officers of the client corporations to desist from the intended violation are unsuccessful, that he should formally report it, together with the probable consequences outlined above, to the boards of directors of the corporations.

2. The Lawyer Should Avoid Continued Legal Services and Other Participation in Connection with the Proposed Illegal Transaction.

The Committee believes that the attorney's continuing to document the illegal transaction on behalf of Affiliate or Company, or continuing legal representation in any way on behalf of either Affiliate or Company, would involve violation of the general ethical prohibition of assistance to a client in conduct known to be illegal contained in ABA Code DR 7-102(A)(7), and,,

implicitly in Rule 2-111(C). See also the Code of Professional Responsibility and the Responsibility of Lawyers Engaged in Securities Law Practice -- A Report by the Committee on Counsel Responsibility and Liability, 30 Business Lawyers 1289 (July 1975); ABA Opinion 335.

While the Committee generally limits its advice to ethical questions, we are constrained to add that the attorney should be aware that his continuing to document an illegal securities issuance transaction, knowing of the illegality, might constitute violation of Federal securities laws, including Section 4(2) of the Securities Act of 1932 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. See e.g., SEC v. Spectrum, Ltd., CCH ¶ Fed. Sec. Reg. Rep. Para 94,300 (2d Cir. 1973) reversing CCH Para 93,600 (S.D.N.Y. 1972); cf. Complaint in SEC v. National Student Marketing Corp., 30 F.Supp. 284 (D.D.C. 1972).

Withdrawal where a client seeks to pursue an illegal course of conduct is explicitly permitted under Rule 2-111(C). In this connection, Rule 2-111(A)(2) requires a member of the State Bar of California to take, prior to withdrawal of representation, reasonable steps to avoid foreseeable prejudice to the rights of his client, including specified steps relating to notice to client, allowance of time for employment of other counsel and delivery of papers and other property to client.

While it is beyond the scope of this opinion to comment on the duties of the attorney as a director of Company, the attorney would presumably be under a duty in this capacity to take all appropriate steps to prevent and, at the least, to avoid parti-

cipating in the illegal violation.

3. The Lawyer Should Avoid Disclosure of the Intended Violation Outside the Client Corporations Unless He is Convinced that the Intended Violation Would Constitute a Very Serious Crime and is Satisfied that the Commission of the Crime is Imminent.(11)

California Business and Professions Code Section 6068(e) states that:

> "It is the duty of an attorney: (e) to maintain inviolate the confidence, and at every peril to himself preserve the secrets, of his client".

The confidentiality of the lawyer-client relationship is a very strong principle in California. Exeeptions to it have been strictly construed. The lawyer should, before failing to preserve the confidences and secrets of his client, be quite satisfied that he falls within an exception to the principle. He truly acts "at every peril to himself" in failing to preserve these confidences and secrets.

The only exception which would appear to be possibly applicable is the exception for the divulgence of future crimes. See People v. Singh, 123 Cal. App. 365 (1932); Abbott v. Superior Court, 78 C.A.2d 19 (1947). See also ABA Code DR 4-101(C)(3). In People v. Singh it was held that even a future intended crime should not be divulged if such disclosure necessarily included the disclosure of past crimes. In addition, information even as to an intended future crime should not be divulged unless the intended acts of the client are of a nature so serious that the benefits of their prevention outweigh the policies underlying the confidentiality principle. L.A. Opinion No. 264. Finally, the exception is inapplicable if the attorney has any doubt "of the existence of an imminent danger

that a crime will be committed." L.A. Opinion No. 274.

ABA Code DR 4-101(C)(3), which states that "A lawyer may reveal: (3) The intention of his client to commit a crime and the information necessary to prevent the crime" is clearly subject, in the case of a California lawyer, to the restrictions of California Business and Professions Code Section 6068(e) and to the limitations on the exceptions thereto described above. ABA Code DR 7-102(B) which requires affirmative disclosure by the attorney of certain frauds, is now expressly subject to the applicable confidential communication privilege.

The lawyer should note one additional exception to the confidentiality relationship. Section 958 of the California Evidence Code states that "There is no privilege under this article as to a communication relevant to an issue of breach, by the lawyer or by the client, of a duty arising out of the lawyer-client relationship". (The privilege therein referred to is the lawyer-client testimonial privilege, which is narrower than the confidentiality privilege of Business and Professions Code Section 6068(e).) In this connection see ABA Code DR 4-101 (C)(4), which permits an attorney to reveal confidences necessary ". . . to defend himself . . . against an accusation of wrongful conduct". See also Myerhoffer v. Empire Fire & Marine Ins. Co., 497 F.2d 1190 (2d Cir. 1974).

Where there appears to be the likelihood of a very serious crime, in the sense that significant injury to members of the public is highly likely, especially though not exclusively where the crime will involve physical violence, See L.A. Opinion 264, and where the attorney is satisfied beyond substantial doubt that the crime will occur and is imminent, there may very well

be duties, not necessarily growing out of specific ethical rules or necessarily limited to or involving a person in his capacity as a lawyer, to take affirmative preventive steps involving disclosure to the intended victim or other third persons. Thus, in Tarasoff v. Regents of the University of California, 13 C.3d 177 (1974), (reh. granted March 12, 1975), a psychotherapist, notified by a patient that such patient intended to commit a homicide, was held to be under a legal duty to take appropriate steps to warn the threatened person of the danger and was liable for damages resulting from such failure. Willful failure to register securities would, in some cases, clearly constitute a serious crime in the sense of involving high probability of damage to the public; a lawyer should speak out to prevent a massive fraud on the investing public. On the other hand, serious damage to the public might not be involved in every failure to register, as perhaps in at least some cases of smaller corporations engaging in transactions not involving sales of securites to the general public for cash and not involving apparent deception in the sense of affirmative misstatements or encouragement of misleading impressions.

In addition, a lawyer who had forcefully made the arguments outlined above to the boards of directors of the client corporations, and who had had no evidence during the relationship of fraudulent tendencies on the part of his clients, might have some difficulty in concluding without significant doubt, save in exceptional circumstances, that his arguments might not in the end prevail.

The "at his peril" requirement of Section 6068(e) indicates that the lawyer should divulge an intended crime only

under exceptional circumstances of serious and imminent damage to the public.

4. The Lawyer should Avoid the Representation of Adverse Interests Where There are Serious Questions as to the Possibility and Sufficiency of Informed Consent by All Parties in Interest.

While the inquiry does not make it completely clear that the attorney is rendering legal services to both Company and Affiliate in connection with this transaction, his position as house counsel to Company's parent and as a director and secretary of Company suggests that he is representing Company as well as Affiliate. Such dual representation, without the written consent of both clients, would appear to be ethically improper under Rule 5-102(B). See also ABA Code DR 5-101(A); EC 5-15; Kohn v. Metals Climax, 322 F.Supp. 1331, 1362 (E.D. Pa. 1971), rev'd 458 F.2d 255 at 268 (3d Cir. 1972). Even if he is not representing Company, his representation of Affiliate would appear to involve the ethically proscribed representation of a conflicting interest because of his relationship with Company and because the transaction involves adversely, in a basic way, the interest of Company and Affiliate.

With respect to the written consent exception, Editor's Note to L.A. Opinion No. 108 indicates that "express consent of all concerned" language in a New York County Opinion "has not been construed as sanctioning such representation in all cases of mutual consent but as specifying a possible exception to the general prohibition in the canon against an attorney representing conflicting interests". In addition, Editor's Note to L.A. Opinion No. 22

states that: "In some situations the lawyer should not accept representation of conflicting interests even where consent can be obtained . . ." One problem is the difficulty of obtaining fully informed consent in situations where both parties represented by the same lawyer are engaged in a transaction on which they are on the opposite side, so that the negotiated benefit of one will often be at the expense of the other. The effect of the loss of the confidential communication privilege between the jointly represented parties, pursuant to California Evidence Code Section 962, is only one of many problem areas involved. The attorney might also wish to consider the possibility that consent of "all" parties concerned might well require the informed consent of the stockholders of Affiliate as well as its management, especially if there are links between management of Company and management of Affiliate.

This Opinion is advisory only. The Committee acts on specific questions submitted ex parte, and as stated initially this opinion is based on such facts only as are set forth in the questions submitted.

(1) A minority of the members of the Committee were of the view that the policy underlying the preservation of a client's confidence would outweigh the competing policy of disclosure in this case and that therefore under the facts of this inquiry disclosure of any intended crime even though imminent would be improper.