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STOCK-BASED COMPENSATION FOR LEGAL SERVICES: RESURRECTING THE ETHICAL DILEMMA

Sharon Mary Mathew*

I. INTRODUCTION

Stock compensation is now a popular method of payment for legal services, especially within the Silicon Valley of California.¹ Rather than part with traditional fees, small startups with little cash often find it much easier to give an attorney an interest in the corporation.² Even after the stock market crash of April 2000, many law firms focusing their practice on the high tech sector still take the “long view” and accept stockholdings from their clients in hopes that the economy will recover.³ But one thing has changed since the crash; the number of federal securities class action suits targeting high-tech companies is increasing.⁴ Although these types of lawsuits are to be expected when the market plummets, law firms should begin to consider carefully whether heavy investments in clients in lieu of traditional fees pose ethical hurdles too high to pass, or lead to potentially serious securities liability.

The underlying ethical question regarding whether attorneys should ever take stock compensation, has, for the

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2. See Baker, supra note 1, at 37.
most part, been dismissed. Instead, law firms are asking for clarification regarding the steps required for meeting American Bar Association ("ABA") standards when taking an equity interest in the client. In an attempt to clear up any misunderstandings regarding the legality of stock compensation, the ABA issued Formal Opinion 418 in July of 2000. The ABA pronounced that the Model Rules of Professional Conduct ("Model Rules") do not prohibit an attorney from accepting fees in the form of client stock. No "inherent" conflict of interest arises when stock compensation is received from a corporate client. Nevertheless, the ABA cautioned that an attorney must comply with Model Rules 1.7(b) and 1.8(a) of the MRPC. Rule 1.7(b) prohibits an attorney from representing a client if the attorney's own interests would interfere, while Rule 1.8 addresses how this prohibition works in the context of business dealings between attorney and client.

The opinion itself, however, seems to pose an inherent conflict. Can an attorney ever accept stock compensation and remain in compliance with Model Rules 1.7 and 1.8, as well as the ABA "reasonable fee" requirements? Non-compliance certainly appears inevitable except in carefully guarded circumstances. But the ethical difficulties that attorneys face when attempting to adhere to the canons of professional responsibility, while at the same time taking an equitable interest in a corporate client, appear somewhat understated in the ABA opinion. The problems are numerous indeed, but the opinion speaks only briefly of the dangers involved.

To add to this ethical quandary, attorneys fearing securi-

6. See id.
8. See id.
9. See id.
10. See Formal Opinion 418, supra note 7.
11. See infra Part IV.C.1.
13. See infra Part IV.
14. See Formal Opinion 418, supra note 7 (stating that taking a stock interest in a client corporation typically enhances representation).
15. See infra Part IV.
ties lawsuits must also evaluate the influence they wield as both attorney and investor in the corporate client. The risk of being sued as a "controlling person" under various provisions of the Securities Exchange Acts, should lead attorneys to consider whether these types of transactions are truly worthwhile in a post-crash environment where litigious stockholders are desperately seeking more defendants.

The purpose of this comment is to encourage law firms and attorneys to be more scrupulous when accepting stock compensation agreements. A conflict appears to exist mainly because compensation in the form of stockholdings may materially limit an attorney's ability to represent the client. An attorney accepting fees in stock may be tempted to disregard the Model Rules requirements of full disclosure and client consent. In addition to examining the ethical limitations placed upon attorneys accepting stock compensation, this comment also analyzes the Securities Exchange Act "controlling person" liability that law firms may face when accepting stock compensation.

Part II of this comment examines the rationale for regulating certain attorney-client conflicts of interest. Part II also reviews the current status of the law regarding conflicts of interest associated with stock compensation agreements and provides background on securities liability for investing attorneys. Part III questions whether law firms should be more diligent in regulating stock compensation transactions, and whether the ABA should consider banning these transactions altogether. Part IV analyzes ABA Formal Opinion 418 and Model Rules 1.7(b) and 1.8(a), and investigates the ways in which attorneys open themselves up for disciplinary action and malpractice suits when they agree to accept stock compensation. Part V suggests steps that law firms should take in order to avoid disciplinary action and federal securities lawsuits.

II. BACKGROUND

It has become quite common for law firms, especially those representing high-tech, start-up companies, to acquire financial interests in their clients in connection with legal

16. See infra Part III.B.
17. See infra Part IV.
services rendered. These exchanges are often used to aid start-ups that cannot afford to pay high legal fees because they do not yet have a product with which to generate revenue. Instead of cash, they can offer their attorney equity in the corporation. Due to the staggering profits that may be gained from these transactions, attorneys also stand to benefit from accepting stock compensation. For example, in December, 1999, Wilson, Sonsini, Goodrich and Rosati posted paper profits of $24.5 million in a single day when its client VA Linux, a Silicon Valley software-maker, made its initial public stock offering. Even after the stock market crash, the potential realization of such high profits still drives law firms to gamble on clients that are about to go public.

This type of “gambling” may occur in one of two ways. Law firms may choose to accept an equitable interest in a client either in lieu of traditional fees or for general investment, to be accompanied by regular fees. Attorneys accepting stock compensation in lieu of fees face greater ethical hurdles both because their dependency on the financial well-being of the company is increased and because they must ensure that the fee requested is reasonable. Either way, the acquisition of stock in a corporate client is basically a business transaction between the attorney or the law firm and the client. The transaction, therefore, must meet the requirements of the professional rules of ethics established by the bar.

Before discussing the status of common law and the ABA professional rules, a brief introduction to conflicts of interest

18. See Baker, supra note 1, at 37.
20. See Neidorf, supra note 1; but see Baker, supra note 1, at 39 (noting that despite the jackpots that many investors find, observers estimate that losers outnumber winners by as many as 20 to 1).
22. See Blackwood, supra note 3.
is useful.

A. Rationale for Regulating Certain Attorney-Client Conflicts of Interest

An attorney owes many duties to his clients including competence, communication and zeal. All of these ethical concerns are threatened when an attorney's personal interests conflict with the interests of his client. In the modern view of professional responsibility, a conflict of interest exists whenever the quality of the attorney's representation is "at risk." This is true even though there may be no actual breach of the aforementioned duties. The risk is not defined as a potential for conflict, but as conflict itself.

Therefore, the conflict of interest arises before the attorney actually breaches one or more of the duties he owes the client. Proscriptions of certain attorney-client conflicts of interest are designed to act as a prophylactic. This rationale is clearly "preventive" in nature in that a potential breach should be stopped before it occurs.

In addition to the preventive rationale, there exists another reason for regulating conflicts of interest. This second rationale basically states that attorneys ought to avoid the appearance of impropriety. There should exist no reasonable grounds for the belief that the attorney has acted on his own behalf. Even if the attorney has not actually engaged in any suspicious action, prohibitions on certain transactions are enacted for the purpose of avoiding the appearance that the suspicious action might have occurred.

26. See id.
28. See id. at § 10.4.
30. See id.
31. See id. at 175-80.
32. See id. at 175.
33. See FREEDMAN, supra note 29, at 177.
34. See id. at 177-80.
35. See id.
36. See id.
B. ABA Standards Governing Conflicts of Interest

1. The ABA Model Rules and Model Code

When entering into business transactions with clients, attorneys are obligated to abide by both common law fiduciary principles and the disciplinary rules adopted by bar associations. For the most part, the states have embraced the ethical standards provided by the bar. The ABA Model Rules of Professional Conduct ("Model Rules") have been adopted by most states, but some still continue to use the older Model Code of Professional Responsibility ("Model Code"). Both sets of provisions enable the bar to take disciplinary action when the rules are violated. Both the Model Rules and the Model Code have similar requirements for business transactions with clients, the main difference being that the Model Rules require that disclosure and consent be in writing. The remainder of this comment will focus on the language of the more modern Model Rules.

a. Model Rule of Professional Conduct 1.7

Rule 1.7(b) of the ABA Model Rules of Professional Conduct states in part:

A lawyer shall not represent a client if the representation of that client may be materially limited by ... the lawyer's own interests, unless (1) the lawyer reasonably believes the representation will not be adversely affected and (2) the client consents after consultation.

It is important to note the particular language used: "may be materially limited" as opposed to "would be materially limited." This generally means that if any possibility of conflict

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38. See 7 C.J.S. Attorney & Client 44 (1980); 1 HAZARD & HODES, supra note 27, at 101.
41. See MODEL CODE OF PROF'L RESPONSIBILITY DR 5-104 (1980); MODEL RULES OF PROF'L CONDUCT R. 1.8(a) (1984).
42. See MODEL RULES OF PROF'L CONDUCT R. 1.7(b) (1984).
exists, and the attorney's own interests would materially limit representation of the client, then the attorney must withdraw from representation unless the two stated conditions are met. The attorney must reasonably believe that even though a conflict exists, the conflict will not adversely affect his representation of the client, and secondly the client must give his informed consent to the transaction.

The ABA, in its official comment to Rule 1.7, states that the possibility or risk of a conflict does not itself preclude the attorney from representing the client. The particular conflict of interest circumstances that the ABA deems serious enough to be banned altogether are included in Rule 1.8. A restriction on receiving stock compensation in lieu of fees is not included among them.

The ABA determining factors for assessing whether representation should be denied are:

- the likelihood that a conflict will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclosure courses of action that reasonably should be pursued on behalf of the client.

Therefore, when the risk of conflict is small, only modest restrictions are required. The same is true of a situation where the risk of conflict is high, but the harm is only likely to be slight, if any at all. On the other hand, where the risk of conflict is high and some harm is likely to occur in the course of representation, the attorney must withdraw from representation of the client.

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43. See Freedman, supra note 29, at 189. "If Model Rule 1.7(b) required that [a] lawyer reasonably believe that there is no risk when, by hypothesis, there is a foreseeable risk, the rule would appear to say that the lawyer can never represent a client when there is a conflict of interest, regardless of client consent." Id. at 190. Most scholars, however, do not interpret the rule this way. Id.

44. See id.

45. See Model Rules of Prof'l Conduct R. 1.7(b) cmt.

46. See id. R. 1.8(b), (c), (d), (g), (h), (i).

47. See id.

48. See id. R. 1.7(b) cmt.

49. See 1 Hazard & Hodes, supra note 27, at § 10.4.

50. See id.

51. See id.
b. Model Rule of Professional Conduct 1.8(a) and Common Law Interpretation

In addition to Rule 1.7(b), Rule 1.8(a) also governs certain conflicts of interest. Rule 1.8(a) requires that in any business transaction between attorney and client, the transaction must be fair and reasonable and fully disclosed in writing to the client, the client must consent in writing to the agreement, and the client must be given time to seek independent counsel. Unlike Rule 1.7(b), which applies only when representation may be materially limited, Rule 1.8(a) applies anytime a lawyer accepts an interest in the client in connection with a fee for legal services. Rule 1.8(a), however, does not apply when an attorney receives stock in other circumstances not involving direct intervention of the client.

As applied to stock compensation, the reasoning behind this rule is clear. There are two main dangers associated with taking stock in lieu of fees: (1) if the business flourishes financially, the fee may later appear unreasonably large for the work performed; or (2) if the business falters, the attorney, worried about recovering his fee, may be tempted to advise his client to take self-motivated or even illegal measures. Due to the trusting relationship that exists between most attorneys and their clients, an attorney may take advantage of his client in these circumstances. The precautionary measures provided in Rule 1.7 and 1.8 aid in preventing this type of overreaching in business transactions.

Rule 1.8(a) requires more on the part of the attorney than

52. See Model Rules of Prof'l Conduct R. 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 to the client in a manner which can be reasonably understood by the client;
(2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and
(3) the client consents in writing thereto.

Id.

53. See id.
54. See Formal Opinion 418, supra note 7, at 3.
55. See Restatement, supra note 24, § 126 cmt. a.
56. See 1 Hazard & Hodes, supra note 27, at § 12.5 illus. 12-3.
57. See Restatement, supra note 24, § 126 cmt. b.
58. See id.
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may initially appear from a hasty reading of the provision. In fact, cases noting violations of Rule 1.8(a) and the corresponding Model Code section are numerous. A few are introduced here.

i. Fair and Reasonable Transaction

The first requirement under Rule 1.8(a) is that the business transaction be fair and reasonable to the client. The relationship between an attorney and client is a fiduciary relationship of the very highest character. For that reason, all dealings between an attorney and his client that are beneficial to the attorney will be closely scrutinized with the utmost strictness for any unfairness.

An attorney bears the burden of showing that the dealings between the parties were fair and reasonable and were fully known and understood by the client. For example, in In Re Imming, an attorney-client business transaction case, the Supreme Court of Illinois held that "the attorney must show a measure of good faith in dealing with clients which is much higher than what is required of parties dealing at arm's length." The fairness of the transaction is determined based on facts that reasonably could be known at the time of the transaction, not as the facts later develop. The best test for this analysis is whether an uninterested attorney would have advised the client not to enter into the transaction.

ii. Full Disclosure

In addition to a showing of fairness, the Model Rules require full written disclosure in order to ensure that the client is aware of all possible conflicts before engaging in the trans-

59. See RESTATEMENT, supra note 24, § 126 cmt. a-g.
60. See MODEL RULES OF PROF'L CONDUCT R. 1.8(a) (1984).
62. See RESTATEMENT, supra note 24, § 126 cmt. b; see also Clancy v. State Bar, 454 P.2d 329 (Cal. 1969).
63. 545 N.E.2d 715 (Ill. 1989).
64. Id. at 722.
65. See RESTATEMENT, supra note 24, § 126 cmt. e; see also Attorney Grievance Comm'n v. Collins, 457 A.2d 1134 (Md. 1983) (discipline of attorney who represented buyer in a contract while secretly working for the seller, advised client that the transaction was reasonable). Compare McCray v. Weinberg, 340 N.E.2d 518 (Mass. App. Ct. 1976) (holding that attorney may not have to prove fairness when the client is knowledgeable and experienced in transaction).
66. See RESTATEMENT, supra note 24, § 126 cmt. e.
action with the attorney. There are numerous state cases regarding this issue. Two such cases are introduced below.

In Committee on Professional Ethics of Conduct v. Mershon, an attorney took twenty percent of stock in lieu of fees in a corporation he formed with his client. The corporation never took off and the attorney never made a profit. Although the attorney was completely honest and forthright in the transaction, he neglected to disclose the possibilities of conflict associated with tying his fee for future services to a present interest in the corporation. The Supreme Court of Iowa reprimanded the attorney for failing to meet the "high standard of disclosure" required by the ABA.

Additionally, in In Re McGlothlen, another conflicting interests case, the Supreme Court of Washington held that the disclosure which accompanies a business transaction between attorney and client must be complete. In defining "completeness" the court held that the attorney must show that he used no undue influence, but that he gave the client all the information that a disinterested attorney would have provided. "So strict is the rule on this subject that dealings between an attorney and his client are held, as against the attorney, to be prima facie fraudulent.

Common law is replete with cases in which attorneys were disciplined for failing to disclose certain information when engaging in business transactions with clients. Therefore, an attorney must be careful to reveal all relevant information to the client before agreeing to stock compensation.

67. 316 N.W. 895 (Iowa 1982).
68. See id.
69. See id.
70. See id.
71. Id. at 899.
72. 663 P.2d 1330 (Wash. 1983).
73. See id.
74. See id.
75. Id. at 1336.
76. See, e.g., Avianca Corp. v. Harrison, 70 F.3d 637 (D.C. Cir. 1995) (holding that lawyer's failure to comply with disclosure obligations created rebuttable presumption that business transaction was unfair); In re D'Angelo 733 P.2d 360 (N.M. 1986) (imposing discipline on attorney who induced client to invest in a real estate development without disclosing attorney's ownership of real estate).
iii. Independent Counsel

Model Rule 1.8(a) also requires that the client be given a reasonable opportunity to obtain independent legal counsel. The Model Rules do not, however, require that the client actually consult another attorney. A client might decide to consult another trusted adviser, such as an accountant, a tax advisor, or a business person, or to consult no one at all.

This opportunity to obtain competent independent advice helps to ensure that the client has time to consider the transaction and that the attorney is not applying undue pressure on the client. On the other hand, if the attorney fails to advise the client to obtain independent advice, evidence of this inaction may be used to show overreaching on the part of the attorney.

Passante v. McWilliam, a California case, provides a good example of the unfortunate repercussions that may occur when an attorney neglects to advise his client to obtain independent counsel. In that case, the attorney attempted to enforce an agreement whereby his corporate client was to pay him three percent of the company stock for legal services. But because the attorney failed to advise the board of the company to consider obtaining independent counsel, the lawyer lost the entire value of his purported portion of the stock, which had been calculated by a jury at 32 million dollars. The attorney was therefore paid nothing for his services.

c. Model Rules of Professional Conduct 1.5 and 2.1

Attorneys accepting stock compensation must also consider the reasonableness of the fee agreement. In Rule 1.5, the ABA has outlined several factors to consider when assigning a fee to particular legal representation. In order to apply

77. See MODEL RULES OF PROF'L CONDUCT R. 1.8(a) (1984).
78. See Formal Opinion 418, supra note 7, at 8.
79. See id.
80. See id.
81. See id.
83. See id.
84. See id.
85. See id.
86. See id.
the reasonableness requirement of Rule 1.5 to stock compensation agreements generally, certain factors must be analyzed. The Utah State Bar, in an Ethics Advisory Opinion, offered the following:

(a) The liquidity of the client's stock, including whether the client's stock trades publicly at the time of the fee agreement and, if the stock is not publicly traded, the risk that the client's stock will not be publicly traded in the future; (b) the present and anticipated value of the client's stock including the risks that a proposed patent or trademark may not be granted, that necessary government approvals (such as FDA approvals), may not be received; (c) whether the stock is subject to restrictions after the law firm receives it, and which affect the value of the stock to the lawyer; (d) the quantity of stock owned by the lawyer and whether the lawyer may exercise voting control over the client after receipt of the stock; and (e) any restrictions placed by the lawyer on the consideration paid for the stock.

The opinion notes that since many of these transactions are made before the stock is offered for public trade, the actual or potential value of the stock may be difficult to determine and attorneys and law firms may be caught inadvertently requesting an unreasonable fee for their services.

The Model Rules do permit attorneys to act as advisors to
their clients in matters outside the scope of legal representation. Rule 2.1 provides that:

In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation.\(^9\)

The first sentence is most relevant to stock compensation agreements between attorneys and their clients. An attorney may choose to take on a more substantial role in a corporation by providing business or "economic" advice to management. It is not uncommon for attorneys to render this advice on a regular basis when they work closely with the management of the corporation. But when the attorney is actually depending on the economic well-being of the corporation for legal fees he may be walking a fine line on the issue of independence.

2. **ABA Formal Opinion 418**

The ABA released Formal Opinion 418 in July of 2000.\(^9\) This opinion deals directly with some of the ethical issues arising when attorneys acquire an ownership interest in a client in lieu of fees.\(^9\) As mentioned above, the ABA has held that no inherent conflict arises when an attorney providing legal services to a business invests in that same business.\(^3\)

The ABA cited several reasons for condoning stock compensation.\(^4\) First, the attorney's willingness to invest with entrepreneurs in a start-up company is often viewed as a vote of attorney confidence in the business.\(^5\) Regarding this issue, the chairman of one Portland law firm stated that from the client's point of view, "it's almost to the point that if your lawyer isn't willing to put a little skin in the game, maybe you have the wrong lawyer." Many clients do see investment as a

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90. See MODEL RULES OF PROF'L CONDUCT R. 2.1 (emphasis added).
91. See Formal Opinion 418, supra note 7.
92. See id.
93. See id. But see generally ABA Commission on Professionalism, In the Spirit of Public Service: A Blueprint for Rekindling Lawyer Professionalism (1986). The commission expressed the view that the conflicts likely to arise when an attorney enters into a business transaction with a client change the attorney-client relationship in a fundamental way. See id.
94. See Formal Opinion 418, supra note 7, at 2.
95. See id.
as a sign of the law firm's loyalty to the corporation and willingness to do whatever it takes to help that company succeed. Additionally, clients sometimes believe that attorneys receiving compensation in stock are more inclined to work efficiently than those attorneys receiving traditional fees.  

As a second reason for permitting stock compensation agreements, the ABA formal opinion notes that an attorney's willingness to accept stock instead of a cash fee may be the only way for a cash-poor client to obtain competent legal advice. Third, the opinion states that because management's role is primarily to enhance the business's value for the stockholders, the interests of the attorney and the corporation will often coincide. The opinion notes that "[i]n some circumstances, such as a merger of one corporation in which the lawyer owns stock in the larger entity, the lawyer's economic incentive to complete the transaction may even be enhanced."

C. Regulation of Stock Compensation and Investments Under the Securities Exchange Acts

1. Liability Under Section 10(b) of the Securities Exchange Act of 1934

Section 10(b) of the Securities Exchange Act makes it unlawful for any person "to use or employ...any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Subsection (5) specifically defines "manipulative" actions:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of material fact or to omit to state a material fact necessary in order to make statements made, (c) To engage in any act, practice, or course of business which operates or

96. See Manning, supra note 21.
97. See Formal Opinion 418, supra note 7, at 2.
98. See id.
99. See id.
would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. An individual may be found liable under section 10b-5 when the plaintiff proves the following: (1) misrepresentation, omission, or nondisclosure, (2) existence of a duty, (3) intent to defraud, (4) materiality, (5) reliance and (6) injury.\(^{100}\)

In order to make a showing sufficient to meet the first requirement "the defendant must make either a material misrepresentation, omit a material fact, or completely fail to disclose a topic of material importance (nondisclosure)."\(^{101}\) Defendants may be held liable for an investor's pecuniary losses caused by the defendant's "misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it."\(^{102}\)

In \textit{Ernst and Ernst v. Hochfelder},\(^{103}\) the Supreme Court held that scienter, or fraudulent intent is required in order for a 10b-5 claim to be successful. Negligence is not sufficient to meet this test. Additionally, in \textit{TSC Industries, Inc. v. Northway, Inc.},\(^{104}\) the Supreme Court defined materiality by stating that "an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."\(^{105}\) With regard to reliance, if the plaintiff is claiming that defendant misrepresented or omitted information, then the plaintiff must show that the "defendant's action induced them to purchase or sell the security."\(^{106}\) On the other hand, if the plaintiff is claiming nondisclosure, then reliance is presumed.


Section 15 of the Securities Exchange Act of 1933 ("1933

\(^{100}\) See Patterson, \textit{supra} note 23, at 649.


\(^{102}\) See \textit{id}.

\(^{103}\) 425 U.S. 185 (1976).

\(^{104}\) 426 U.S. 438 (1976).

\(^{105}\) \textit{Id.} at 449. In TSC, the definition applied to 14a-9 claims, but the definition has been extended to cover 10b-5 claims. \textit{See} Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

\(^{106}\) See Bedrick, \textit{supra} note 101, at 1301 (citing Latigo Ventures v. Lavelthol & Horwath, 876 F.2d 1322, 1325 (7th Cir. 1989)).
Act") provides that individuals may be held liable for controlling the actions of other parties who are found liable under section 11 or section 12 of the Securities Exchange Act. These controlling individuals will be held jointly and severally liable with the controlled person “unless the controlling person had no knowledge of or reasonable ground to believe in the existence of facts” of which the controlled person had knowledge.

Section 11 of the 1933 Act provides a cause of action for plaintiffs acquiring security where the registration contained an “untrue statement of material fact or omitted to state a material fact required to be stated.” These plaintiffs may sue, among others, every person who signed the registration statement and every director or partner at the time of filing. As noted above, attorneys may be held liable for the actions of such directors and partners, when the plaintiff can show that the attorney was acting as a controlling person in these transactions.

Furthermore, section 20 of the Securities Exchange Act of 1934 provides that “every person who, directly or indirectly, controls any person liable under any provision of this title or any regulation thereunder shall also be liable jointly and severally” along with the controlled person. Unlike section 15, section 20 makes controlling persons liable for “violations of any part of the 1934 act.” Therefore, liability under section 20 is broader than section 15 liability which only holds individuals responsible for misrepresentations associated with an initial public offering.

D. Rules Governing Certified Public Accountants

Unlike attorneys, accountants are not permitted to engage in stock compensation agreements with clients. The American Institute of Certified Public Accountants (“AICPA”) Code of Professional Conduct provides specific standards for maintaining independent judgment. Rule 101 states that “[a]
member in public practice shall be independent in the performance of professional services." ¹¹⁴ The AICPA interpretation of Rule 101 provides that "independence shall be considered impaired if: during the period of professional engagement a covered member had or was committed to acquire any direct or material indirect financial interest in the client."¹¹⁵ Although it is certainly true that these rules do not regulate the conduct of attorneys, it is interesting that another group of professionals looks at the same type of transaction with such great scrutiny. Furthermore, it seems that the regulation has been put in place simply to guard against lack of "independent" action on the part of accountants. Maintaining independence from the client is a requirement for attorneys as well as accountants, so it is somewhat perplexing that one group of professionals should treat the same type of transaction so much more harshly than another group.¹¹⁶ It appears that if the ABA were truly interested in preserving attorney independence, they too would prohibit these types of investments.

III. IDENTIFICATION OF THE PROBLEM

Attorneys and law firms face a serious ethical dilemma when deciding whether to accept stock compensation from their clients in lieu of traditional fees. In 2000, all eyes turned to the ABA for an ethical mandate.¹¹⁷ The ABA surprised many by refusing to ban stock compensation agreements and instead asserting that attorneys may avoid ethical battles altogether when accepting such compensation as long as they abide by the Model Rules.¹¹⁸ Caselaw has shown, however, that unless attorneys are exceptionally fastidious in their business dealings with clients, they will not be able to meet the stringent requirements of Model Rule 1.7 and 1.8.¹¹⁹ Additionally, by entering into stock compensation agreements, attorneys open themselves up for actions based on various provisions of the Securities Exchange Acts. Thus, two

¹¹⁵. See id. R. 101 interpretation .02 101-1.
¹¹⁷. See supra Part II.
¹¹⁸. See supra Part II.B.2; Formal Opinion 418, supra note 7.
¹¹⁹. See supra Part II.B.1.
issues must be addressed: whether the ABA should prohibit these transactions altogether, and, if that is not a viable option, whether law firms should consider implementing more stringent stock compensation regulations in order to reduce the likelihood of securities fraud and other ethical violations.

IV. ANALYSIS

A. Taking Stock Compensation and Abiding by Model Rule 1.7(b) and Model Rule 1.5

An attorney has three options when considering whether to accept stock from a start-up business: (1) make no investment; (2) invest, but discontinue legal service; or (3) invest and provide legal services. The last choice is sometimes referred to as the most "ethically perilous."  

1. Meeting the Reasonableness Requirement

An attorney must abide by Model Rule 1.7 whenever the possibility of conflict exists between his own interests and the interests of the corporation. Therefore, an attorney must make two "reasonableness" assessments: (1) whether it is reasonable to believe that there is no possibility of conflict, and (2) whether it is reasonable to believe that representation will not be affected by the attorney's own interests. The conflict will be waived if the attorney's representation of the client will not be adversely affected by his own interest and the client gives full consent to the transaction.

The MRPC define the phrase "reasonably believe" to mean that the attorney ought to "believe the matter in question and that the circumstances are such that the belief is reasonable." "Reasonableness of lawyers" is defined as "the conduct of a reasonably prudent and competent lawyer."

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120. See Althoff, supra note 19.
121. See id.
122. See FREEDMAN, supra note 29, at 190.
123. See id. Additionally, Model Rule 1.5 sets forth a third reasonableness test. Attorneys may not charge an excessive or unreasonable fee. See MODEL RULES OF PROF'L CONDUCT R. 1.5 (1984); see also Jason M. Klein, No Fool for a Client: The Finance and Incentives Behind Stock-Based Compensation for Corporate Attorneys, 2 Colum. Bus. L. Rev. 330, 331 (1999).
124. See MODEL RULES OF PROF'L CONDUCT R. 1.7(b) (1984).
125. See GILLERS, supra note 39, at 16-17.
126. See id.
Taking these definitions together, one can deduce that reasonableness is measured both subjectively and objectively.\textsuperscript{127} The attorney must believe that his own interests will not materially interfere with the interests of the client, and objectively, in the eyes of other reasonably prudent and competent attorneys, that belief must be reasonable.\textsuperscript{128} This standard is difficult to meet when accepting stock compensation from a client.\textsuperscript{129} Attorneys will think differently about investments based on “the size of the investment, their personal comfort with differing levels of risk, whether their investment is active or passive, and the scrupulousness of their conscience.”\textsuperscript{130}

When attorneys live by the subjective rule, they are bound for rough waters. If an attorney unreasonably believes that his representation of the client will not be affected by his equity interest in the corporation, he is violating Rule 1.7 by continuing to represent the client even if the client consents to the agreement.\textsuperscript{131} This problem is often faced because many start-up businesses without cash are desperate to acquire legal representation. An attorney who jumps into the deal and accepts stock compensation without thinking the matter through carefully may open himself up to malpractice lawsuits.\textsuperscript{132} Additionally, more problems will arise for the attorney who neglects to make the required reasonableness assessment at every emerging conflict during the course of representation.

In Formal Opinion 418, the ABA mentions some of the circumstances where an attorney’s interests in the corporation could conflict with the interests of the client in such a way that it would be unreasonable to continue representation.\textsuperscript{133} The opinion notes that the attorney’s ability to render an opinion on behalf of the corporation may be jeopardized when he is receiving stock compensation.\textsuperscript{134} The attorney must “evaluate h[is] ability to maintain the requisite profes-

\textsuperscript{127} See Althoff, supra note 19.
\textsuperscript{128} See id.
\textsuperscript{129} See id.
\textsuperscript{130} See id.
\textsuperscript{131} See 1 HAZARD & HODES, supra note 27, at § 11.
\textsuperscript{132} See Jill Schachner Chanen, Banking on Client Futures: Internet Economy Spurs Solos and Small Firms to Trade Services for Stock, 86 A.B.A. J. 78 (June 2000).
\textsuperscript{133} See Formal Opinion 418, supra note 7, at 8-11.
\textsuperscript{134} See id.
sional independence by subordinating any economic incentive arising from her stock ownership in the corporation." 135 Another example is a situation where an attorney is depending upon the proceeds of the stock compensation as a major asset. 136 These are just some of the ways that an attorney's representation may be materially limited when stock compensation agreements are made.

2. The Misconception of Client Consent

Rule 1.7(b) permits client consent to waive a conflict of interest, provided that the consent is given after consultation and the lawyer has satisfied the reasonable belief requirement. 137 Under this subsection, because the client obviously does not know whether the representation will be affected by the attorney's personal interests, an attorney must be careful not even to ask for or accept client consent unless he is himself independently satisfied that his representation will not be adversely affected by his own interest in the transaction. 138

One problem with client consent, noted by the ABA Standing Committee on Ethics and Professional Responsibility in Formal Opinion 93-372, is the issue of prospective conflicts of interest between attorney and client. 139 This would be a situation where the exact nature of the conflict is not yet known, but the client is still agreeing to waive it. 139 The ABA has stated that although this type of waiver is acceptable, it may not be dispositive if a later conflict does arise. 140 The ABA is guarded in its acceptance of prospective waivers.

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135. Id.
136. See id.
137. See MODEL RULES OF PROF'L CONDUCT R. 1.7(b) (1984); see also RESTATEMENT, supra note 24, § 122(2).
Notwithstanding the informed consent of each affected client or former client, a lawyer may not represent a client if:
(a) the representation is prohibited by law;
(b) one client will assert a claim against the other in the same litigation; or
(c) in the circumstances, it is not reasonably likely that the lawyer will be able to provide adequate representation to one or more of the clients.

Id.
138. See 1 HAZARD & HODES, supra note 27, at § 11.
140. See id.
141. See id.
mainly because it acknowledges that a waiver is not sufficient to cure a conflict of interest situation. As mentioned above, a reasonable belief on the part of the attorney is required in addition to client waiver.\textsuperscript{142}

Additionally, it bears repeating that waiver of a presently unknown conflict differs from waiver of an actual conflict where the attorney is already aware that the risk of harm is present. In the latter case, the client must consent to that specific conflict even if a prospective waiver has been signed in advance.\textsuperscript{143} As the ABA has noted, a prospective waiver is never ethically conclusive.\textsuperscript{144} Therefore, when an attorney faces an actual conflict between his personal interests in the stock of the corporation and his duty to represent the client, he must determine whether he can reasonably continue to represent the client.\textsuperscript{145} After that evaluation is made, the attorney must once again seek the client's consent in order to continue representation.\textsuperscript{146}

For attorneys accepting stock in lieu of fees these "actual conflicts" arise with some frequency. Circumstances surrounding corporate disclosures, mergers and attorney evaluations for third parties are just a few examples of such conflicts.\textsuperscript{147} In these situations, the conflict "might foreclose alternatives that otherwise might be available to the client."\textsuperscript{148} Therefore, the attorney must seek client consent again in order to continue representation.

The difficulty here is obvious. If an attorney forgets to reevaluate the circumstances and obtain client consent when an actual conflict arises, he is then opening himself up for malpractice suits and possible disciplinary action. Liability is even more likely with start-ups because the chances of the client business ending up bankrupt are often great.\textsuperscript{149}

\textsuperscript{142} See id.
\textsuperscript{143} See 1 HAZARD & HODES, supra note 27, at 256.15.
\textsuperscript{144} See Formal Opinion 372, supra note 139.
\textsuperscript{145} See 1 HAZARD & HODES, supra note 27, at 256.15.
\textsuperscript{146} See id.
\textsuperscript{147} See Formal Opinion 418, supra note 7, at 10.
\textsuperscript{148} See MODEL RULES OF PROF'L CONDUCT R. 1.7(b) cmt. (1984).
\textsuperscript{149} See Baker, supra note 1, at 36.
B. Abiding by Model Rule 1.8 and Accepting Stock Compensation

Compliance with Model Rule 1.7 is required when any possibility of material conflict exists between the attorney's own interests in the corporation and the interests of the client. On the other hand, Model Rule 1.8 applies in all business transactions between attorney and client. An attorney's receipt of stock compensation from the client is considered a business transaction and is therefore governed by Rule 1.8.

1. Meeting the Full Disclosure Requirement

The terms of the transaction must be fully disclosed in writing in a manner that can reasonably be understood by the client. Full disclosure includes, for example, discussions of the consequences of any rights by virtue of the attorney's stock ownership that may limit the client's control of the corporation under special corporate by-laws or other agreements. Full disclosure also includes encouraging the client to seek independent counsel before agreeing to a stock compensation transaction. Additionally, the attorney must disclose the possibility that his economic interests as a stockholder could create a conflict with the client's interests, perhaps even necessitating withdrawal from representation.

As mentioned above, there are many cases dealing with an attorney's failure to meet the full disclosure requirement. In In re Spear, the Supreme Court of Arizona held that the full disclosure requirement presents a high standard for any attorney. It requires more than making the client fully aware of the nature and terms of the transaction. Because of the fiduciary relationship that exists between an attorney and his client, the attorney must exercise "active diligence to

150. See MODEL RULES OF PROF'L CONDUCT R. 1.7(b) (1984).
151. See id. R. 1.8(a).
152. See RESTATEMENT, supra note 24, § 126 cmt. a.
153. See MODEL RULES OF PROF'L CONDUCT R. 1.8(a); supra Part II.B.1.
154. See Formal Opinion 418, supra note 7, at 10.
155. See 1 HAZARD & HODES, supra note 27, at 256.15.
156. See id.
158. See id.
159. See id.
see that his client was fully informed of the nature and effect of the transaction proposed and of his own rights and interests in the subject matter involved.\textsuperscript{6}

Recall Committee on Professional Ethics v. Mershon,\textsuperscript{61} where the attorney agreed to contribute legal advice to a corporation formed by the client.\textsuperscript{62} In lieu of fees, the attorney was to be paid twenty percent of the stock in the corporation.\textsuperscript{63} The attorney made sure that the client knew all of the terms of the transaction.\textsuperscript{64} Additionally, the client was an active participant in the transaction.\textsuperscript{65} Yet, according to the court, this was still not enough to fulfill the burden of full disclosure.\textsuperscript{66} The court suggests that the best advice for the attorney would have been to refuse to take stock in the corporation altogether.\textsuperscript{67}

Additionally in In the Matter of the Disciplinary Proceeding Against Gary G. McGlothlen, the Supreme Court of Washington held that in attorney-client transactions, the attorney must not only show that he made an unbiased full disclosure to the client but also that no undue influence was used.\textsuperscript{68} In this case, though the attorney’s conduct as measured against ordinary standards was “entirely proper,” it did not meet the “stringent requirements imposed upon an attorney dealing with his or her client.”\textsuperscript{69} While the attorney had disclosed the issues of the transaction with the client, the court found that he had not done so in sufficient detail.\textsuperscript{70}

These cases illustrate many of the problems presented for attorneys taking stock compensation from their clients. The requirements of full disclosure are stringent. The attorney must present all known possibilities for conflict to the client in order for the client to evaluate and determine whether to consent to the transaction.\textsuperscript{71} Additionally, this type of disclosure is not only required when the agreement is first made,

\begin{itemize}
\item \textsuperscript{161} 316 N.W.2d 895 (Iowa 1982); see supra Part II.B.1.b.ii.
\item \textsuperscript{162} See id.
\item \textsuperscript{163} See id.
\item \textsuperscript{164} See id.
\item \textsuperscript{165} See id.
\item \textsuperscript{166} See id.
\item \textsuperscript{167} See Mershon, 316 N.W.2d at 899.
\item \textsuperscript{168} See id.
\item \textsuperscript{169} Id.
\item \textsuperscript{170} See id.
\item \textsuperscript{171} See Reimer, supra note 5, at 36.
\end{itemize}
but also when every actual conflict arises. According to Rule 1.7(b) the client may consent to a conflict in representation only after consultation. Therefore, this is an on-going requirement for the attorney. It lives as long as the attorney is taking stock fees from his client.

C. Rationale for Strictly Regulating Stock Compensation

1. The Difficulty of Complying with the Model Rules

The brief analysis above presented some of the problems that attorneys face when taking stock compensation and trying to comply with the Model Rules at the same time. Even well-meaning attorneys and law firms are liable to make unreasonable assumptions regarding the effect their equity interest in the corporation has on their representation. For these reasons, ABA Formal Opinion 418 poses its own “inherent conflict” when it counsels attorneys to take compensation and abide by the Model Rules at the same time.

2. Avoiding the Appearance of Impropriety

As mentioned above, an attorney ought not to engage in activities that bear the appearance of impropriety. Such impropriety would be exhibited if the representation of the client appears in any way colored by the attorney’s own interests. Many members of the bar recognize that as a general counselor and adviser to their client, if an attorney also has “a hand in the cash register” it is likely that his representation will appear colored by his interest in the well-being of the stock of the corporation.

This affected representation is even more pronounced when the attorney is not making a simple investment in the corporation, but is instead accepting stock compensation in lieu of normal cash fees. Stock compensation creates a much greater dependency on the part of the attorney; he is not relying on the price of the corporation’s stock merely for recrea-

172. See supra Part IV.A.2.
173. See MODEL RULES OF PROF'L CONDUCT R. 1.7(b) (1984).
174. See supra Part IV.
175. See supra Part IV.A.1.
176. See supra Part II.A.
177. See supra Part II.A.
178. See Chanen, supra note 132, at 81.
tional investment purposes, but for his very payment.\footnote{179}{See Baker, supra note 1.}


Attorneys investing in clients may also open themselves up to securities liability under various provisions of the 1933 and 1934 Securities Exchange Acts. Of the six elements comprising a 10b-5 claim, fraudulent intent or "scienter" is often the most difficult element to prove. But when a law firm actually has a financial stake in the corporation, it becomes more likely that a factfinder will find that the firm or the specific attorney did act with the requisite mental intent or recklessness required by the courts.\footnote{180}{See Patterson, supra note 23, at 655.} Once intent is found, attorneys are held jointly and severally liable.\footnote{181}{See id.}

Securities fraud issues arise for attorneys in many different types of situations.\footnote{182}{See Patterson, supra note 23, at 653.} First, an attorney may be held liable for engaging in intentional fraud or deceit.\footnote{183}{See Bedrick, supra note 101, at 1304.} Second, an attorney may be held liable under either the traditional or misappropriation theories of insider trading.\footnote{184}{See id.} Traditional insider trading is trading by an individual, typically management of the corporation, based on inside information.\footnote{185}{See id.} Attorneys may be held liable under this theory as "temporary insiders" if they have some interest in or relationship to the conduct of the corporation and have assented to an expectation on the part of the corporation that the information will be kept confidential.\footnote{186}{See id.} The misappropriation theory holds liable those attorneys that trade based on information they have gained in violation of a fiduciary duty. Attorneys may also be accused of 10b-5 fraud when they are relied upon for opinion letters regarding the viability of the corporation or the fairness of a particular transaction, or when drafting a prospectus for an issuer.\footnote{187}{See also Dirks v. SEC, 463 U.S. 646, 655 n.14 (1983).}

When an attorney takes an interest in a corporation, and then attempts to draft documents regarding the viability of the company, it is clear that bias could easily play a role.

\footnote{179}{See Baker, supra note 1.}
\footnote{180}{See Patterson, supra note 23, at 655.}
\footnote{181}{See id.}
\footnote{182}{See Patterson, supra note 23, at 653.}
\footnote{183}{See Bedrick, supra note 101, at 1304.}
\footnote{184}{See id. at 1304.}
\footnote{185}{See id.}
\footnote{186}{See id. at 1303. See also Dirks v. SEC, 463 U.S. 646, 655 n.14 (1983).}
\footnote{187}{See Bedrick, supra note 101, at 1304.}
Furthermore, the argument that the loyalties of attorneys or law firms with stock in their clients naturally align with the shareholders is not always an accurate depiction of reality.\(^{188}\) Unlike typical shareholders, attorneys often possess confidential knowledge about the viability and financial structure of the company. Additionally, corporations often give attorneys stock at “different prices and with different rights than those sold at IPO.”\(^{189}\) For these reasons, when 10b-5 claims are involved, knowledge can most definitely become lethal for the corporate attorney.

With regard to section 15 and section 20 “controlling person” liability, it is important to note that the client corporation must first commit an illegal act before any liability would fall on the attorney. If this can be shown, then under section 15, every person who through “stock ownership or otherwise” controls a person who is liable for registration fraud will be found jointly and severally liable as well. Typically, attorneys who strictly perform their professional duties, will not be held liable under section 15. Those firms that branch out and provide services that go beyond traditional legal services, however, may be opening themselves up to liability.\(^{190}\)

Section 20 liability is broader, in that attorneys may be held liable not simply as controlling persons whose actions led to a misrepresentation in the initial public offering, but also for controlling any other violations under the 1934 Act. The legal implications associated with accepting stock compensation as applied to these two sections are obvious. Some large law firms are interested in providing business advice to the client as well as other services in order to increase the total profits for the law firm. This itself could lead to controlling person liability. But add to that the fact that a law firm is receiving their compensation for services rendered in the form of corporate stockholdings, and the chances of a jury finding liability are increased significantly. Unfortunately, the appearance of the situation simply looks bad for any law firm when the corporate client or “controlled entity” engages in any type of Security Exchange Act violation. Any kind of “in-

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188. See Patterson, supra note 23, at 656.
189. See id.
dependence" on the part of the law firm appears lost.

V. PROPOSAL

Many good reasons exist for allowing attorneys to take stock compensation. Some of the most cited are: (1) cash-poor start-ups are in need of representation; (2) the interests of the corporation typically coincide with the personal interests of the attorney in increasing his wealth; and (3) both parties benefit from the transaction. But these reasons may not always be sufficient to overcome the ethical dilemma that attorneys face whenever they are deciding whether to accept compensation in the form of stockholdings.

The purpose of enacting conflict of interest regulations is to prevent conflicts from occurring, and to avoid the appearance of impropriety on the part of the attorney. The ABA has concluded that any conflict of interest associated with stock compensation for services is not sufficient to characterize it as a prohibited transaction altogether. Instead, the ABA has stated that attorneys taking stock compensation must be sure to comply with the requirements of Model Rules 1.7 and 1.8.

But, as seen above, this is a daunting task. It requires an attorney to be attentive to small details that could grow into serious conflicts. Additionally, the attorney must make several "reasonableness" assessments in order to determine whether or not to even continue representation. At any of these stages an attorney may make an incorrect determination and open himself up to malpractice lawsuits and disciplinary action. Furthermore, an attorney or law firm heavily involved in the business dealings of the client, may also face liability under the Securities Exchange Act.

Some would argue that the better rule would be for the ABA to follow the lead of the AICPA and recognize a per se conflict of interest whenever an attorney receives stock compensation for services rendered. There appears to be no fun-

191. See supra Part II.
192. See Formal Opinion 418, supra note 7.
193. See supra Part II.A.
194. See Formal Opinion 418, supra note 7.
195. See id.
196. See supra Part IV.
197. See supra Part IV.A.1.
damental reason for banning stock-based compensation for one group and not the other. Both are advising and counseling their clients. Both are involved in financial matters of the corporation. Both would have an interest in seeing the stock of the corporation succeed if they were accepting an equity interest in lieu of fees.

Beyond this similarity, there are many other reasons for prohibiting these types of transactions. First, the extent of coverage under attorney professional responsibility policies when the lawyer is also a stockholder is typically limited. Many professional responsibility policies do not cover attorneys that take equity interests in their clients. Second, there is a great possibility for civil liability claims, including stockholder derivative actions resulting from the attorney representing the client in certain matters. Third, stock compensation agreements increase internal disharmony among lawyers in the firm regarding investment opportunities that individual attorneys may be offered by clients. Finally, whenever stock compensation agreements are made, the risks of attorney non-compliance with securities laws and regulations increase.

There has been significant pressure placed on the bar and on many law firms to condone stock compensation agreements. While prohibiting these transactions altogether may potentially be the better rule, it appears unlikely that the ABA or law firms themselves will ban these profit-generating transactions. After tasting sweet success in the late nineties, law firms representing start-ups are eager to experience the rush of high profits again. In addition, attorney retention within large law firms is often at least partially based on whether stock agreements are accepted. Therefore, since it is improbable that these agreements will be prohibited at this stage, it would be beneficial for law firms to

198. See Formal Opinion 418, supra note 7.
199. See id.
201. See Formal Opinion 418, supra note 7.
202. See id.
203. See id.
204. See Cleary, supra note 200.
205. See id.
take certain precautions in order to prevent the liability that naturally follows many stock compensation transactions.

A. **Supervising Attorney Takes No Equitable Interest in the Client**

This option is recommended in the ABA's Formal Opinion on stock compensation. Basically, the ABA argues that for law firms accepting stock compensation, the supervisory responsibility over the lawyer-client transactions should be given to a partner who does not have equitable ownership in the client. This arrangement would ensure at least some independence for the law firm and reduce the appearance of conflict. The supervising attorney would be able to evaluate the transaction from a less biased perspective and could attempt to ensure that the attorney accepting stock compensation exercises no undue influence on the client.

B. **Limit the Percentage of Stockholdings in the Client**

Another possible avenue would be for law firms to limit the percentage of stockholdings that the firm may take in a particular client. A smaller percentage of stockholdings will likely lead to less controlling person liability. The more stock a law firm takes in a corporation, the more it steps outside its traditional legal role into the realm of business dealings, running the risk of being sued by angry shareholders. Beyond the actual percentage, law firms should be careful not to accept an amount of stock that has such high value that it creates a major dependency on the client by the law firm. Specifically, small firms should be careful not to become completely dependent on the stock of a particular client.

C. **Avoid Close Business Dealings with the Client**

Law firms interested in avoiding disciplinary action under the Model Rules and the Securities Exchange Act should take steps to show that the firm is not engaging in a significant business advisory role with the client. Some large firms are now considering branching out and providing this type of business advice to their corporate clients. This situation, however, creates a dependency relationship between attorney and client which may very well lead to controlling person li-

206. See Formal Opinion 418, supra note 7, at 11.
ability. Therefore, for firms interested in preventing future lawsuits by disgruntled shareholders, it is better to avoid creating this type of business relationship.

D. Give up Voting Rights Associated with Stock

In order to prevent a situation where the law firm must take a voting position that is adverse to the corporate client, many law firms already do give up the voting rights associated with their stockholdings.207 This is an essential step; law firms holding on to voting rights may get caught in a situation where they are tempted to exercise their rights in a way that may actually hurt the client, creating an undeniable conflict of interest between the attorney's own interests and the interests of the client. The conflict of interest is serious in nature, but if law firms agree to give up voting rights altogether this problematical situation may be avoided.

IV. CONCLUSION

Model Rules 1.7(b) and 1.8(a) pose high ethical hurdles for attorneys desiring to invest in promising start-ups.208 Though an attorney might believe he is taking all the necessary precautions required by the Model Rules, some small mistake on his part could lead to serious liability.209 Additionally, whenever an attorney enters into any business agreement with his client, he is risking his professional reputation.210 This risk is heightened for attorneys accepting stock compensation in lieu of fees because they are putting their actual salary on the line.211

While the ABA may be incorrect in stating that no inherent conflict of interest arises when attorneys accept stock in lieu of fees, it appears unlikely that the ABA will actually prohibit these transactions. It seems even more improbable that large law firms handling high-tech clients will be willing to give up the potential profits that these transactions generate. Therefore, at this point, the best idea for law firms insisting on stock compensation agreements would be to employ the suggested precautions in order to avoid opening them-

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207. See Manning, supra note 21.
208. See supra Parts II, IV.
209. See supra Part IV.A-B.
210. See supra Part II.A.
211. See supra Part IV.A.1.
selves up to future liability.