THE BAR ASSOCIATION OF SAN FRANCISCO

Legal Ethics
Ethics Opinions

OPINION 1997-1

An attorney need not comply with Rule 3 300 of the Rules of Professional Conduct in the negotiation of any fee arrangements with a client concerning the current or future representation unless the attorney acquires an ownership, possessory, security, or other pecuniary interest adverse to the client. In the event the attorney/client relationship has already begun, the attorney must comply with all appropriate fiduciary obligations.

ISSUE:

Under what circumstances must an attorney comply with Rule 3-300 of the California Rules of Professional Conduct when entering into or changing the terms of a fee agreement with a client?

DIGEST:

An attorney need not comply with Rule 3-300 of the Rules of Professional Conduct in the negotiation of any fee arrangements with a client concerning the current or future representation unless the attorney acquires an ownership, possessory, security, or other pecuniary interest adverse to the client. In the event the attorney/client relationship has already begun, the attorney must comply with all appropriate fiduciary obligations.

AUTHORITIES INTERPRETED:

California Rules of Professional Conduct, Rule 3-300; COPRAC Opinion 1981-62

DISCUSSION

California Rules of Professional Conduct, Rule 3-300 proscribes a member from entering into a business transaction with a client or acquiring an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

A. The transaction or agreement must be in writing, fair and reasonable to the client, reasonably understood by the client;

B. The client must be given written notice of the right to seek independent legal advice and given a reasonable opportunity to do so; and,

C .The client must consent in writing.

In this opinion, we evaluate the applicability of this rule as it relates to attorney fee agreements which contain provisions giving the attorney some form of security for payment of legal fees. The purpose of Rule 3-300 is to prohibit an attorney from acquiring an interest adverse to a client without giving the client appropriate warnings. Thus, if the fee agreement gives the attorney an ownership, possessory, security, or other pecuniary interest where it is reasonably foreseeable that the attorney's interest may become detrimental, i.e. adverse to the client, Rule 3-300 applies.

Rule 3-300 is inapplicable to the extent a security interest is given the attorney for payment of legal fees by someone on behalf of the client. A contractual provision in a fee agreement which provides for an attorney's lien for fees and costs against the proceeds or assets recovered by the client arising out of the attorney's efforts is permissible, e.g. Haupt v. Charlie's Kosher Market (1941) 17 Cal.2d 843 (a contractual nonpossessory lien in a contingency fee matter) and Cetenko v. United California Bank (1982) 30 Cal.3d 528 (a contractual non-possessory lien in an hourly fee agreement). Neither of these cases discussed the applicability of Rule 3-300 in upholding the validity of a contractual nonpossessory lien and the committee has found no cases which have applied Rule 3-300 in such situations.

Is an attorney's contractual non-possessory lien a "pecuniary interest adverse to a client' as that phrase is used in Rule 3-300? Cases in which predecessors to Rule 3-300, i.e. Rule 5-101 and Rule 4 have been found applicable are collected in Hawk v. State Bar (1988) 45 Cal.3d 589 [a case which involved the attorney obtaining a promissory note secured by a deed of trust] and include situations in which an attorney: i) obtained

a loan from the client in lieu of fees; ii) obtained a non-recourse interest in a company indebted to a client; iii) entered into an arrangement whereby the attorney profits from the success of an obligor of his client but is not personally liable for any default on the obligation; iv) took a fee by accepting an assignment of a note secured by a deed of trust which was one of the assets of the estate he was to probate for the client and caused an execution to be levied on the note without notice to the client; v) obtained an interest in real property of a client where it was reasonably foreseeable that his acquisition may become detrimental to the client; vi) obtained an order for attorney fees in a domestic relations matter, then obtained a writ of execution and levied against husband's real property (the only asset owned by husband) instead of protecting his client's rights to satisfy her judgement against the husband; and, vii) obtained a confession of judgement from the client.

As the Hawk court said, "acquiring the ability to summarily extinguish the client's interest in property is what makes the acquisition adverse" and the attorney must comply with the requirements of the Rule. The Hawk Court, at page 600, citing Hulland v. State Bar (1972) 8 Cal.3d 440, 450, goes on to say that "An unsecured promissory note, by contrast, gives an attorney only a right to proceed against the client's assets in a contested judicial proceeding at which the client may dispute the indebtedness. The note allows the attorney to obtain a judgement, and to seek to enforce the judgement against the client's assets, if any. It does not give the attorney a *present* interest in the client's property which the attorney can summarily realize." The Hawk Court did not mention COPRAC Opinion 1981-62 which held that an attorney could take a promissory note from the client as security for fees, both at the outset or after commencement of the professional relationship, provided however, the attorney complied with Rule 5-101 (predecessor to Rule 3-300).

The above analysis leads us to the following conclusions. If the attorney obtains an interest in property which allows the attorney to extinguish the client's interests in the property, *without judicial scrutiny,* Rule 3-300 applies. If the property interest obtained by the attorney is subject to judicial scrutiny then the mandates of Rule 3-300 are not required. Thus, a simple unsecured promissory note, an attorney's contractual lien, or any other ownership, possessory, security, or other pecuniary interest acquired by the attorney securing payment of attorney's fees entered into with a client, *which is subject to judicial scrutiny* prior to the ability of the attorney to enforce [or take advantage of] the ownership, possessory, security, or other pecuniary interest, does not trigger the application of Rule 3-300.

QUESTIONS/ANSWERS

1. Would a fee agreement entered into with a client containing a clause giving the attorney a lien on the proceeds or assets recovered by the attorney trigger the application of the rule? No, the attorney cannot extinguish the client's interest in that property without being subject to judicial scrutiny.
2. Would a fee agreement entered into with a corporate client, containing a clause whereby a major shareholder/officer where required to give a "personal guarantee" that the attorney fees incurred by the entity would be paid, trigger the application of the rule? No, because the guarantor is not a client and even if he were, the answer to 1. above applies.

   A. Would the result be different if the client were a partnership? No.

   B. Would the result be different if the "guarantor" were not a principal, e.g. a friend, parent, someone with assets? No.
3. Would a fee agreement entered into with a client containing a clause requiring the client to deposit funds/assets as security for payment of fees trigger the application of the rule? No, however, the funds/assets would be held by the attorney as trustee and be subject to Rules of Professional Conduct Rule 4-100.
4. What if the attorney where to obtain a self executing security interest such as a promissory note secured by a deed of trust, or a signed vehicle "pink slip," or a signed check in blank amount? etc. Yes, Rule 3-300 would be applicable because the attorney would be able to "self execute" without judicial scrutiny.
5. Would the answer to any of the above be different if the agreement granting the attorney a security for fees were entered into after the formation of the attorney/client relationship commenced with respect to the current engagement? It is not clear if Rule 3-300 applies. However, even if it does not there are other considerations that a member must evaluate which are set forth in the following endnote.

CONCLUSION

After the attorney/client relationship is formed the attorney assumes, and owes to his client, the exercise of the highest good faith and any fee arrangement entered into subsequent to the formation of the relationship is measured by that standard, see Rader v. Thrasher (supra) and cases cited therein. However, as discussed

below, the evidentiary presumption dealing with burden of proof issues in a fee context is not governed by the usual fiduciary relationship rules.

As the Official Discussion the Rule indicates, the applicability of the Rule 3-300 is intended to cover past due or future fees. In addition, as pointed out in Walton v. Broglio (1975) 52 Cal.App.3d 400 there is no presumption of undue influence in fee dealings post commencement of a professional relationship. The Walton Court, citing the predecessor to Calif. Probate Code § 16004(c), Calif. Civil Code § 2235, indicated that "A transaction between the trustee and a beneficiary which occurs during the existence of the trust or while the trustee's influence with the beneficiary remains and by which the trustee obtains an advantage from the beneficiary is presumed to be a violation of the trustee's fiduciary duties. This presumption is a presumption affecting the burden of proof. This subdivision does not apply to the provisions of an agreement between the trustee and a beneficiary relating to hiring or compensation of the trustee." Thus, the attorney does not have the burden of proving the absence of undue influence in a fee agreement entered into with a client after commencement of the relationship. Prior to the amendment to Civil Code § 2235 in 1973 which added, in substance, the above quoted language, there were two presumptions which arose when an attorney entered into a contract with a client for his fee while the relationship of attorney and client existed: i) the client entered into the contract under undue influence; and, ii) without sufficient consideration, so that the burden of going forward with proof to rebut both of these presumptions was cast upon the attorney. See Rader V.Thrasher (1962) 57 Cal.2d 244. These presumptions concerning burden of proof no longer apply. However, the attorney's obligations to his/her client based upon the fiduciary relationship remain and any fee agreement is subject to being measured by those standards, e.g., Ramirez v. Sturdevant (1994) 21 Cal.App4th 904; Blattman v. Gadd (1931) 112 Cal.App. 76; and also see COPRAC Formal Opinion No. 1989-116 Section E; Tri-Growth Centre City, Ltd. v. Silldorf, Burdman, Duignan & Eisenberg et al. (1989) 216 Cal.App.3d 1139 and David Welch Co., v. Erskine & Tulley et al. (1988) 203 Cal.App.3d 884.

The rules, e.g. Rules 3-700(D), 4-100, 4-400, and Bus. & Prof. Code Sections 6146-6149.5 and 6200-6206 governing attorney fee agreement issues apply equally both before and after the attorney/client relationship is formed. However, after the attorney/client is formed a fiduciary relationship comes into existence which imposes upon the attorney a higher standard or degree of responsibility to the client. For example, if there is a possible conflict of interest between the parties in resolving the application of the terms of the agreement (e.g. in disbursing funds received in settlement negotiations), the attorney has the burden of proving that the proposed distribution is fair and reasonable to the client (the attorney has the burden of proving that the allocation does not violate his/her fiduciary duty [Evid. Code § 606]). Also, it is the duty of an attorney to exercise the utmost good faith. Thus, before entering into a new fee agreement, or changing an existing fee agreement, the attorney must make a full and complete disclosure to the client of all relevant factors relating to the proposed fee agreement. As Rule 3-500 provides, the attorney shall keep the client reasonably informed of significant developments and that would include explaining the financial terms and, if necessary or appropriate, the need for the client's obtaining independent financial advice.
