

**COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION II, AT TACOMA**

VALLEY/50TH AVENUE, LLC,

Appellant

**RANDALL STEWART, Trustee and MORSE and BRATT,
a professional service corporation,**

Respondent

REPLY BRIEF

Case No. 39939-3-II

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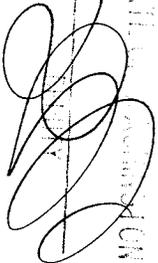
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SUMMARY OF REPLY ARGUMENTS

The Respondents' arguments purport to defend the rulings of the trial court, but fail to do so. The duties of 'full disclosure' imposed by both RPC 1.7 and 1.8¹ were neither considered nor fulfilled. Both the trial court and Respondents essentially ignore the primary case governing trial: *Valley/50th Ave., L.L.C. v. Stewart*, 159 Wn.2d 736, 153 P.3d 186 (2007). To the extent that the trial court rejected the testimony of the expert at trial, that ruling was erroneous. The Respondents clearly failed in meeting their burden of proof, and the Judgment in their favor must be reversed.

APPLICATION OF RPC 1.7

The trial court failed to properly consider or analyze the evidence under the requirements of RPC 1.7. The Respondents (hereinafter referred to as the Firm) did not comply with the requirements of RPC 1.7.²

a. *Valley/50th Avenue LLC was a client at all material times.*

The Firm argues that Appellant (Valley/50th Avenue LLC, hereinafter referred to as Valley) was not a client of the Firm for the purposes of the challenged documents. Neither the facts nor the law support the Firm's position.

¹ For all purposes herein, the references to the Rules of Professional Conduct (RPC) are made to those in effect when the collateral in question was discussed, negotiated and completed.

² See Exhibit A.

The general test in the context of ethics is the two-part test described in *Bohn v. Cody*, 119 Wn.2d 357, 832 P.2d 71 (1992). *See, generally*, Washington Legal Ethics Deskbook (Wn. St. Bar Ass'n, 2003), §10.2. However, the initial question is when that test is to be applied. The trial court did not consider or address that initial question, particularly from the perspective of Valley. The question which the court should have asked was simple: what was the status of Valley when discussions regarding the disputed transaction first began?

The Firm first asserts that it was not actively involved in Valley's affairs. This is contrary to the facts. In addition to Valley's initial organization and funding, the Firm remained as registered agent for Valley, and kept its books and records. Exhibits 21, 23, 25; RP 81. The Firm's involvement remained active well after the documents under scrutiny had already been executed. *Id.* The Firm did not undertake any effort to disassociate itself from that relationship prior to or during the initial discussion, contract formation, negotiation, and client reviews. The attorney/client relationship therefore remained intact at all material times throughout that critical interval. *Conner v. Hodgdon*, 120 Wash. 426, 432, 207 P. 675 (1922)(Held: "It seems to us uncontrovertible (sic) that the confidential relationship is here shown to have existed between Conner and Hodgdon, and no abandonment of it or positive act tending towards its

severance can be pointed out in the record, and none can be presumed.”)
Cited with approval, In re McGlothlen, 99 Wn.2d 515, 663 P.2d 1330
(1983).

b. *Conflicts of interest existed when discussion of collateralization began.*

Conflicts of interest were not discussed nor consent to the same obtained when the discussions regarding Valley’s property as collateral for the Firm’s benefit initially arose, or throughout the discussion and negotiation phases. At all material times, Valley and Rose were both clients of the Firm when the Firm had a critical vested interest itself in the transaction under consideration. Multiple conflicts were in play. Mr. Nellor acknowledged the same in his testimony. RP 204.³ However, no attempt at disclosure was undertaken when the conflicts arose. Extraordinarily, Respondents claim that the conflict between Rose and Valley, and Rose and the Firm, is “irrelevant”!⁴ The basis for this

³RP 204:

Q (Tubbs): You would agree that Rose had a potential conflict of interest in using Valley's real estate as collateral for his own debt; right?

A (Nellor): Yes.

Q: And that conflict was with Valley of course?

A: Well, there's more than that. I mean, there was a conflict between the firm and -- the interest of the firm and Rose.

Q: Right.

A: And then there was Rose's potential conflicts with Valley. Of course, in many respects that's academic since he was at that time the sole manager and sole owner.

⁴ Brief of Respondent, p. 12.

assertion erroneously examines the parties to litigation, and fails to examine the parties to the documents under scrutiny.

Obviously the Firm recognized some form of conflict, belatedly and certainly fortuitously for the Firm, when Rose allegedly asked for advice. Prior to this alleged inquiry, during the critical interval⁵ when the discussion of Valley's assets as collateral first arose and the terms of the transaction were discussed and negotiated, the Firm failed to consider or recognize any conflict at all. RP 39.

c. RPC 1.7 imposes a duty of 'full disclosure', which the Firm did not fulfill.

Under RPC 1.7, The Firm was required to consider its own interests and its duties to both Rose and Valley in a timely manner, and provide "full disclosure" of all "material facts" when the potential for conflict first arose. RPC 1.7; *In re Botimer*, 166 Wn.2d 759, 214 P.3d 133, 139 (2009). It is undisputed that this was not done. Accordingly, a violation of RPC 1.7 resulted and continued throughout the discussions and negotiations leading to the final version of the documents in question.⁶

⁵ See Footnote 7, *Valley/50th Avenue LLC v. Stewart*, *supra*.

⁶ The alleged conversation between Rose and Nellor occurred after all revisions to the documents had been completed, when Rose asked for legal advice whether "he" should sign the documents. RP 72-74.

The next issue posed by inference by the trial court in its oral opinion⁷ is whether the violation of RPC 1.7 can nonetheless be absolved by the alleged subsequent disclaimer *after* the arrangement and its terms had already been fully negotiated. In other words, once the transaction has been tainted with the presumption of fraud and unethical dealing, may the transaction be ‘cleansed’ by the alleged referral?

There appears to be no substantive authority on this novel question. However, it surely hinges on the circumstances at the time, including the clients’ needs, the clients’ reasonable expectations, and the nature and extent of the disclosure and disclaimer. It does not hinge upon the desire of the Firm to get paid.

The clients’ needs required first and foremost that they be treated as separate entities. *Valley, supra* at 747. Accordingly, they required independent advice. *Valley, supra* at 747; RPC 1.7. Accepting Mr. Nellor’s testimony that the impetus for the disclosure was a specific request for legal advice, the Firm must concede that its clients were expecting assistance, simply because it allegedly was sought. The Firm, to avoid the taint that permeates the transaction, must discuss the existence of a conflict in its fullest terms, explaining how and why the conflict exists and why it operates to require independent review. RPC 1.7(2);

⁷ RP 266.

Eriks v. Denver, 118 Wn.2d 451, 824 P.2d 1207 (1992). This duty of full disclosure required that the Firm emphasize how critical the independent review must be; or alternatively, the clients must be given the option to waive the conflict after full disclosure. Since the collateral was sought based upon an inability to pay for legal fees in the first instance, and with knowledge that Rose was being and had been sued for nonpayment of fees⁸, it was highly probable that Rose would forego independent review for the simple reason that he could not afford it. Waiver was a distinct option to be explained and considered.

If Rose disclosed after ‘full disclosure’ that he could not or would not consult with independent counsel, the duty to provide ‘full disclosure’ under RPC 1.8 is enhanced. See discussion, *infra*.

The testimony at trial shows that the Firm did not

- discuss any conflict between Valley and Rose;
- direct Rose to seek independent review for Valley;
- provide Rose the option to waive a conflict and obtain advice from the Firm for his own benefit in acting as Valley’s manager;
- instruct Rose that it was important for Rose to obtain review independently from Valley as his use of Valley’s

⁸ See, *e.g.*, Exhibits 13, 14; RP 102.

assets may adversely affect Valley's status as an independent entity, and furthermore expose him to liability from claims by Valley that he had misused Valley's assets.

The requirement of "full disclosure" mandated by RPC 1.7 was not fulfilled.

Valley contends that it essentially proved that the alleged meeting and conversation did not occur, particularly in light of the 'clear, cogent and convincing' standard.⁹ Nonetheless, even if Nellor's recollection is accepted as a verity, that testimony does not provide sufficient proof to avoid the presumption of fraud that attached when the Firm discussed, negotiated, and drafted the critical documents that conflicted with the interests of their clients. His alleged instruction was 'too little, too late'. The trial court failed to consider or apply the requirements of RPC 1.7. Given the absence of full disclosure, much less written consent, the deed of trust is invalid, and the trial court erred in sustaining its viability.

NONCOMPLIANCE WITH RPC 1.8

The trial court failed to properly consider or analyze the evidence under the requirements of RPC 1.8¹⁰. The Firm did not comply with the requirements of RPC 1.8.

⁹ Respondent does not question the standard of review set forth in Appellant's brief.

¹⁰ See Exhibit B.

RPC 1.8 imposes a number of distinct obligations upon the Firm. For example, the transaction in question is invalid unless both the transaction *and* its terms are: (a) fully disclosed; and (b) fair and reasonable to the client See Exhibit B.

The leading and most recent case to analyze these requirements is *Valley/50th Ave., L.L.C. v. Stewart*, 159 Wn.2d 736, 153 P.3d 186 (2007). The Firm does not cite it for any substantive purpose, although it is clearly the leading case. The trial court acknowledged that it had difficulty with the case. However, the mandate from the Supreme Court is clear and unambiguous.

Under this rule [RPC 1.8], the lawyer must establish, " '(1) there was no undue influence; (2) he or she gave the client exactly the same information or advice as would have been given by a disinterested attorney; and (3) the client would have received no greater benefit had he or she dealt with a stranger.' The disclosure which accompanies an attorney-client transaction must be complete. Attorneys, to defend their actions, must prove they complied with the "stringent requirements imposed upon an attorney dealing with his or her client."

The burden of proving compliance with RPC 1.8 rests with the lawyer; "an attorney-client transaction is prima facie fraudulent." A lawyer must prove strict compliance with the safeguards of RPC 1.8(a); full disclosure, opportunity to consult outside counsel, and consent must be proved by the communications between the attorney and the client. (citations omitted).

Valley, supra, at 745.

The ‘full disclosure’ element¹¹ within RPC 1.8 requires that the lawyer give “the client exactly the same information or advice as would have been given by a disinterested attorney”. The “opportunity to consult independent counsel” is meaningless in the absence of full disclosure. Clearly, the concept of “opportunity” is not solely a function of time: “The opportunity to seek independent advice must be real and meaningful. It is not enough that at some moment in time an opportunity existed no matter how brief or fleeting that opportunity might have been. *The disclosures and notices required by RPC 1.8* are meaningless unless the client is given a reasonable amount of time *to act upon the information.*” *Valley, supra* at 190 (emphasis added). The mandate of ‘opportunity’ must therefore be considered in conjunction with the ‘full disclosure’ requirement of the Rule¹².

Full disclosure is not fulfilled if the client is merely supplied with a copy of the documents. Much more is required. *Valley, supra* at 746-747.¹³ See, e.g., ABA/BNA Lawyer’s Manual on Professional Conduct, §51.504, pp. 6-7.

¹¹ RPC 1.8(a)(1).

¹² The ‘full disclosure’ required under RPC 1.8 is separate and distinct from the ‘full disclosure’ obligation imposed by RPC 1.7.

¹³ “The record reflects that the trial court felt the agreement, note, and deed of trust themselves would satisfy the disclosure requirements of former RPC 1.8. *We disagree. These documents alone are inadequate evidence of compliance with RPC 1.8.* (emphasis added)”

The Supreme Court does not stand alone in requiring that ‘full disclosure’, in the context of a business transaction with a client, go well beyond the mere recital of the terms of the transaction¹⁴.

See, e.g., *Goldman v. Kane*, 329 N.E.2d 770, 3 Mass.App.Ct. 336, 341 (1975):

When an attorney bargains with his client in a business transaction in a manner which is advantageous to himself, and if that transaction is later called into question, the court will subject it to close scrutiny. In such a case, the attorney has the burden of showing that the transaction 'was in all respects fairly and equitably conducted; that he fully and faithfully discharged all his duties to his client, not only by refraining from any misrepresentation or concealment of any material fact, but by active diligence to 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, and by seeing to it that his client either has independent advice in the matter or else receives from the attorney such advice as the latter would have been expected to give had the transaction been one between his client and a stranger.' (citations omitted).

See also, Rodgers v. State Bar of California, 256 Cal. Rptr. 381, 48 Cal.3d 300, 314, 768 P.2d 1058 (1989)(Held: attorney failed to fully or adequately disclose the transaction, including “information that might have discouraged [the client] from agreeing to the loans.”); *Hawk v. State Bar*, 247 Cal. Rptr. 599, 601, 45 Cal.3d 589, 754 P.2d 1096 (1988)(Held: “rule 5-101 merely requires the attorney to *fully explain such transactions*,

¹⁴ For a comparative analysis of states adopting the pre-2000 version of the ABA’s Model Rule 1.8, see <http://www.law.cornell.edu/ethics/comparative/index.htm#1.8>. Curiously, Washington is not contained in this website annotation.

to offer only fair and reasonable terms, *to give the client a copy of the agreement, and to give the client an opportunity to seek independent legal advice.*”(emphasis added); *Miller v. Sears*, 636 P.2d 1183 (Alaska 1981)(“Courts will scrutinize such transactions for fairness and the lawyer's obligation is to explain all relevant facts and the legal significance of the documents. Thus, even though the transaction may be fair, and the lawyer may have disclosed all matters of fact relevant to the transaction, the transaction is voidable if the legal consequences flowing from it are not explained.”); *Selby v. Stewart*, 853 N.Y.S.2d 489, 19 Misc.3d 310 (2008); *Iowa State Bar Ass'n v. Oehler*, 350 N.W.2d 195, 199 (Iowa, 1984); *Williams v. Waldman*, 108 Nev. 466, 472, 836 P.2d 614 (Nev., 1992); *Monco v. Janus*, 222 Ill.App.3d 280, 583 N.E.2d 575 (Ill.App., 1991).

It is undisputed that the Firm did not fulfill these responsibilities¹⁵. Faced with this admitted failure to adhere to the applicable standard, the trial court was compelled to reach but one conclusion: that the Firm had not met the burden imposed upon it by RPC 1.8, and the resulting transactions are therefore invalid. The trial court clearly erred in ignoring the mandate from the Supreme Court to consider this issue in the manner

¹⁵ See, e.g., Respondent's brief at p. 1.

set in the decision of the Supreme Court. This error requires reversal and entry of Judgment in favor of Appellant Valley.

HANDLING OF EXPERT TESTIMONY

The reliance of the Firm upon its objections to the testimony of Ms. Dial at the time of trial is misplaced. The grounds asserted in support of its objections to the testimony of Ms. Dial did not concern lack of foundation. Its first objection concerned the propriety of attesting to standard of care. RP 116. Its second objection was directed to “the form of the question”, and the use of hypothetical questions. RP 122. Its third objection as simply asserted as the “same objection”. RP 125. Finally, the Firm sought and was permitted to assert a “continuing objection”. RP 126. No objection was raised on the grounds that there was a lack of foundation¹⁶. *Compare*, ER 104; ER 705. Objections to testimony must be specific. Teglund, Washington Practice, *Evidence Law and Practice* (5th ed.), §103.7. The Firm may not now assert grounds that it had waived at trial by failing to make timely and specific objection asserting the same. *Id.*

¹⁶ Opinion testimony does not require that the witness have personal knowledge of the facts upon which the opinion of the witness is based. ER 703. For discussion on admissibility of expert testimony and hypothetical questions, see, Teglund, Washington Practice, *Evidence Law and Practice*, (5th Ed.), §703.4.

UNDOCUMENTED TESTIMONY AND SUBSTANTIAL EVIDENCE

The Court erred in its finding that a referral to independent counsel had been made, in the absence of, and contrary to, documented evidence.

In *Proctor v. Huntington*, 146 Wn.App. 836, 846, 192 P.3d 958 (2008)(review granted, 205 P.3d 132 (2009)), the Court confirmed that the burden of establishing evidence according to the “clear, cogent and convincing” standard of persuasion requires a quantum of evidence that makes the issue of fact “highly probable”. While the Court in that case deferred to the trial court’s ruling, it did so upon determining that “the evidence is closely conflicting or equally balanced”, citing *Hovila v. Bartek*, 48 Wn.2d 238, 241, 292 P.2d 877 (1956).

In this case, where the issue involves an issue of presumptive fraud and claims of ethical transgression, the evidence must be weighed not only by the onerous burden of persuasion that makes the proposition “highly probable”, but the obligation to “document” that proof. *In Re Ocean Shores Park*, 132 Wn. App. 903, 911-912, 134 P.3d 1188 (2006).

Documentary evidence of compliance with the burdens imposed by the Rules of Professional Conduct is ‘substantial’ evidence, which must be of record to sustain the challenged finding. As noted succinctly in *In re Sego*, 82 Wn.2d 736, 739, 513 P.2d 831 (1973):

Evidence that may be sufficiently 'substantial' to support an ultimate fact in issue based upon a 'preponderance of the evidence' may not be sufficient to support an ultimate fact in issue, proof of which must be established by clear, cogent and convincing evidence. Thus, the question to be resolved is not merely whether there is 'substantial evidence' to support the trial court's ultimate determination of the factual issue but whether there is 'substantial evidence' to support such findings in light of the 'highly probable' test. (citation omitted).

In the absence of substantial evidence, a finding of a material fact by 'clear, cogent and convincing' evidence must be set aside. *Merriman v. Cokeley, per curiam*, 83700-7 (Wn. S.Ct, April, 2010).

The "documentation" before the trial court established that, more likely than not, no meeting with Mr. Rose was held in which the alleged conversation about 'independent counsel' occurred. There was no calendar of such a meeting, no notes of such a meeting, no time record of such a meeting, no confirming correspondence of such a meeting, and Mr. Rose denied that it occurred. Oral testimony, unsupported and even controverted by the absence of support in the records customarily kept by the Firm in its ordinary course of business, and controverted by the only other person allegedly present, did not approach the requisite level. The evidence at trial shows that it was "highly probable" that the meeting did *not* occur, and the trial court's determination to the contrary is erroneous. If the trial court's finding of alleged disclosure is allowed to stand, it

renders any judicial review meaningless, and substitutes a '*per se*' standard in its stead.

CONCLUSION

The Firm made a conscious decision to transact business with an existing client, Valley. That course of action is not *per se* unreasonable. It is, however, so untrustworthy that it is deemed to be presumptively fraudulent. It is incumbent upon the Firm to prove that it fulfilled the ethical burdens imposed upon it to avoid the consequence of invalidation if it did not do so. *Valley, supra*.

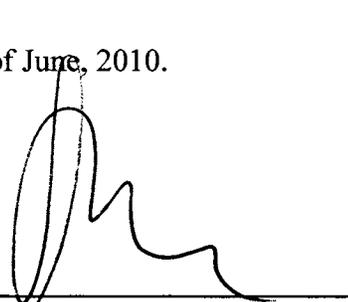
The essence of its responsibilities to its clients is embedded in an obligation of full disclosure. RPC 1.7 imposes a duty of disclosure, which is distinct from the burden of disclosure which is also imposed by RPC 1.8. The Firm failed to fulfill its obligations to Valley imposed by each of those rules.

The terms upon which it acquired an interest in Valley's property were unfair and unreasonable. The trial court, if it rejected the testimony of Valley's expert for want of adequate foundation, erred. If it weighed and rejected that testimony, it erred by imposing a standard that is impossible to fulfill: a 'disinterested attorney' must have the same personal knowledge as that of the 'interested' attorney.

The Firm failed in meeting the stringent burden of proof imposed upon it, and the 'substantial evidence' before the trial court did not establish that any referral of Valley had occurred under the 'clear, cogent and convincing' standard.

The Judgment in favor of the Firm must be reversed, and Judgment entered in favor of Valley, together with an award of fees and costs.

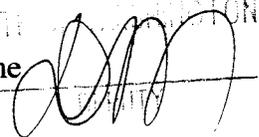
Respectfully submitted this 3rd day of June, 2010.

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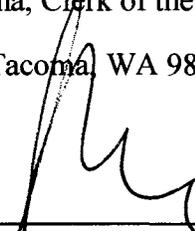
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CERTIFICATE OF SERVICE

I, Steven B. Tubbs, certify that I hand delivered a copy of the above Brief of Appellant to Mr. James Hamilton, Attorney for Respondents Morse and Bratt, at 201 NE Park Plaza Dr. Suite 285, Vancouver, WA 98684-5881; and deposited the original and one copy in the US Mail, postage prepaid, to David C. Ponzoha, Clerk of the Court of Appeals, Division II, 950 Broadway, Suite 300, Tacoma, WA 98402-4454, on the 3rd day of June, 2010.



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EXHIBIT A

RPC 1.7

CONFLICT OF INTEREST; GENERAL RULE.

(b) a lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:

(1) The lawyer reasonably believes the representation will not be adversely affected; and

(2) The client consents in writing after consultation and a full disclosure of the material facts (following authorization from the other client to make such a disclosure). When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

EXHIBIT B

RPC RULE 1.8

CONFLICT OF INTEREST; PROHIBITED TRANSACTIONS;

CURRENT CLIENT

A lawyer who is representing a client in a matter:

(a) 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 thereto.