



Legal Ethics

Ethics Opinions

LEGAL ETHICS

OPINION 1985-2

It is ethically proper for an attorney who advances costs in litigation to provide in the contingent fee agreement that costs will be recoverable only out of a judgment or settlement.

QUESTION:

Attorney is representing client in a personal injury case on a contingent fee basis. Client's financial status is such that it is virtually certain that he would be unable to reimburse attorney for costs advanced in connection with the litigation. Under such circumstances, it is attorney's practice not to attempt to collect from a client costs advanced for litigation expenses. Client has requested that the contingent fee contract contain an express provision that costs will be recoverable by the attorney only in the event of a favorable settlement or judgment. Attorney has asked whether the inclusion of such a provision in the contingent fee contract is ethically permissible.

DISCUSSION

(A) INTRODUCTION

Preliminarily, it should be noted that section 6147 of the Business & Professions Code requires that all contingent fee contracts be in writing, that the plaintiff or his representative receive a copy of such contract, and that the contract, at a minimum, include five specified provisions. Failure to comply with any provision of section 6147 renders the contract voidable at the option of the client, leaving the attorney to a quantum meruit recovery. With respect to costs, section 6147(a)(2) provides that the contract shall include "A statement as to how disbursements and costs incurred in connection with the prosecution or settlement of the claim will affect the contingent fee and the client's recovery." [1]

(B) RELEVANT CODE PROVISIONS

Rule 5-104 of the California Rules of Professional Conduct provides in part, that:

"(A) A member of the State Bar shall not directly or indirectly pay or agree to pay, guarantee, or represent or sanction the representation that he will pay personal or business expenses incurred by or for a client, prospective or existing and shall not prior to his employment enter into any discussion or other communication with a prospective client regarding any such payments or agreements to pay; provided this rule shall not prohibit a member:

1. with the consent of the client, from paying or agreeing to pay to third persons such expenses from funds collected or to be collected for the client; or
2. after he has been employed, from lending money to his client upon the client's promise to repay such a loan; or
3. from advancing the costs of prosecuting or defending a claim or action or otherwise protecting or promoting the client's interest. Such costs within the meaning of this subparagraph (3) shall be limited to all reasonable expenses of litigation or reasonable expenses in preparation for litigation or in providing any legal services to the client.

Rule 5-104 was derived from former rule 3a, which provided that:

"Any member of the State Bar shall not directly or indirectly pay or agree to pay, or represent or sanction the representation that he will pay medical, hospital or nursing bills or other personal expenses incurred by or for a client, prospective or existing; provided this rule shall not prohibit a member

1. with the consent of the client, from paying or agreeing to pay to third persons such expenses from funds collected or to be collected for the client; or

2. after he has been employed, from lending money to his client upon the client's promise in writing to repay such loan; or
3. from advancing the costs of prosecuting or defending a claim or action. Such costs within the meaning of this subparagraph (3) include all taxable costs or disbursements, costs of investigation and costs of obtaining and presenting evidence."

In dramatic contrast to California rule 5-104 and its predecessor, disciplinary rule 5-103(B) of the ABA Code of Professional Responsibility provides that:

"While representing a client in connection with contemplated or pending litigation, a lawyer shall not advance or guarantee financial assistance to his client, except that a lawyer may advance or guarantee the expenses of litigation, including court costs, expenses or investigation, expenses or medical examination, and costs of obtaining and presenting evidence, provided the client remains ultimately liable for such expenses." (Emphasis added).

Disciplinary rule 5-103(B) was derived from former Canon 42 of the ABA Canon of Ethics, which provided that:

"Expenses of Litigation. A lawyer may not properly agree with a client that the lawyer shall pay or bear the expenses of litigation; he may in good faith advance expenses as a matter of convenience, but subject to reimbursement."

In short, both the present and former ABA rules clearly and specifically prohibit an attorney from agreeing to bear the costs and expenses of litigation in the event there is no recovery for the client. Both the present and former California rules are silent on the issue of ultimate liability. The recently adopted ABA Model Rules of Professional Conduct provide in rule 1.8(e) that:

"A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that: (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and (2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client."

In summary, then, there are two significant differences between the ABA Code provisions and the California Rules of Professional Conduct. First, the ABA Code precludes any financial assistance except the advancement of costs; the California Rules allow financial assistance in the form of loans to the client. Second, the ABA Code requires that the client be ultimately responsible for payment of costs advanced by the lawyer; the California Rules are silent on the matter. And, as noted, the new Model Rules continue the prohibition on financial assistance other than the advancement of costs but allow the attorney to make reimbursement of those costs contingent upon a successful outcome.

(C) AUTHORITY

Several ethics opinions deal with the question presented. In Formal Opinion No. 1976-38, issued by the Standing Committee on Professional Responsibility and Conduct of the State Bar (COPRAC), it was held that:

"Compliance with the existing rule 5-104 of the Rules of Professional Conduct, therefore, involves as an essential element, that the client is obligated to repay the advanced costs and the client must be informed of his liability to reimburse the client."

COPRAC, however, went on to state:

"Nothing in the rule, however, requires the attorney to attempt to evaluate his client's prospective ability to pay such costs in the event that the lawsuit involved is unsuccessful. Nor does the rule require any initial decision by the attorney as to whether, or under what circumstances, he would be willing to sue his client for such costs, should the client fail to pay them."

In support of its conclusion, COPRAC cited three opinions issued by the Committee on Legal Ethics of the Los Angeles County Bar Association [\[2\]](#) and Disciplinary Rule 5-103(B) (and the corresponding Ethical Consideration, 5-8) of the ABA Code of Professional Responsibility.

In the opinion of the Committee the conclusion arrived at in Opinion 1976-38 is not supported by the authorities cited by COPRAC. In light of the dramatic differences in the language of DR 5-103(B) and rule 5-104(A)(3), it seems clear that a rule flatly prohibiting a lawyer from absorbing costs of unsuccessful litigation in no way supports a similar reading of a rule that is silent on the matter. Given the absence of any analysis in Opinion 1976-38, its citation of the ABA Code is not persuasive.

Nor, in the opinion of the Committee, is the citation to the Los Angeles County Bar Association opinions conclusive. It is true that in each of those opinions, the Legal Ethics Committee held that the client must be ultimately responsible for costs. It is, however, also true that in each of those opinions the Committee relied on Canon 42 of the Canons of Ethics and made no reference to either former rule 3a or present rule 5-103(B). (It should be noted that rule 5-103(B) was not adopted until December 31, 1974). In short, the continuing validity of the Los Angeles County Opinions rests on the assumption that the difference in language between the Canons of Ethics and the California rules is meaningless. It is the opinion of this Committee that assumption is unwarranted. Consequently, we treat the question not as one controlled by precedent, but as one of statutory interpretation.

(D) ANALYSIS

First, looking to the language of the rule, a lawyer in California is not precluded from "advancing the costs of prosecuting or defending a claim or action." Certainly, the concept of an "advance" is distinguishable from the concept of a gift. In the latter case, the donor anticipates receiving nothing in return; in the former case, the person advancing funds expects to receive something in return. Put it does not follow that an "advance" implies an absolute obligation to repay. Advances to authors, for example, are typically not recoverable by publishers and simply represent a non-refundable portion of royalties that may or may not ever be earned. Similarly, it does not strain the meaning of "advance" in the context of litigation to read it as requiring repayment out of a recovery and only to the extent that there is a recovery.

Second, unlike the ABA Code which precludes any other financial assistance, the California rule does allow a lawyer to lend money to his client. But in that situation the lawyer must obtain "the client's promise in writing to repay such loan." A requirement that specific financial assistance be repaid (and that the promise to do so be in writing) strongly suggests that repayment of other financial assistance allowed by the rule is properly a matter of negotiation between lawyer and client.

Third, it is clear that at the time of the enactment of former rule 3a, the California Supreme Court was aware of Canon 42, and at the time of the enactment of rule 5-104, the Court was aware of the existence of Disciplinary Rule 5-103 (B) of the ABA Code. The failure to include in either California rule a requirement of ultimate liability on the part of the client seems deliberate and, in our view, supports an interpretation that would allow this to be a matter of negotiation between attorney and client.

Moreover, as a matter of policy, the historical reasons for rules prohibiting lawyers from financing litigation seem much less persuasive today. Historically, such prohibition was based on common law doctrines of maintenance and champerty, both of which reflected a suspicion of and distaste for litigation as such. Certainly today, the assertion of one's rights in litigation is hardly viewed as an evil indeed, that fact is dramatically illustrated by the recent series of decisions relating to attorney advertising and solicitation as well as the above provisions of rule 5-104. And to the extent that these rules are designed to assure the preservation of independent judgment, on the part of the lawyer, it is difficult to see how an agreement to bear costs in the event of an unfavorable result will compromise an attorney's judgment significantly more than the agreement to work for nothing, or the agreement to lend a client living expenses based on a promise that is, in many cases, valueless unless the case is brought to a successful conclusion.

The Committee is also disturbed by an interpretation - not compelled by the language of the rule - that encourages disingenuous behavior. It is common knowledge that lawyers simply do not enforce their "right" to reimbursement against impecunious clients [3]. To persist in an interpretation which is, in reality, completely disregarded by most attorneys does not, in our view, encourage respect for the rules or compliance with high ethical standards.

We note that our opinion is supported by the recent case of *Kroff v. Larson* (1985) 167 Cal.App.3d 857. In *Kroff*, plaintiff attorney (Kroff) entered into a contingent fee contract with defendant which provided in part, that "costs advanced will be reimbursed to attorney out of the gross recovery on behalf of client." (Emphasis in original.) When plaintiff was discharged by his client, he brought suit for reimbursement of approximately \$700 he had advanced in costs. In affirming the trial court's sustaining of defendant's demurrer, the appellate court held the action premature, as the contingency-the recovery on behalf of the client-had not occurred. The court specifically rejected plaintiff's contention that recovery of costs be treated differently than quantum meruit recovery of fees. Implicit in the *Kroff* court's holding is its acceptance of the validity of the cited contractual provision.

For all the foregoing reasons, it is the opinion of the Committee that the provision in a contingent fee contract making recovery of costs advanced by the lawyer contingent upon the successful outcome of the litigation, is ethically proper and is permissible under California Rule of Professional Conduct 5-104. To the extent that this opinion is inconsistent with Informal Opinion 1974-4, issued by the Committee, that opinion is disapproved.

Nevertheless, the Committee recommends that this matter be clarified by an amendment to the rule similar to Model Rule 1.8 of the ABA Rules of Professional Conduct.

Finally, the Committee wishes to point out several issues that should be considered by attorneys who agree to bear costs. First, any dollar limitation should, of course, be specifically provided for. Second, the contract should make clear that costs or attorneys' fees awarded to one's adversary are not included in the attorney's undertaking. Finally, any "communication" made pursuant to California Rule of Professional Conduct 2-101 should be carefully drafted to insure that it is not misleading or deceptive.

Footnotes:

1. For purposes of this opinion, "costs" are defined as out of pocket expenses incurred on behalf of the client in the prosecution of an action. They would include such things as expert witness fees, costs of discovery, filing fees, witness fees, transportation expenses, and the like. Again, for purposes of this opinion, "costs" do not include costs assessed against the client in the event of an unsuccessful outcome, nor do they include attorneys fees assessed against the client pursuant to any statutory or common law fee-shifting provision. The Committee strongly urges that attorneys who agree to bear the costs of litigation make clear precisely which "costs" are included in their undertaking.
2. It should be noted that these opinions were promulgated prior to the enactment of the present Rules of Professional Conduct.
3. Interestingly, the suggested form in Deering's Annotated Code is a nineteen paragraph contract, paragraph 15 of which reads as follows: "In the event no recovery is obtained on the claim that compromises (sic) the subject matter of this agreement, the attorney will make no charges for his time, services, fees, costs, or other expenses that he may have advanced ." (Emphasis added.)

All opinions of the Committee are subject to the following disclaimer:

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