

FORMAL ETHICS OPINION NO. 463
(December 17, 1990)

ADVERSE AND CONFLICTING INTERESTS -- CONFIDENTIAL INFORMATION --
Unless the former client gives informed written consent, an attorney may not disclose to a current client about to enter a financial arrangement with the attorney's former client the former client's prior act of securities fraud which the attorney discovered in the course of the prior representation. When a current client proposes to borrow funds from an attorney's former client, the latter's prior act of securities fraud will in most cases be "material" to the representation, so as to require the former client's consent. The current client's consent also is required because the former client is "interested" in the representation under Rule 3-310(A), but that Rule does not require the consent of the former client.

AUTHORITIES CITED:

LACBA Formal Op. Nos. 159, 274, 353, 389, 395, 406, 436.
California Business and Professions Code § 6068(e).
California Rule of Professional Conduct 3-310.
Former California Rule of Professional Conduct 5-102(A).
Anderson v. Eaton, 211 Cal. 113 (1930).
Global Van Lines, Inc. v. Superior Court, 144 Cal. App. 3d 483 (1983).
Goldstein v. Lees, 46 Cal. App. 3d 614 (1975).
People v. Singh, 123 Cal. App. 365 (1932).
TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976).
Trone v. Smith, 621 F.2d 994 (9th Cir. 1980).
Zweig v. Hearst Corp., 594 F.2d 1261 (9th Cir. 1979).

FACTS

The facts of the inquiry are as follows. Law Firm was retained by Corporation A to provide services in the areas of corporate and securities law. A is in the business of providing financing to certain types of business ventures. During the representation, Law Firm learned from A that A intentionally failed to disclose the existence of a particular debt on a prospectus filed with the SEC. The prospectus had been prepared in the course of a public offering of A's stock, though Law Firm had no involvement in preparing the prospectus. We assume that the omitted debt was material, and that the omission amounted to securities fraud.

Law Firm advised A to rectify its intentional concealment. A refused and made clear its desire that Law Firm not reveal A's securities fraud to anyone. Law Firm withdrew from further representation of A, having represented it for a total of about six weeks.

Corporation B has been a client of Law Firm for many years and has received various legal services. After Law Firm terminated its representation of A, B informed Law Firm that it had received from A a proposal for the financing of one of B's ventures and that it wanted Law Firm's advice in responding to A.

Law Firm asks three sets of questions:

(1) May or must Law Firm disclose to B the fact that A committed securities fraud?

(2) To what extent may Law Firm represent B in a transaction with A? To what extent may it do so in a matter that does not involve A? If Law Firm must decline either such representation, what explanation may Law Firm give B for doing so?

(3) If Law Firm's representation of B requires the consent of A, what form must the consent take? Must A consent to Law Firm's disclosure to B of confidential information, such as its act of securities fraud?

DISCUSSION

Our conclusions may be stated as follows:

(1) Law Firm may not disclose to B that A committed securities fraud unless A consents to the disclosure.

(2) A's act of securities fraud will most likely be "material" to the representation so as to require A's consent under Rule 3-310(D), except in rare circumstances. If A refuses to consent to Law Firm's representation of B, Law Firm may tell B that it cannot accept the representation because of a conflict of interest.

(3) Law Firm also must obtain B's consent after disclosing the nature and duration of its prior representation of A, because A is "interested" in the representation under Rule 3-310(A). Law Firm need not obtain A's consent under Rule 3-310(A), which requires only the consent of clients, not former clients.

(4) With respect to transactions that do not involve A, Law Firm may represent B without obtaining any consent so long as the representation is not adverse to A and A is not "interested" in the representation.

I. May Law Firm Disclose To B A's Prior Securities Fraud?

Law Firm may not disclose to B the fact that A committed securities fraud. Section 6068(e) of the California Business and Professions Code imposes on attorneys the duty to "maintain inviolate the confidence, and at every peril to himself to preserve the secrets, of his client." This duty does not expire when the representation ends. L.A. County Formal Opinion Nos. 159, 274, 389. Even a client's prior commission of a crime is a confidence that the attorney may not disclose. E.g., People v. Singh, 123 Cal. App. 365 (1932).

Although there are exceptions to this duty of confidentiality, none appears applicable here. For example, it does not appear that A is about to commit a future crime in connection with its financing of B's venture, let alone a crime likely to result in imminent death or serious bodily injury. See L.A. County Formal Opinion No. 436 (adopting standard of ABA Model Rule 1.6).¹ Moreover, under the facts presented, A has refused to consent to the disclosure.

1. We have not been asked to address, and therefore express no opinion, whether Law Firm had any duty to disclose A's securities fraud to purchasers of the public offering or others at the time it withdrew from the representation of A. Compare L.A. Formal Opinion No. 353 (disclosure authorized in (Continued on next page)

II. Law Firm's Representation of B In Transaction With A

Law Firm's representation of B in a transaction with A raises two issues concerning consent. The first is whether Law Firm must get the consent of its former client A. The second is whether it must get the consent of its current client B.

A. Is Consent Of Former Client A Required Under Rule 3-310(D)?

1. Materiality Standard.

Rule 3-310(D) provides:

A member shall not accept employment adverse to a client or former client where, by reason of the representation of the client or former client, the member has obtained confidential information material to the employment except with the informed written consent of the client or former client.

(Emphasis added.) If Law Firm were to represent B in connection with A's proposal to finance B's venture, Law Firm's employment would be "adverse" to its former client A. Therefore, whether Law Firm must get A's written consent depends on whether Law

Continued from previous page

"exceptional circumstances of serious and imminent damage to the [investing] public") with id. No. 436 (disclosure authorized only when imminent death or serious bodily injury likely). See also id. No. 329 (disclosure required to avoid participation by attorney in crime).

Firm's knowledge that A committed securities fraud is "material" to its current representation of B.

Rule 3-310(D), which took effect in May 1989, differs from the former rule. Under former Rule 4-101, consent was required if the current adverse employment was one "relating to a matter [for another client or former client] in reference to which [the attorney] has obtained confidential information by reason of or in the course of his employment by such client or former client" (emphasis added). If the two matters were "relat[ed]," consent was required even if the attorney did not actually receive any confidential information related to the second matter. Global Van Lines, Inc. v. Superior Court, 144 Cal. App. 3d 483, 489 (1983); L.A. County Formal Opinion No. 395. Consent was required if there was "a reasonable probability that confidences were disclosed which could be used against the client in the later, adverse representation" Trone v. Smith, 621 F.2d 994, 998 (9th Cir. 1980) (emphasis added) (federal "substantial relationship" test).

Under the new rule, even if the current employment "relat[es]" to the representation of another client or former client, consent is not required unless the attorney actually obtained confidential information that is "material" to the later representation. Although the term "material" is not defined, its meaning may be distilled from prior cases. Previously, consent was required if there was a reasonable probability that the attorney obtained a certain type information. Under the new

rule, the information must actually have been obtained, but the type of information actually obtained is the same as that for which only a reasonable probability of possession was previously required: namely, information that "could be used against the client in the later, adverse representation," Trone, 621 F.2d at 998 (emphasis added). Information is "material" if it is information that the new employment "inherently tempts the attorney to reveal or improperly monopolize," Goldstein v. Lees, 46 Cal. App. 3d 614, 620 (1975); accord Anderson v. Eaton, 211 Cal. 113, 117 (1930) (Attorney should not accept adverse representation so "as to be open to the temptation of violating his obligation of fidelity and confidence.").

We thus are of the opinion that confidential information is "material" under Rule 3-310(D) if it is information a reasonable attorney would be obliged to impart to his client if it were not subject to the requirement of confidentiality. It is in these circumstances that the attorney would be "tempt[ed]" to violate the duty of confidentiality, and that the information "could be used" in the later representation.

For example, under the securities laws, information is "material" if "there is a substantial likelihood that a reasonable investor would consider the fact important in making his or her investment decision." Zweig v. Hearst Corp., 594 F.2d 1261, 1266 (9th Cir. 1979). See TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (fact "would have assumed actual significance in the deliberations of a reasonable

shareholder"). Similarly, if there is a substantial likelihood that a client would consider it important in his or her activities connected to the representation, the attorney accordingly would be under an obligation to disclose the information were it not subject to restrictions of confidentiality. In that case, the information is "material."

2. Is The Prior Act Of Securities Fraud "Material" To The Loan Transaction With B?

Whether a reasonable attorney would be obliged to disclose to B that A committed securities fraud -- so that the information is "material" to the representation of B -- is a question to be resolved on the basis of all relevant facts. Although the inquiry does not reveal sufficient facts for the Committee to give a definitive answer, we assume that the prior securities fraud would sufficiently reflect on A's integrity to make it "material" to the representation of B.² Presumably, the decision to omit the debt from the prospectus, and to refuse counsel's request to rectify that omission, was made at the highest levels of the corporation and so would reflect on the entire organization's integrity. Absent extraordinary facts indicating to the contrary, an attorney would be obliged to

2. The omission of the debt from the prospectus also could be relevant to the contemplated loan transaction for reasons other than that it reflects on the integrity of A. For example, if the omitted debt affected A's financial condition so substantially that it affected A's ability to perform its obligations in the loan transaction, then the information would be material for quite different reasons.

disclose the securities fraud to B, and the information therefore is "material" to the representation of B.

3. Must The Consent Law Firm Receives From A Include Its Consent To Disclose The Information To B?

Law Firm asks whether it must obtain not merely A's consent for Law Firm to represent B but also A's consent for Law Firm to disclose A's prior act of securities fraud. This question turns not on Law Firm's duty to A but its duty to B. That is, the question is whether Law Firm can discharge its obligations to B without disclosing A's prior act of fraud.

If Law Firm determines from all the relevant circumstances that A's prior act of securities fraud is material to the representation of B, then we are of the opinion that Law Firm cannot discharge its obligations to B without disclosing to B its knowledge of A's prior crime. This is true for at least two reasons.

First, without A's consent to reveal this information to B, Law Firm would be caught between the rock of protecting A's confidences and the hard place of zealously representing B. Knowing of A's dishonesty, Law Firm might be tempted to recommend that B take special precautions to protect itself, but would be forbidden from using A's confidences to its detriment in this manner. Thus, Law Firm would constantly have to second-guess whether its advice to B was affected by Law Firm's secret knowledge of A's dishonesty. As the court stated in Goldstein v. Lees, 46 Cal. App. 3d 614, 620 (1975):

It is difficult to believe that a counsel who scrupulously attempts to avoid the revelation of former client confidences -- i.e., who makes every effort to steer clear of the danger zone -- can offer the kind of undivided loyalty that a client has every right to expect and that our legal system demands.

Second, if Law Firm were to represent B without revealing its knowledge of A's dishonesty, it would create an impermissible appearance of impropriety. B would quite justifiably become upset if it later learned that Law Firm acted as its lawyer in the transaction without warning B that its proposed borrower lacked integrity. Law Firm's response that it was merely maintaining its obligation of confidentiality to A would be little solace to B, who had its lawyer conceal admittedly relevant information. Even if Law Firm provided exactly the same advice as would another law firm that was ignorant of A's wrongdoing, it would not dispel the appearance of impropriety.

4. If A Does Not Consent To Let Law Firm Represent B, What May Law Firm Tell B In Declining The Representation?

If A's consent is required and A declines to give consent for Law Firm to represent B, it should be fairly easy for Law Firm to explain without revealing any confidential information why it cannot undertake the representation. Law Firm

may simply tell B that it had previously represented A and that a conflict of interest prevents Law Firm from undertaking the representation. If B inquires further, Law Firm may say that it is bound not to say more for fear of revealing client confidences.

B. Is Consent Of Current Client B Required Under Rule 3-310(A)?

1. Consent Is Required Whenever Attorney Has Or Had A Relationship With A Party Interested In The Representation.

Law Firm must also get the informed written consent of client B before undertaking the representation in connection with A's financing proposal. Rule 3-310(A) provides:

If a member has or had a relationship with another party interested in the representation, or has an interest in its subject matter, the member shall not accept or continue such representation without all affected clients' informed written consent.

Here, Law Firm "had a relationship" with A when it represented A. A obviously is "interested in the representation" Law Firm proposes to have of B in connection with A's financing proposal. Therefore, the rule plainly provides that Law Firm must get B's "informed written consent."

Former Rule 5-102(A) required an attorney to disclose "his relation, if any, with [an] adverse party" and to obtain the

client's written consent. Although this Committee had opined that a "relation" included that between an attorney and a former client, L.A. County Formal Opinion No. 406, this was not universally recognized. Accordingly, the new rule "expand[ed] the rule to include situations in which the member had a relationship with another party in the past." 1 Proposed Amendments to the Rules of Professional Conduct, Commission for the Revision of the Rules of Professional Conduct 23 (July 1987) (emphasis in original).

The purpose of the rule is to permit a client to evaluate whether the attorney has conflicting loyalties that will dilute the attorney's ability to provide zealous representation. Although conflicting loyalties are particularly likely to exist when an attorney attempts concurrently to represent two present clients, the new rule recognizes that an attorney's lingering loyalties to even a former client could present this danger, and it leaves to the current client the decision whether this danger is sufficient to make the attorney's representation inappropriate.

2. What Disclosures Are Necessary To Make B's Consent Informed?

The question then arises what disclosures Law Firm must make to B to permit B to give its informed consent. Subsection (F) of Rule 3-310 states that informed consent is "full disclosure to the client of the circumstances and advice to the client of any actual or reasonably foreseeable adverse effects of

those circumstances upon the representation." As noted, the purpose of the rule is to permit B to judge the extent to which Law Firm may have lingering loyalties to A. To this end, Law Firm should disclose to B that Law Firm previously represented A in connection with corporate and securities matters, and that the representation lasted for six weeks. If Law Firm has any intention of representing A in the future, or if it has no such intention, it also should disclose that fact.³

C. Is Consent Required Of Former Client A Under Rule 3-310(A)?

We now address a possible source of confusion over the correct interpretation of Rule 3-310(A)'s requirement that an attorney obtain "all affected clients' informed written consent." This provision does not require Law Firm to obtain the consent of A, which is not a client, but a former client.

The language of Rule 3-310 makes plain that its drafters did not intend subsection (A) to require the consent of former clients. As discussed above, subsection (D) requires that when certain confidential information is obtained the attorney must receive the consent of the "client or former client." In

3. As noted in Part II(A)(3) supra, if A's dishonesty is deemed material to the representation, then Law Firm may not represent B without A's consent to disclose that information. On the other hand, if A's dishonesty is deemed not to be material for some reason, then it need not be disclosed for B's consent to be "informed," unless for some reason it appears that this information might adversely affect the representation.

contrast, subsection (A) requires the consent of "all affected clients." Given the explicit reference to former clients in subsection (D), the omission of any reference to former clients in subsection (A) is significant.⁴

Also significant is the omission of any reference in the commentary to what would have been a radical departure from Rule 3-310(A)'s predecessor, former Rule 5-102(A). As noted above, Rule 5-102(A) required that an attorney obtain the consent of a "client" after disclosing the attorney's "relation, if any," with an adverse party. That an adverse party was a former client of the attorney was not universally thought to be a "relation" requiring disclosure. Thus, the commentary to the new rule notes that it was "expand[ed]" to "include a situation in which the member had a relationship with another party in the past."

Nothing in the commentary suggests, however, that the former rule was expanded to require not only the disclosure of the attorney's past relationship with the client but the consent of the former client. Because such a requirement would have been a far more radical departure from the prior rule than the change which the commentary mentioned, it is difficult to believe that

4. The rule requires the consent of all "clients" in the plural because it may apply when an attorney represents multiple current clients, not because it requires the consent of a former client. The official Discussion to the rule states that, when an attorney represents "multiple parties," the attorney must disclose the potential dangers "and must obtain the consent of the clients thereto" (emphasis added).

the drafters would have made this substantial change without so much as noting it.

Apart from these indications of the intent of the drafters, the scheme of Rule 3-310 as a whole makes the most sense when subsection (A) is read to require the consent of a client alone, not a former client. When an attorney has obtained material confidential information from a former client, subsection (D) requires the consent of the former client. When the attorney has not obtained such information, however, it is hard to see what interest is served by requiring the former client's consent to a future adverse representation. The effect of such a rule would be to give a client permanent veto power over any such representation by the attorney, no matter how long it was after the first attorney-client relationship was terminated or how unrelated it was to the prior representation.

In sum, although Rule 3-310(A) does require Law Firm to obtain the consent of its current client B, it does not require obtaining the consent of former client A.

III. Law Firm's Representation Of B In Transaction Not Involving A

With respect to matters that do not involve A, the requirements of Rule 3-310 would not require disclosures to or the consent of either A or B.

Subsection (D) applies only where an attorney "accept[s] employment adverse to a client or former client." If Law Firm represents B in a matter that is not adverse to A, Rule 3-310(D)

does not apply. This is true even if Law Firm has obtained confidential information that is "material" to the representation. Consent is required only when the former client may fear that its confidences could be used against the former client itself.

Subsection (A) of Rule 3-310 would apply only when A was "interested" in the representation of B. Whenever A is not so interested, disclosures and consent are not required.

This opinion is advisory only. The committee acts on specific questions submitted ex parte, and its opinions are based only on such facts as are set forth in the questions submitted.