RE: Rule 1.8.1 [3-300]
12/11&12/09 Commission Meeting
Open Session Agenda Item V.B.

McCurdy, Lauren

From: Kevin Mohr [kemohr@charter.net]
Sent: Monday, December 07, 2009 7:28 PM
To: Marlaud, Angela; Hollins, Audrey; Dominique Snyder; Ellen Peck; Harry Sondheim; Ignazio J. Ruvolo; Jerome Sapiro; JoElla L. Julien; Kevin Mohr; Kevin Mohr; Kurt Melchior; McCurdy, Lauren; Lee, Mimi; Linda Foy; Mark Tuft; Paul Vapnek; Difuntorum, Randall; Raul Martinez; Robert L. Kehr; Stan Lamport
Subject: RRC - 1.8.1 [3-300] - V.B. - E-mail Compilations & SWL's Proposed Changes to 1.8.1 [#14] & 1.5 [#10]
Attachments: RRC - 3-300 [1-8-1] - E-mails, etc. - LONG - REV (12-08-09)-EXC.pdf; RRC - 4-200 [1-5] - Rule - DFT10 (12-06-09) - Cf. to DFT9.pdf; RRC - 3-300 [1-8-1] - Rule - DFT14 (12-06-09) - Cf. to DFT13.pdf

Greetings:

I've attached an e-mail compilation for 1.8.1, as well as Stan's proposed revisions to 1.8.1, Draft 14 (12/6/09) and 1.5, Draft 10 (12/6/09). All in PDF.

The latter two documents are redline versions showing changes to version submitted to BOG w/ the November 14, 2009 submission.

Please let me know if you have any questions. Thanks,

Kevin

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Kevin E. Mohr
Professor
Western State University College of Law
1111 N. State College Blvd.
Fullerton, CA 92831
714-459-1147
714-738-1000 x1147
714-525-2786 (FAX)
kevin_e_mohr@compuserve.com
kevinm@wsulaw.edu

Rule 1.8.1 Business Transactions with a Client and Acquiring Interests Adverse to the Client

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 each of the following requirements has been satisfied:

(a) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner that reasonably can be understood by the client; and

(b) The client either is represented in the transaction or acquisition by an independent lawyer of the client's choice or is advised in writing by the lawyer to seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(c) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition and the lawyer's role in the transaction or acquisition, including whether the lawyer is representing the client in the transaction or acquisition.

COMMENT

Scope of Rule

[1] A lawyer's legal training and skill, and the relationship of trust and confidence that arises between a lawyer and client, create the possibility that a lawyer, even unintentionally, will overreach or exploit client information when the lawyer enters into a business transaction with the client or acquires a pecuniary interest adverse to the client. In these situations, the lawyer could influence the client for the lawyer's own benefit, could give advice to protect the lawyer's interest rather that the client's, and could use client information for the lawyer's benefit rather than the client's. This Rule is intended to afford the client the information needed to fully understand the terms and effect of the transaction or acquisition and the importance of having independent legal advice. (See, e.g., *Beery v. State Bar* (1987) 43 Cal.3d 802, 813 [239 Cal.Rptr. 121].) This Rule also requires that the transaction or acquisition be fair and reasonable to the client.

[2] Except as set forth in Comment [5], this Rule does not apply when a lawyer enters into a transaction with or acquires a pecuniary interest adverse to a client prior to the commencement of a lawyer-client relationship with the client. However, when a lawyer's interest in the transaction or in the adverse pecuniary interest results in the lawyer having a legal, business, financial or professional interest in the subject matter in which the lawyer is representing the client, the lawyer is required to comply with Rule 1.7(d)(4) [Rule 3-310(B)(4)].

Business Transactions With Clients

[3] This Rule applies even when the transaction is not related to the subject matter of the representation, as when a lawyer drafting a will for a client agrees to make a loan to the client to pay expenses that are not related to the representation. This Rule also applies when a lawyer sells to a client goods or non-legal services that are related to the practice of law, such as insurance, brokerage or investment products or services to a client.

[4] This Rule does not apply to standard commercial transactions for products or services that a lawyer acquires from a client on the same terms that the client generally markets them to others, where the lawyer has no advantage in dealing with the client, and the requirements of the Rule are unnecessary and impractical. Examples of such products and services include banking and brokerage services, medical services, products manufactured or distributed by the client, and utilities' services. The Rule also does not apply to similar types of standard commercial transactions for goods or services offered by a lawyer when the lawyer has no advantage in dealing with the clients, such as when a client purchases a meal at a restaurant owned by the lawyer or when the client pays for parking in a parking lot owned by the lawyer. This Rule also ordinarily would not apply where the lawyer and client each make an investment on terms offered to the general public or a significant portion thereof as when, for example, a lawyer invests in a limited partnership syndicated by a third party, and the lawyer's client makes the same investment on the same terms. When a lawyer and a client each invest in the same business on the same terms offered to the public or a significant portion thereof, and the lawyer does not advise, influence or solicit the client with respect to the transaction, the lawyer does not enter into the transaction "with" the client for purposes of this Rule.

[5] This Rule is not intended to apply to an agreement by which a lawyer is retained by a client or to the modification of such an agreement, unless the agreement or modification confers on the lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client, such as when the lawyer obtains an interest in the client's property to secure the amount of the lawyer's past due or future fees. An agreement by which a lawyer is retained by a client and modifications to such agreements are governed, in part, by Rule 1.5 [Rule 4-200]. Even when this Rule does not apply to the negotiation of the agreement by which a lawyer is retained by a client, other fiduciary principles might apply.

[6] An agreement to advance to or deposit with a lawyer a sum to be applied to fees or costs incurred in the future is not an ownership, possessory, security, or other pecuniary interest adverse to the client for purposes of this Rule. This Rule is not intended to apply to an agreement with a client for a contingent fee in a civil case.

~~[6] In general, the negotiation of an agreement by which a lawyer is retained by a client is an arms-length transaction. *Setzer v. Robinson* (1962) 57 Cal.2d 213 [18 Cal.Rptr. 524]. However, even when this Rule does not apply to the negotiation of the agreement by which a lawyer is retained by a client, other fiduciary principles might~~

~~apply. Once a lawyer-client relationship has been established, the lawyer owes fiduciary duties to the client that apply to the modification of the agreement. Lawyers should consult case law and ethics opinions to ascertain their professional responsibilities with respect to modifications to an agreement by which a client retains a lawyer's services. (See, e.g., *Ramirez v. Sturdevant* (1994) 21 Cal.App.4th 904, 913 [26 Cal.Rptr.2d 554]; *Berk v. Twentynine Palms Ranchos, Inc.* (1962) 201 Cal.App.2d 625 [20 Cal.Rptr. 144]; *Carlson, Collins, Gordon & Bold v. Banducci* (1967) 257 Cal.App.2d 212 [64 Cal.Rptr. 915].)~~

Adverse Pecuniary Interests

[7] An ownership, possessory, security or other pecuniary interest adverse to a client arises when a lawyer acquires an interest in a client's property that is or may become detrimental to the client, even when the lawyer's intent is to aid the client. *Hawk v. State Bar* (1988) 45 Cal.3d 589 [247 Cal.Rptr. 599]. An adverse pecuniary interest arises, for example, when the lawyer's personal financial interest conflicts with the client's interest in the property; when a lawyer obtains an interest in a cause of action or subject matter of litigation or other matter the lawyer is conducting for the client; or when the interest can be used to summarily extinguish the client's interest in the client's property. (See *Fletcher v. Davis* (2004) 33 Cal.4th 61 [14 Cal.Rptr.3d 58].) An adverse pecuniary interest also arises when a lawyer acquires an interest in an obligation owed to a client or acquires an interest in an entity indebted to a client. (See *Rodgers v. State B*ar (1989) 48 Cal.3d 300 [256 Cal.Rptr. 381]; *Kapelus v. State Bar* (1987) 44 Cal.3d 179 [242 Cal.Rptr. 196].)

Full Disclosure to the Client

[8] Paragraph (a) requires that full disclosure be transmitted to the client in writing in a manner that reasonably can be understood by the client. Whether the disclosure reasonably can be understood by the client is based on what is objectively reasonable under the circumstances.

[9] Full disclosure under Paragraph (a) requires a lawyer to provide the client with the same advice regarding the transaction or acquisition that the lawyer would provide to the client in a transaction with a third party. *Beery v. State Bar* (1987) 43 Cal.3d 802 [239 Cal.Rptr. 121]. It requires a lawyer to inform the client of all of the terms and all relevant facts of the transaction or acquisition, including the nature and extent of the lawyer's role and compensation in connection the transaction or acquisition. It also requires the lawyer to fully inform the client of risks of the transaction or acquisition and facts that might discourage the client from engaging in the transaction or acquisition. (See *Rodgers v. State Bar* (1989) 48 Cal.3d 300 [256 Cal.Rptr. 381]; *Clancy v. State Bar* (1969) 71 Cal.2d 140 [77 Cal.Rptr. 657]; *Brockway v. State Bar* (1991) 53 Cal.3d 51 [278 Cal.Rptr. 836].) Except in a disciplinary proceeding, the burden is always on the lawyer to show that the transaction or acquisition and its terms were fair and just and that the client was fully advised. *Felton v. Le Breton* (1891) 92 Cal. 457, 469 [28 P. 490, 494].

[10] The risk to a client is heightened when the client expects the lawyer to represent the client in the transaction or acquisition itself. Under this Rule, the lawyer must disclose the risks associated with the lawyer's dual role as both legal adviser and participant in the transaction or acquisition, such as the risk that the lawyer will structure the transaction or acquisition or give legal advice in a way that favors the lawyer's interests at the expense of the client. Because the lawyer has an interest in the transaction or acquisition, the lawyer must also comply with Rule 1.7(d). In some cases, the lawyer's interest may be such that Rule 1.7 will preclude the lawyer from representing the client in the transaction or acquisition.

[11] There are additional considerations when the lawyer-client relationship will continue after the transaction or acquisition. For example, if the lawyer and the client enter into a transaction to form or acquire a business, the client might expect the lawyer to represent the business or the client with respect to the business after the transaction is completed. When the lawyer knows or reasonably should know that the client expects the lawyer to represent the business or the client with respect to the business or interest after the transaction or acquisition is completed, the lawyer must act in either of two ways. Before entering into the transaction or making the acquisition, the lawyer must either (i) inform the client that the lawyer will not represent the business, or the client with respect to the business or interest, and must then act accordingly; or (ii) disclose in writing the risks associated with the lawyer's dual role as both legal adviser and participant in the business or owner of the interest. The client consent requirement in paragraph (c) includes a requirement that the client consent to the risks to the lawyer's representation of the client, which the lawyer has disclosed to the client as required by this Rule. A lawyer must also comply with the requirements of Rule 1.7(d) when the lawyer has an interest in the subject matter of the representation as a result of the transaction or acquisition.

[12] Even when the lawyer does not represent the client in the transaction or acquisition, there may be circumstances when the lawyer's interest in the transaction or acquisition may interfere with the lawyer's independent professional judgment or faithful representation of the client in another matter. When the lawyer's interest in the transaction or acquisition may interfere with the lawyer's independent professional judgment or faithful representation of the client, the lawyer must also disclose in writing the potential adverse effect on the lawyer-client relationship that may result from the lawyer's interest in the transaction or acquisition and must obtain the client's consent under paragraph (c). A lawyer must also comply with the requirements of Rule 1.7(d) when the lawyer has an interest in the subject matter of the representation as a result of the transaction or acquisition.

Full Disclosure and Consent
Opportunity to Seek Advice of Independent Counsel

[13] Under paragraph (b), a lawyer must encourage the client to seek the advice of an independent lawyer and may not imply that obtaining the advice of an independent

lawyer is unnecessary. An independent lawyer is a lawyer who (i) does not have a financial interest in the transaction or acquisition, (ii) does not have a close legal, business, financial, professional or personal relationship with the lawyer seeking the client's consent, and (iii) represents the client with respect to the transaction or acquisition.

[14] A lawyer is not required to advise the client to seek the advice of independent counsel if the client already has independent counsel with respect to the transaction or acquisition; however, the lawyer must still afford the client a reasonable opportunity to seek the advice of the independent counsel. A lawyer is not required to provide legal advice to a client who is represented by independent counsel; however, the lawyer is still required under paragraph (a) to make full disclosure to the client in writing of all material facts related to the transaction or acquisition when the lawyer knows or reasonably should know that the client has not been informed of such facts. The fact that the client was independently represented in the transaction or acquisition is relevant in determining whether the terms of the transaction or acquisition are fair and reasonable to the client as paragraph (a) requires.

Rule 1.5: Fees For Legal Services

(a) A lawyer shall not make an agreement for, charge, or collect an unconscionable or illegal fee or an unconscionable or illegal in-house expense.

(b) A fee is unconscionable under this Rule if it is so exorbitant and wholly disproportionate to the services performed as to shock the conscience; or if the lawyer, in negotiating or setting the fee, has engaged in fraudulent conduct or overreaching, so that the fee charged, under the circumstances, constitutes or would constitute an improper appropriation of the client's funds. Unconscionability of a fee shall be determined on the basis of all the facts and circumstances existing at the time the agreement is entered into except where the parties contemplate that the fee will be affected by later events.

(c) Among the factors to be considered, where appropriate, in determining the conscionability of a fee or in-house expense are the following:

(1) the amount of the fee or in-house expense in proportion to the value of the services performed;

(2) the relative sophistication of the lawyer and the client;

(3) the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

(4) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

(5) the amount involved and the results obtained;

(6) the time limitations imposed by the client or by the circumstances;

(7) the nature and length of the professional relationship with the client;

(8) the experience, reputation, and ability of the lawyer or lawyers performing the services;

(9) whether the fee is fixed or contingent;

(10) the time and labor required;

(11) whether the client gave informed consent to the fee or in-house expense.

(d) A lawyer shall not enter into an arrangement for, charge, or collect:

(1) any fee in a family law matter, the payment or amount of which is contingent upon the securing of a dissolution or declaration of nullity of a marriage or upon the amount of spousal or child support, or property settlement in lieu thereof; or

(2) a contingent fee for representing a defendant in a criminal case.

(e) A lawyer shall not make an agreement for, charge, or collect a non-refundable fee, except:

(1) a lawyer may charge a true retainer, which is a fee that a client pays to a lawyer to ensure the lawyer's availability to the client during a specified period or on a specified matter, in addition to and apart from any compensation for legal services performed. A true retainer must be agreed to in a writing signed by the client. Unless otherwise agreed, a true retainer is the lawyer's property on receipt.

(2) a lawyer may charge a flat fee for specified legal services, which constitutes complete payment for those services and may be paid in whole or in part in advance of the lawyer providing the services. If agreed to in advance in a writing signed by the client, a flat fee is the lawyer's property on receipt. The written fee agreement shall, in a manner that can easily be understood by the client, include the following: (i) the scope of the services to be provided; (ii) the total amount of the fee and the terms of payment; (iii) that the fee is the lawyer's property immediately on receipt; (iv) that the fee agreement does not alter the client's right to terminate the client-lawyer relationship; and (v) that the client may be entitled to a refund of a portion of the fee if the agreed-upon legal services have not been completed.

(f) A lawyer shall not modify an agreement by which the lawyer is retained by the client unless the client is either represented with respect to the modification by an independent lawyer or is advised in writing by the lawyer to seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice.

Comment

Unconscionability of Fee

[1] Paragraph (a) requires that lawyers charge fees that are not unconscionable or illegal under the circumstances. An illegal fee can result from a variety of circumstances, including when a lawyer renders services under a fee agreement that is unenforceable as illegal or against public policy, (e.g., *Kallen v. Delug* (1984) 157 Cal.App.3d 940, 950-951 [203 Cal.Rptr. 879] [fee agreement with other lawyer entered under threat of withholding client file]), when a lawyer contracts for or collects a fee that

exceeds statutory limits (e.g., *In re Shalant* (Review Dept. 2005) 4 Cal. State Bar Ct. Rptr. 829; *In re Harney* (Review Dept. 1995) 3 Cal. State Bar Ct. Rptr. 266 [fees exceeding limits under Bus. & Prof. Code, § 6146]), or when an unlicensed lawyer provides legal services. (e.g., *Birbrower, Montalbano, Condon and Frank v. Superior Court* (1998) 17 Cal.4th 119, 136 [70 Cal.Rptr.2d 304]; *In re Wells* (Review Dept. 2006) 4 Cal. State Bar Ct. Rptr. 896.) Paragraph (b) defines an unconscionable fee. (See *Herrscher v. State Bar* (1934) 4 Cal.2d 399, 402 [49 P.2d 832]; *Goldstone v. State Bar* (1931) 214 Cal. 490 [6 P.2d 513].) The factors specified in paragraphs (c)(1) through (11) that are to be considered in determining whether a fee is conscionable are not exclusive. Nor will each factor necessarily be relevant in each instance. Contingent fees, like any other fees, are subject to the unconscionability standard of paragraph (a) of this Rule. In-house expenses are charges by the lawyer or firm as opposed to third-party charges.

Basis or Rate of Fee

[2] In many circumstances, Business and Professions Code, sections 6147 and 6148 govern what a lawyer is required to include in a fee agreement, and provide consequences for a lawyer's failure to comply with the requirements. (See, e.g., *In re Harney* (1995) 3 Cal. State Bar Ct. Rptr. 266.)

[3] ~~With respect to modifications to the basis or rate of a fee after the commencement of the lawyer-client relationship, see Rule 1.8.1, Comments [5], [6].~~ Paragraph (f) imposes a specific requirement with respect to modifications of agreements by which a lawyer is retained by a client. In general, the negotiation of an agreement by which a lawyer is retained by a client is an arms length transaction. *Setzer v. Robinson* (1962) 57 Cal.2d 213 [18 Cal.Rptr. 524]. Once a lawyer-client relationship has been established, the lawyer owes fiduciary duties to the client that apply to the modification of the agreement that are in addition to the requirements in Paragraph (f). Lawyers should consult case law and ethics opinions to ascertain their professional responsibilities with respect to modifications to an agreement by which a client retains a lawyer's services. (See, e.g., *Ramirez v. Sturdevant* (1994) 21 Cal.App.4th 904, 913 [26 Cal.Rptr.2d 554]; *Berk v. Twentynine Palms Ranchos, Inc.* (1962) 201 Cal.App.2d 625 [20 Cal.Rptr. 144]; *Carlson, Collins, Gordon & Bold v. Banducci* (1967) 257 Cal.App.2d 212 [64 Cal.Rptr.915].)

Terms of Payment

[4] A lawyer may require advance payment of a fee but is obliged to return any unearned portion. (See Rule [1.16(e)(2)]) A fee paid in property instead of money may be subject to the requirements of Rule 1.8.1.

[5] An agreement may not be made whose terms might induce the lawyer improperly to curtail services for the client or perform them in a way contrary to the client's interest. For example, a lawyer should not enter into an agreement whereby services are to be provided only up to a stated amount when it is foreseeable that more extensive services

probably will be required, unless the situation is adequately explained to the client. Otherwise, the client might have to bargain for further assistance in the midst of a proceeding or transaction. However, it is proper to define the extent of services in light of the client's ability to pay.

Prohibited Contingent Fees

[6] Paragraph (d)(1) does not preclude a contract for a contingent fee for legal representation in connection with the recovery of balances past due under child or spousal support or other financial orders because such contracts do not implicate the same policy concerns.

Payment of Fees in Advance of Services

[7] Every fee agreed to, charged, or collected, including a fee that is a lawyer's property on receipt under paragraph (e)(1) or (e)(2), is subject to Rule 1.5(a) and may not be unconscionable.

[8] Paragraph (e)(1) describes a true retainer, which is sometimes known as a "general retainer," or "classic retainer." A true retainer secures availability alone, that is, it presumes that the lawyer is to be additionally compensated for any actual work performed. Therefore, a payment purportedly made to secure a lawyer's availability, but that will be applied to the client's account as the lawyer renders services, is not a true retainer under paragraph (e)(1). The written true retainer agreement should specify the time period or purpose of the lawyer's availability, that the client will be separately charged for any services provided, and that the lawyer will treat the payment as the lawyer's property immediately on receipt.

[9] Paragraph (e)(2) describes a fee structure that is known as a "flat fee". A flat fee constitutes complete payment for specified legal services, and does not vary with the amount of time or effort the lawyer expends to perform or complete the specified services. If the requirements of paragraph (f)(2) are not met, a flat fee received in advance must be treated as an advance for fees. See Rule 1.15.

[10] If a lawyer and a client agree to a true retainer under paragraph (e)(1) or a flat fee under paragraph (e)(2) and the lawyer complies with all applicable requirements, the fee is considered the lawyer's property on receipt and must not be deposited into a client trust account. See Rule 1.15(f). For definitions of the terms "writing" and "signed," see Rule 1.0.1(n).

[11] When a lawyer-client relationship terminates, the lawyer must refund the unearned portion of a fee. See Rule 1.16(e)(2). In the event of a dispute relating to a fee under paragraph (e)(1) or (e)(2) of this Rule, the lawyer must comply with Rule 1.15(d)(2).

Division of Fee

[12] A division of fees among lawyers is governed by Rule 1.5.1.

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July 31, 2008 Scott J. Drexel (OCTC) Comment:

Comment Submitted By		Date Received:
Scott J. Drexel	**State Bar of California Office of the Chief Trial Counsel**	**7/31/2008**

Thank you for the opportunity to submit a public comment on the Standing Committee on Professional Responsibility and Conduct's ("COPRAC") proposed Formal Opinion Interim No. 05-0001 regarding the applicability of rule 3-300 of the Rules of Professional Conduct to two fact patterns involving the mid-representation modification of written fee agreements between an attorney and his/her client.

In its interim opinion, COPRAC has tentatively concluded that modification of a fee agreement is not a "business transaction" between the attorney and the client within the meaning of rule 3-300. Additionally, COPRAC has also tentatively concluded that neither of the fact patterns set forth in the interim opinion confers upon the attorney the type of adverse interest contemplated by the rule. As a result, COPRAC has tentatively concluded that rule 3-300 is not applicable to either of the modifications to the fee agreement set forth in the interim opinion. The Office of the Chief Trial Counsel respectfully disagrees with COPRAC's interim opinion.

e believe that it is indisputable that a contract between an attorney and a client is a "business transaction." Nevertheless, we agree that the negotiation of an initial fee agreement between an attorney and a prospective client is an arm's length transaction. (Ramirez v. Sturdevant (1994) 21 Cal.App.4th 904,913; Setzer v. Robinson (1962) 57 Cal.2d 213,217.) The discussion to rule 3-300 specifically provides that "[r]ule 3-300 is not intended to apply to the agreement by which the member is retained by the client . . ." The rationale for that exclusion is that, during the initial negotiations regarding the terms upon which the attorney is willing to represent the client, there is no fiduciary relationship between them. Therefore, the parties may deal at arm's length. (See Cooley v. Miller & Lux (1909) 156 Cal. 510,524; Lee v. Gump (1936) 14 Cal.App.2d 729,733.)

However, once the relationship of attorney and client is established, the parties stand in a fiduciary relationship of the very highest character, a relationship that binds the attorney to the most conscientious fidelity to his or her client. (Lee v. State Bar (1970) 2 Cal.3d 927,939; Yorn v. Superior Court (1979) 90 Cal.App.3d 669,675.) The parties are no longer in an equal bargaining position. Further, the attorney owes the client undivided loyalty and it is a violation of that duty to assume a position adverse or antagonistic to his client without the client's free and intelligent consent. (See Santa Clara County Counsel Attys. Assn. v. Woodside (1994) 7 Cal.4th 525, 548.) In most cases, the client has shared his or her confidences with the attorney, has developed a high level of trust in the attorney and justifiably believes that the attorney is solely motivated by the client's best interests. The Supreme Court has recognized that one of the purposes of rule 3-300 is to protect clients from their attorneys' use of financial information gained from confidences disclosed during the attorney-client relationship. (See Hunniecutt v. State Bar (1988) 44 Cal.3d 362,370 [applying former rule 5-1011.) Consequently, the Supreme Court has applied the rule to transactions that occur after the creation of the attorney-client relationship because the Court recognizes that often a special trust develops as a result of that relationship. (See Hunniecutt v. State Bar, supra, 44 Cal.3d at pp. 370-372.)

In light of the creation and existence of a fiduciary relationship between the attorney and his or her client, a mid-representation modification of the fee agreement between them cannot, and should not, be viewed as an arm's length transaction. Likewise, the rationale for excluding the negotiation of the initial fee agreement from the ambit of rule 3-300 (i.e., that there is no fiduciary relationship between the parties) no longer existences. Thus, in the view of the Office of the Chief Trial Counsel, the modification of an existing fee agreement is a business transaction within the meaning of rule 3-300 of the Rules of Professional Conduct and is subject to its requirements.

In In re Silverton (2005) 36 Cal.4th 81, 84-87,91, the Supreme Court found the attorney culpable of a violation of rule 3-300 where, subsequent to his settlement of the client's personal injury claims, he negotiated with the client a written authorization for the attorney to compromise the client's medical bills and to keep any amount saved as a result of the compromise. In consideration for this authorization, the attorney agreed to increase the client's share of the proceeds from the personal injury settlement. However, pursuant to COPRAC's interim opinion that rule 3-300 does not apply to either the initial fee agreement or to a modified subsequent agreement, the attorney's conduct could not constitute a violation of rule 3-300.

In addition, in In the Matter of Van Sickle (Review Dept. 2006) 4 Cal. State Bar Ct. Rptr. 980, 989 (fn. 13), the State Bar Court Review Department stated, during a discussion of the attorney's alleged violation of rule 4-200 and without making any specific reference to rule 3-300, that a second contingency fee could be charged pursuant to a fee agreement, but only if the attorney has fully disclosed the exact nature of his or her fees and the attorney has obtained the informed consent of the client (i.e., the essential requirements of rule 3-300).

Moreover, earlier this year, the Office of the Chief Trial Counsel tried a matter before the State Bar Court Hearing Department in which a client who could no longer afford to pay for the attorney's legal services entered into a modification agreement with the attorney whereby the client agreed to exchange contractor services for legal services at the client's rate of $80 per hour. The attorney's hourly rate had been and remained at $285 per hour. The Office of the Chief Trial Counsel argued that this modification of the fee agreement constituted a business transaction with the client and that the attorney did not comply with the requirements of rule 3-300. The hearing judge did not find the violation and the Office of the Chief Trial Counsel did not seek review because of other considerations; nevertheless, the Office of the Chief Trial Counsel believes that its position is correct and reserves the right to file charges against an attorney in an appropriate case.

The Office of the Chief Trial Counsel does not believe that requiring members to comply with rule 3-300 when a modification to a fee agreement is contemplated would be either difficult or unreasonable. In Hawk v. State Bar (1988) 45 Cal.3d 589,601, the Supreme Court specifically stated that requiring an attorney to comply with former rule 5-101 (current rule 3-300) before acquiring an interest adverse to his or her client is not an onerous obligation. Finally, the issue of whether the modification of an existing fee agreement with a client constitutes a business transaction within the meaning of rule 3-300 has not been specifically decided by either the State Bar Court or the Supreme Court and it should not be decided by COPRAC for all
purposes. In our view, COPRAC should limit its Formal Opinion to situations where there is clearly not a business transaction with the client or a pecuniary interest adverse to the client as that phrase was intended, but leave open the possibility that a fee modification could constitute a business transaction with a client. To do otherwise may lead the unwary practitioner into a false sense of security.

~~***August 1, 2008 Andrew I. Dilworth (BASF) Comment:***~~

~~Comment Submitted By~~		~~Date Received:~~
~~**Andrew I. Dilworth**~~	~~**Bar Association of San Francisco Legal Ethics Committee**~~	~~**8/1/2008**~~

~~This letter is being sent on behalf of the Ethics Committee of the Bar Association of San Francisco ("we or the "Committee"). We welcome the opportunity to comment on your Proposed Porinal Opinion Interim No. 05-000-1. Having considered the reasoning and proposed conclusions of the opinion, the majority of our Committee recommends that the State Bar disapprove of the proposed opinion and/or amend the proposed opinion for the following reasons.~~

August 26, 2008 OCTC Letter Excerpt to RRC [Page 5] (forwarded to RRC by Lauren McCurdy on 8/28/08):

Proposed Rule 1.8.1 [Business Transactions with a Client; Acquiring Interests Adverse to the Client]

The Office of the Chief Trial Counsel does not oppose exempting original fee agreements from the conflict of interest rules. However, for the reasons stated in the Office of the Chief Trial Counsel's July 31, 2008 written comment to COPRAC's Proposed Formal Opinion Interim No. 05-0001, we vigorously oppose exempting modifications to original fee agreements from the application of either current rule 3-300 or proposed rule 1.8.1.

A copy of the Office of the Chief Trial Counsel's July 31, 2008 comment is attached hereto as Appendix A. See ***July 31, 2008 Scott J. Drexel (OCTC) Comment:***, above.

~~**August 30, 2008 Kehr E-mail to Drafters, cc Chair & KEM:**~~

~~Here is my suggestion for the second sentence of Comment [3] ---~~

> ~~"This Rule also applies when a lawyer sells to a client goods or non-legal services that are related to the practice of law, such as insurance, brokerage, or investment products or services."~~

~~**August 30, 2008 Lamport E-mail to Kehr, cc Drafters, Chair & KEM:**~~

~~That works.~~

~~**September 2, 2008 Voogd E-mail to Drafters, cc Kehr & KEM:**~~

~~There is nothing in the rule itself suggesting that not all business transactions are covered. Yet Comment 4 states "Not all business transactions with a client are within the scope of this Rule." This statement simply is inaccurate.~~

~~Comment 5 says "This Rule is not intended to apply to an agreement by which a lawyer is retained by a client . . . ." Considering the usual rule that intent is to be determined from the language of legislation alone, this statement is also inaccurate.~~

~~Why not make the simple fix and avoid possible ridicule?~~

~~**September 2, 2008 Lamport E-mail to Voogd, cc Drafters, Kehr & KEM:**~~

~~So do you think that if your client owns a McDonalds and you can't go in to buy a burger and fries without complying with rule?~~

October 18, 2009 Tuft E-mail to RRC List (w/ Dissent):

Kevin, there are a few typos in the version of this minority position I sent you. Please use this corrected version instead. Thank you.

> The majority's intent to treat all modifications of a fee agreement with existing clients the same as an original agreement that is negotiated at arm's length is unprecedented in rules governing lawyers. Comment [5] would eliminate the application of this rule to any modification of an existing fee agreement, no matter how significant it impairs the rights of the client, unless the revised agreement amounts to the lawyer acquiring an adverse pecuniary interest. Whether a particular modification to an existing agreement triggers the rule depends on the particular modification and the effect it has on the existing client's substantive rights. A minor modification to clarify an existing provision or correct a technical error would not invoke the rule. On the other hand, a material modification, such as a change in the method by which the lawyer is compensated or a modification that results in the client losing a substantive legal or contractual right would require compliance with this rule. For example, the Supreme Court in In re Silverton (2005) 36 Cal. 4th. 81, 84-87, 89, confirmed the State Bar Court's holding that the terms of an agreement, made during the representation, that authorized the attorney to compromise the client's medical bills constituted a "business transaction" requiring compliance with current rule 3-300. Changing a fee agreement in mid stream with an existing client to add a binding arbitration clause that deprives the client of the client's right to a jury trial and appellate review should also trigger the rule. The rule is intended to apply where important matters are left out of an initial fee agreement, such as whether the lawyer or the client is entitled to a statutory fee award or whether the lawyer can receive his or her fee up front in the event of a structured settlement. See State Bar Formal Opinion 1994-135. Comment [5] would eliminate the application of the rule to significant changes in a fee agreement that do not amount to an adverse pecuniary interest but which result in a transfer of a present interest to the lawyer. Comment [6] acknowledges that other rules would not afford adequate protection and lawyers would have to look outside the rules for guidance on their fiduciary duties. No known authority supports the majority's proposed limitation of the rule and no other jurisdiction has such a provision. Proposed Comments [5] and [6] take away important public protection that exists under the current rule and under the rules in other jurisdictions.

October 20, 2009 Difuntorum E-mail to McCurdy, Lee, Yen & KEM, cc Sondheim:

Attached are the following final versions of documents for Rule 1.8.1. I have added Mark Tuft's minority statement to the Introduction. I also fixed the numbering of the comments in the rule itself as there was no Comment [13] in the middle column of the Explanation Chart considered at the October meeting (new clean version of the rule is attached; Comment [14] is now Comment [13] and Comment [15] is now Comment [14]).

1. Dashboard, (10/20/09) SWL-ML-RD-RD

2. Introduction, Draft 3 (10/20/09)SWL-ML-RD-RD-MLT-RD

3. Rule/Comment Comparison Explanation, Draft 3 (10/20/09)SWL-ML-RD-RD

4. Public Commenter Chart, (9/18/09)

5. Clean Version of Rule 1.8.1 Draft 11 (11-17-09) – CLEAN-RD

6. State Variation excerpt

October 20, 2009 Difuntorum E-mail to KEM, cc McCurdy, Lee, Yen & Sondheim:

Two questions:

(1) On the Dashboard, there's a bunch of folks listed (COPRAC, Carol Langford, OCBA, etc…), is this correct?

(2) On the Public Comment Chart by Commenter, the alpha sorting is sorting individuals by first name (Carol Langford seems to be the first commenter listed based on "Carol" not "Langford"), is this correct?

October 20, 2009 KEM E-mail to Difuntorum, cc McCurdy, Lee, Yen & Sondheim:

1. I've left only OCTC as a named stakeholder and referenced others who join in the position. However, I wouldn't view them as "stakeholders" on the fee modification issue, particularly not the "legal ethics educators." See attached Draft 2.1 (10/20/09)SWL-ML-RD-KEM

   a. However, we have to change the Draft # and date.

   b. The last version of the Rule that I have confidence in, i.e., as having been approved by the Commission and for which I have a current draft, is Draft 11 (11/17/08). However, from what you and Mimi mentioned during our telephone conference on 11/9, Stan made some changes to the middle column of the Rule & Comment chart that he submitted on 11/7. Would you please send me a copy of the Clean draft that was cobbled together from the middle column? (you or Mimi may have done so but I can't find it anywhere on my computer). We should renumber that draft 12 and give it a date of 11/7/09.

   c. I can't easily determine from reviewing my notes whether there were any further changes to the Comment (middle column) based on the deliberations during the meeting. If yes, I would renumber that draft 13 (or 14 if we give into superstition) and give it today's date, and insert that draft number and date in the Dashboard, Introduction and Rule & Comment charts.

2. I've fixed the Public Comment chart. I thought I had done that already but I think I confused it w/ 1.5.1 (another Stan rule). See attached Draft 3.1 (10/20/09)RD-KEM

Please let me know if you have any questions.

October 20, 2009 Difuntorum E-mail to KEM, cc McCurdy, Lee, Yen & Sondheim:

I recently asked Mimi to run a comparison to ascertain Stan's changes. The attached draft is the post October meeting version redlined to show Stan's pre-meeting edits to the rule comments. I had to manually manipulate the redline markings to account for the nits and

changes implemented at the October meeting. The remaining redline marks should be Stan's pre-meeting edits. He appears to have made only two edits (see Comment [3] and [4]) and I would treat them as non-substantive. Mimi is not in today but when she is, I'll ask her to create a clean version of Stan's draft that does not have the October edits and I will ask her to name it Draft 12.

The clean version attached to my prior message and also attached here should be considered the current clean version and per your suggestion for maintaining continuity, I have renamed it Draft 13 but retained the 10/17/09 date. I will update all of the other documents with that draft number and date and resend to all. Changes were made at the October meeting to the middle column but they were all non-substantive (including deletion of a COPRAC opinion citation).

October 20, 2009 Difuntorum E-mail to McCurdy, Lee, Yen, KEM & Sondheim:

Following input from Kevin, attached are the following revised final documents for Rule 1.8.1. Disregard the earlier message and attachments.

1. Dashboard, Draft 2.1 (10/20/09) SWL-ML-RD-RD-KEM

2. Introduction, Draft 3.1 (10/20/09)SWL-ML-RD-RD-MLT-RD-KEM

3. Rule/Comment Comparison Explanation, Draft 3.1 (10/20/09)SWL-ML-RD-RD-KEM

4. Public Commenter Chart, Draft 3.1 (10/20/09) RD-KEM

5. Clean Version of Rule 1.8.1 Draft 13 (10-17-09) – CLEAN-RD

6. State Variation excerpt

October 20, 2009 Sondheim E-mail to Difuntorum, cc McCurdy, Lee, Yen, KEM:

In the Introduction, third paragraph, there is a reference to the California Supreme Court without a citation. I believe a citation should be added, especially since the minority also refers to a Supreme Court case with a citation.

October 20, 2009 Difuntorum E-mail to Lamport, cc McCurdy, Lee, Yen, KEM & Sondheim:

Please see Harry's message below and the attached Rule 1.8.1 (3-300) Introduction. Is there a specific case that can be cited? The case that I can think of is Santa Clara County Counsel Attys. Assn. v. Woodside (1994) 7 Cal.4th 525 but this case is red flagged by Westlaw, probably for other grounds. If you can supply a case to satisfy Harry's request, then we will try to add it. However, we are nearly out of time for doing any editing.

Attached:

Introduction, Draft 3.1 (10/20/09)SWL-ML-RD-RD-MLT-RD-KEM

October 21, 2009 Difuntorum E-mail to McCurdy, cc Lee, Yen, KEM & Sondheim:

Lauren: Attached please find a revised public commenter chart for Rule 1.8.1 that now includes OCTC's late comment. I have saved this to your individual rule file for Rule 1.8.1.

November 20, 2009 McCurdy E-mail to RRC:

If you are interested in listening to the discussion of the subject rules that occurred at RAC's November 12th meeting, use the links below to connect to the audio clips. Due to the large size of these files it is necessary for us to use MediaFire.com as a web hosting site. A copy of these clips on CD have been sent by mail to the lead drafters of each of these rules, as the redrafts of these rules are assigned for the Commission's December meeting agenda.

RULE 1.7 (KEHR, Melchior, Mohr, Snyder):
File name: RAC - Proposed Rule 1.7 Discussion - Nov 2009.mp3:

RULE 1.8.1 (LAMPORT):
File name: RAC - Proposed Rule 1.8.1 Discussion - Nov 2009.mp:

RULE 1.8.10 (RUVOLO, Foy, Julien):
File name: RAC - Proposed Rule 1.8.10 - Nov 2009.mp3:

November 24, 2009 Lamport E-mail to Hebert (BOG), cc Chair, Hawley & Staff:

Thank you for returning my call regarding your input on this Rule. Your message indicated that you wanted to review the draft rule and the COPRAC draft opinion on modifications to fee agreements before we spoke and that you did not have those handy. In that regard, I enclose a copy of the COPRAC draft opinion and a link to the Commission's report to the BOG, which includes the draft rule starting at page 244 as numbered on the page (page 245 of the PDF). Once you have had a chance to review these materials, please call me. You can reach on my cell phone, 213-393-2033.

http://bog.calbar.org/docs/agendaItem/Public/agendaitem1000005384.pdf

November 25, 2009 McCurdy E-mail to Lamport, cc Drafters (Tuft, Melchior), Chair & Staff:

Thanks for submitting the materials for Rule 3.6.

Please let me know where you're at with the following assignments for the December meeting:

1. IV.A. Rule 1.8(d) – Conflicts of Interests -- Specific Rules: Literary or Media Rights (codrafters Tuft & Melchior)

2. IV.B. Rule 1.8(j) – Conflicts of Interests – Specific Rules: Proprietary Interest in the Subject Matter of Representation (codrafters Tuft & Melchior)

3. V.B. Rule 1.8.1 – Business Transactions and Adverse Interests [3-300] – solo assignment

You've got to stop volunteering for so many assignments!

I'll be finishing up the compilation of the agenda materials for mailing on Monday. If you can get any or all of these in by then that would be great. Please let us know if you need any assistance pulling together any of the parts for these items.

November 25, 2009 Lamport E-mail to McCurdy, cc Drafters (Tuft, Melchior), Chair & Staff:

I thought 1.8(d) and (j) were put over due to the RAC issues. If I am mistaken, I will work on this and get something out on Friday.

As far as 1.8.1, I have been working on something. I have been trying to coordinate with Jon Streeter and Bill Hebert, with whom I was asked to consult after the RAC meeting. Probably due to the short week, I have not heard back from either of them. Bill left me a message saying he needed to refresh his memory on the issues by looking at the draft rule and the COPRAC draft opinion, which I emailed to him yesterday. I will follow up with both of them on Monday and will have something out on Monday as well.

November 25, 2009 McCurdy E-mail to Lamport, cc Drafters (Tuft, Melchior), Chair & Staff:

It's true there were some modifications made to the assignments (the Batch 5 rule assignments were removed), however, Rules 1.8(d) and 1.8(j) are Batch 6 rules that, as far as I can tell are still on the agenda (revised assignments agenda attached). I hate to be the bearer of this bad news. Do what you can, and we'll take it from there.

As for Rule 1.8.1, hopefully Bill will get back to you soon. If you haven't already done so, refer to the audio clip for the RAC discussion of this rule.

November 25, 2009 Lamport E-mail to McCurdy, cc Drafters (Tuft, Melchior), Chair & Staff:

Okay. I work on the two. I have listened to the audio. Part of the direction was to talk to the three board members who spoke out, which is what I been trying to do.

December 6, 2009 Kehr & Peck Memo re Fee Agreement Modifications:

The purpose of this Memo is to explain to the Commission our view that the current draft of Rule 1.8.1 is correct that the modification of a fee agreement generally should not be governed by Rule 1.8.1. We believe that to reverse the current draft, and to require lawyers to comply with Rule 1.8.1 in all fee modifications, would violate common sense, would be inconsistent with the Model Rule, and would be inconsistent with long-standing California law and the Restatement. This Memo will address each of these in turn.

If the Commission retains its current draft as we hope it will, this Memo with minor modifications also could serve as an explanation to the Board of the Commission's action. We believe that the audio recording of the recent RAC meeting demonstrates that the comments made in favor applying Rule 1.8.1 to all fee modifications was based on misunderstandings as to the current state of the law and the consequences that would flow from changing current law.

Common sense:

Anyone who advocates the application of Rule 1.8.1 to all agreements between lawyers and clients that have the effect of altering an existing fee agreement presumably has in mind a situation in which a lawyer takes advantage of the client's circumstances in order to trick or force the client into a new arrangement that benefits the lawyer but not the client, and that furthermore does not pass muster at some visceral level. However, the general application of Rule 1.8.1 to fee modifications also would cover at least the following:

- Substantive changes that are for the benefit of the client but not the lawyer.
    - Contingency fee example --- lawyer accepts a representation, but at a 50% contingency because there is a lack of case authority to support the client's position in the proposed lawsuit, and the lawyer reasonably believes there is a substantial risk that the contingency will not occur Some time later, the lawyer reports to the client the happy news of the publication of a supportive appellate decision. The client replies by asking the lawyer to reduce the fee. The lawyer is a *mensch*, agrees to reduce the fee to 40%, but does not comply with Rule 1.8.1. If the Rule were to apply to fee modifications, that logically should include a fee reduction as well as a fee increase even though the lawyer had a binding fee agreement and had no legal obligation to entertain the client's request (Should the lawyer have recommended to the client that a better figure would be 35%? Would an independent lawyer have advocated 35%?). This lawyer is subject to professional discipline, is subject to the threat of discipline if the client later demands the lawyer reduce the fee still further, and the lawyer arguably might lose the entire fee.
    - Hourly fee example --- client suffers a financial reversal and requests a reduction in the billing rate. The lawyer has various legitimate alternatives, including among others, terminating the representation and leaving the client without representation (because of the client's inability to perform the fee agreement), humiliating the client by demanding that he borrow from relatives (or sell his wife's wedding ring, *etc*.), and keeping the current billing rate with a portion of the accumulating fee to be accrued with interest. The lawyer rejects all these alternatives and agrees to a reduction as requested by the client; the consequences are the same as in the contingency example. Should the fee reduction have been greater? Should the timing of payment been changed in some way? Should the lawyer have advised the client of these and other reasonably identifiable alternatives to the fee reduction requested by the client?
- Non-substantive changes that are for the benefit of the client but not the lawyer. Lawyer and client enter into an hourly fee agreement that requires the client to pay fees within 30 days after receipt of each monthly bill. The lawyer accedes to the client request for a short delay in the payment of a single statement. Again, the lawyer is subject to discipline, to the threat of discipline, and potentially to the loss of the entire fee.

- The negotiation with a current client of a new fee agreement for a new matter in which the current client seeks to retain the lawyer. If the existence of a lawyer-client relationship is the watershed event, then logically any fee negotiation between lawyer and a current client should be included, even if it is in a new matter. Nothing in principal distinguishes a new matter from an existing matter.

- The agreement between lawyer and client to apply an existing fee agreement to a new matter. Again, if the existence of a lawyer-client relationship is the watershed event, then the client would be entitled to all the protections of Rule 1.8.1 when discussing the application of an existing fee agreement to a new matter. Should the price or terms be different because the two matters are not the same, because the lawyer's level of experience in the second matter is less, or for some other reason?

- Billing rates provided for in an initial fee agreement. Example --- Lawyer agrees to represent a client in what is hoped to be (and turns out to be) a long-term relationship not limited to a single matter. Because hourly billing rates increase with time due to factors such as inflation and the increasing skill of young lawyers, and to avoid Rule 1.8.1, the lawyer's initial fee agreement states that the client will be billed at each lawyer's and each paralegal's normal billing rates. The lawyer's firm provides a notice of new rates that is sufficient to satisfy the standard of *Severson & Werson v. Bolinger*, 235 Cal. App.3rd 1569, 1673 (1991). The lawyer arguably would be subject to discipline under Rule 1.8.1.

We do not believe that the application of Rule 1.8.1 to any of these situations is supportable, and we are not aware of any authority for doing so. As appears from the opinion in the *Severson & Werson* case, the enforceability of the fee agreement is based on contract principles (which is consistent with the Restatement), and without any suggestion that the validity of the fee agreement has any connection with Rule 1.8.1.

Applying Rule 1.8.1 to all fee agreement modifications would be inconsistent with Model Rule 1.8(a):

ABA Model Rule 1.8(a), Comment [1], excludes the application of Rule 1.8(a) to "ordinary fee arrangements between client and lawyer ...." Presumably because of the consequences outlined above, the Model Rule fee agreement exception applies to *all* ordinary fee agreements without regard to whether they are fee agreements with new clients, modifications of existing fee agreements, or new fee agreements with existing clients.

The plain meaning of the Model Rule is understood and accepted. See *Mauzy v. Edward Kraemer & Sons, Inc.*, 2004 U.S. Dist. LEXIS 5098 (D. Minn. 2004) ["The assignment was a modification [of] a pre-existing fee agreement which did not encompass a loan or exchange of property which would justify characterization as a business transaction. Consequently, the plaintiff attorney was not required to comply with the writing and disclosure provisions of Minn. R. Prof. Cond. 1.8(a)."]; *Valley/50th Ave., LLC v. Stewart*, 159 Wn.2d 736, 743-44 (2007) [this involved a fee agreement that conveyed to the lawyer a deed of trust on real property, a transaction that would be covered by all versions of the Rule, but the court before the section dealing with Rule 1.8(a) effectively repeated the content of California Probate Code § 16004(c) in saying: "A fee agreement between a lawyer and a client, revised after the relationship has been established on terms more favorable to the lawyer than originally agreed upon, may be void or voidable unless the attorney shows that the contract was fair and reasonable, free from

undue influence, and made after a fair and full disclosure of the facts on which it is predicated."]; *Cotton v. Kronenberg*, 111 Wn. App. 258, 272 (2002) [This is consistent with the Restatement's contract approach (see below), saying: "We note that our Supreme Court has held that any modification of a fee agreement after an attorney-client relationship has been established is subject to 'particular attention and scrutiny' [citations omitted]. If renegotiation after commencement of the attorney-client relationship results in greater compensation for the attorney than that under the initial agreement, courts may refuse to enforce the renegotiated fee unless it is supported by new consideration (citation omitted).] Cf. *In the Matter of Thayer*, 745 N.E.2d 207 (Ind. 2001) [at 211, n. 3, the Court stated: "The present situation differs from typical contingent fee negotiations between lawyers and their clients because here the contingency of the fee had expired with conclusion of the settlement negotiations – the insurer had offered to settle for $11,000 and the client had advised the respondent to accept the offer. In effect, the respondent attempted to increase his contingency fee arrangement with an unsophisticated client after the contingency no longer existed. These unique circumstances activated the need for the protections required for lawyer-client business transactions provided in Prof.Cond.R. 1.8(a). By this holding today, however, we do not mean to require that all modifications to contingency fee agreements under any circumstances be subject to the client protections contained in Prof.Cond.R. 1.8(a)." Query whether the Court would have come to the same conclusion if the Respondent had not agreed that he violated Rule 1.8(a) as discipline was possible in other ways, for example, under Rule 1.5, which Respondent also was found to have violated].

<u>Applying Rule 1.8.1 to all fee agreement modifications would alter current California law</u>:

California Probate Code § 16004(c) provides:

> 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. **<u>This subdivision does not apply to the provisions of an agreement between a trustee and a beneficiary relating to the hiring or compensation of the trustee.</u>** (emphasis added)

The Law Revision Commission Comment states:

> Subsection(c) restated the second sentence of former Civil Code Section 2235 without substantive change. For background on the provisions of this division, see the Comment to this division under the division heading. [20 Cal.L.Rev.Comm.Reports 1001 (1990)].

Walton v. Broglio (1975) 52 Cal.App.3d 400, 403-404,125 Cal.Rptr. 123, understood that the final sentence of former section 2235, now Probate Code section 16004(c) applies to a modification of a fee agreement with an existing client, and stated:

> Plaintiff contends on appeal that the presumption of invalidity codified in section 2235 of the Civil Code does not apply. We agree.
>
> In contracting with his client, where there is a pre-existing attorney-client relationship, the attorney is charged with a rebuttable presumption of undue influence and thus invalidity of the contract. (<u>*Bradner v. Vasquez*</u> (1954) 43

Cal.2d 147, 272 P.2d 11; *Denton v. Smith* (1951) 101 Cal.App.2d 841, 226 P.2d 723.) This rule is based on section 2235 of the Civil Code, which reads as follows:

> 'All transactions between a trustee and his beneficiary during the existence of the trust, or while the influence acquired by the trustee remains, by which he obtains any advantage from his beneficiary, are presumed to be entered into by the latter without sufficient consideration, and under undue influence. The presumptions established by this section do not apply to the provisions of an agreement between a trustee and his beneficiary relating to the hiring or compensation of the trustee.'

The last sentence was added in 1963. By its terms, it broadly excludes all agreements relating to hiring or compensation, including those made after the fiduciary relationship is established. Prior law had created an exception only where there was no pre-existing fiduciary relationship. Thus, in *Setzer v. Robinson* (1962) 27 Cal.2d 213, 216, 18 Cal.Rptr. 524, 526, the Supreme Court said: 'The presumption of 'insufficient consideration' and 'undue influence' created by Civil Code, section 2235, is not applicable to a contract by which the relation of attorney and client is originally created and the attorney's compensation is fixed. 'The confidential relation does not exist until such contract is made, and in agreeing upon its terms the parties deal at arm's length.' (*Cooley v. Miller & Lux*, 156 Cal. 510, 524, 105 P. 981; see also *Cooley v. Miller & Lux*, 168 Cal. 120, 131, 142 P. 83; *Youngblood v. Higgins*, 146 Cal.App.2d 350, 352, 303 P.2d 637; 5 Am.Jur., Attorneys at Law, s 189, p. 375.) . . . No attorney could safely or reasonably negotiate any fee agreement with a prospective client without some preliminary investigation of the facts of the case and a disclosure to the prospective client of the legal steps which in his judgment must be taken. If by the very fact of such investigation and disclosure the relationship of attorney and client would thereby be created, the attorney would be placed in the impossible position of becoming the prospective client's attorney while he was attempting to reach an agreement with him as to whether he should become his attorney or not.'

None of the cases since the 1963 amendment have directly construed it. Three cases, *Gold v. Greenwald* (1966) 247 Cal.App.2d 296, 55 Cal.Rptr. 660; *Carlson, Collins, Gordon & Bold v. Banducci* (1967) 257 Cal.App.2d 212, 64 Cal.Rptr. 915; and *Trafton v. Youngblood* (1968) 69 Cal.2d 17, 69 Cal.Rptr. 568, 442 P.2d 648, dealt with events that occurred before the amendment became effective and thus did not discuss it. The fourth, *Baron v. Sarlot* (1975) 47 Cal.App.3d 304, 120 Cal.Rptr. 675 found the amendment was not 'significant' on the particular facts alleged. **We hold that the amendment, properly construed, prevents the application of the presumption to any agreement relating to fees, even where there is a pre-existing attorney-client relationship.** (emphasis added)

This case was decided after the 1974 amendments to the Rules of Professional Conduct, including the predecessor to rule 3-300 [former rule 5-101] were adopted. After *Walton v. Broglio* was decided, the Legislature adopted section 16004(c) with the stated intent of adopting section 2235 and the case law interpreting it.

Therefore, the policy of the State of California is that the fiduciary obligations of a trustee should not apply to an initial compensation agreement or a modification of that agreement respecting compensation.

Rule 3-300's discussion, sentence one, stated:

> Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client, unless the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client. . . ."

Thus, the foregoing discussion sentence in rule 3-300 stated language substantially similar to the last sentence of section 16004(c) [which applies to modifications as well as initial agreements], excepting terms and conditions of a retainer agreement involving an ownership, possessory, security, or other pecuniary interest adverse to the client consistent with *Ames v. State Bar* and its progeny.

Ramirez v. Sturdivant, (1994) 21 Cal.App.4th 904, 917, 26 Cal.Rptr.2d 554, 560-561, again considered whether section 16004(c) applied to a second, different fee agreement by a lawyer resuming an attorney-client relationship in the same litigation matter and found that there was no duty to advise the client to seek the advice of independent counsel:

> It was generally understood that Civil Code section 2235 applied to the attorney-client relationship (e.g., *Walton v. Broglio* (1975) 52 Cal.App.3d 400, 403, 125 Cal.Rptr. 123), and we see no reason why Probate Code section 16004 also should not apply to that relationship. The statute, however, does no more than affect the burden of proof. In other words, under it, the trustee/attorney has the burden of proving that the transaction at issue did not violate a fiduciary duty. (Evid.Code, § 606.) Where, as here, the trustee/attorney produces evidence that the transaction was conducted at arms-length with an intelligent, experienced and sophisticated client, the trial court is entitled to conclude that the burden of proof has been met. In reviewing that conclusion, our only duty is to determine whether or not that conclusion is supported by substantial evidence. (*Priester v. Citizens Nat. etc. Bank* (1955) 131 Cal.App.2d 314, 317, 280 P.2d 835.) <u>In addition, the last sentence of this provision specifically exempts from the presumption of undue influence any agreement relating to the "hiring or compensation" of the trustee/attorney. This exemption has been held to apply "even where there is a pre-existing attorney-client relationship."</u> (*Walton v. Broglio, supra*, 52 Cal.App.3d at p. 404, 125 Cal.Rptr. 123; and see *Vella v. Hudgins* (1984) 151 Cal.App.3d 515, 519, 198 Cal.Rptr. 725: "A contingency fee contract may be modified by the parties at any time during the subject litigation.")
>
> In all events, and contrary to Ramirez's contentions, substantial evidence supports the conclusion that Sturdevant did not take unfair advantage of Ramirez in negotiating the supplemental retainer agreement. Ramirez already had changed attorneys twice in the action and was perfectly aware that she could do so again. Prosecuting an appeal is a proceeding discrete from proceedings in the trial court, and often is accomplished by someone other than the trial attorney. Sturdevant, as we have discussed, was entitled to withdraw from the case, and thus was entitled to negotiate the terms under which he would continue. Ramirez's interest in continuing with Sturdevant may have caused her to agree to

> terms she otherwise would have refused, **but that fact does not by itself translate into duress or a breach of fiduciary duty**. **Finally, we can see no reason why, under the circumstances present here, the supplemental agreement should be struck down simply because Sturdevant did not advise Ramirez that she should seek advice of other counsel in negotiating with him. Counsel could only have explained that Sturdevant was certainly entitled to insist on reimbursement of advanced fees and that $150,000 was a reasonable settlement figure.**

In *In re Silverton* (2005) 36 Cal.4th 81, 29 Cal.Rptr.3d 766, the Supreme Court stated:

> The Review Department determined that the arrangement involving a compromise of the medical bills was a business transaction, in that "the authorization to compromise constituted an immediate transfer from the Hous of both the ownership and possessory interest in all funds remaining after payment to the Hous of their distributive share of the settlement proceeds and the payment of attorney's fees as called for in the original retainer agreement" in exchange for an upfront payment by the attorney. The transaction was therefore barred unless Silverton could show that [he complied with rule 3-300] . . . (Rule 3-300; see generally *Fletcher v. Davis* (2004) 33 Cal.4th 61, 69-70, 14 Cal.Rptr.3d 58, 90 P.3d 1216.) The Review Department determined that Silverton (1) failed to disclose to the Hous information necessary for a reasonable understanding of the transaction, (2) failed to provide the Hous with written notice of their right to seek independent legal counsel, and (3) failed to discharge his burden to show the transaction was fair and reasonable to the Hous. In particular, Silverton failed to share with his clients, as he had with cocounsel Watson, his confidence that the medical bills could be compromised at a lower amount. (See *Mayhew v. Benninghoff* (1997) 53 Cal.App.4th 1365, 1369, 62 Cal.Rptr.2d 27.)

Thus, the Supreme Court did not find that rule 3-300 applied to any modification of a fee agreement or a new agreement with an existing client. Rather, it applied rule 3-300 to a modification consistent with the discussion sentence. Rule 3-300 applied only because the fee agreement negotiated during the course of the relationship if the agreement amounts to a business transaction between lawyer and client or grants to the lawyer an adverse pecuniary interest on the lawyer. We are aware of no reported authority holding that a lawyer is required to comply with rule 3-300 in all fee modifications.

To the contrary, it generally is accepted that § 16004(c) applies to the renegotiation as well as the original negotiation of a lawyer's fee agreement. In addition to the authorities cited above, see L.A. County Bar Ethics Opn. 521 (2007) and Opn. 496 (1998); Brandon, *Burning Issues: The Representation of Insureds Under Burning Limits Policies Raises a Host of Ethical Issues*, 27 L.A. Lawyer 30, 33 n.37 and accompanying text (2004); Family Law Practice & Procedure 2d Ed at §61.02 (Matthew Bender); and California Forms of Pleading and Practice §215.81 (Matthew Bender).

<u>The Restatement Approach</u>: The Restatement Third, The Law Governing Lawyers is consistent with *Walton* and with the Model Rule because it does not suggest at any place that we can locate that any conflict of interest rule applies to ordinary fee arrangements. Its position is expressed in §18, Comment *e*, and is based squarely on contract principles: "*e. Contracts*

entered into during a representation. Client-lawyer fee contracts entered into after the matter in question is under way are subject to special scrutiny (cf. Restatement Second, Contracts § 89(a) (promise modifying contractual duty is binding if fair and equitable in view of circumstances unanticipated when contract was made)). A client might accept such a contract because it is burdensome to change lawyers during a representation. A client might hesitate to resist or even to suggest changes in new terms proposed by the lawyer, fearing the lawyer's resentment or believing that the proposals are meant to promote the client's good. ..." Section 89(a) to which it refers states: "A promise modifying a duty under a contract not fully performed on either side is binding (a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made; ...."

Thus, as suggested in the first portion of this Memo, the Restatement categorizes together all lawyer-client contracts entered into during the existence of the relationship, which would include modifications of existing fee agreements and new fee agreements on new matters.

The Burden of Compliance: It was stated at the November 2009 RAC meeting that applying Rule 1.8.1 to fee modifications would require the lawyer only to give written notice to the client that the client should obtain independent counsel. This is wrong, as we will explain in a moment, but we first will follow the logic of this assertion. The logic is that there would be some material benefit to the client from the mere recitation of the client's right to independent counsel. We believe this makes no sense in the situation where the client most needs protections – where, to use the facts of the *Van Sickle* case cited below, the client has a young child, a house in foreclosure, and a car that is going to be foreclosed. More fundamentally, it simply is wrong to say that, if every fee agreement with an existing client is labeled as a business transaction, the lawyer's only additional duty would be the recommendation to seek independent counsel.

In fact, a lawyer who enters into any business transaction with a client bears the heavy burden of providing the same advice to the client as the lawyer would have if not a party to the transaction. As our Supreme Court stated in *Felton v. LeBreton*, 92 Cal. 457, 469 (1891) (emphasis added):

> "While an attorney is not prohibited from having *business transactions with his client*, yet, inasmuch as the relation of attorney and client is one wherein the attorney is apt to have very great influence over the client, especially in transactions which are a part of or intimately connected with the very business in reference to which the relation exists, such transactions are always scrutinized by courts with jealous care, and *are set aside at the mere instance of the client, unless the attorney can show by extrinsic evidence that his client acted with full knowledge of all the facts connected with such transaction, and fully understood their effect*; and in any attempt by the attorney to enforce an agreement on the part of the client growing out of such transaction, the burden of proof is always upon the attorney to show that the dealing was fair and just, and that the client was fully advised. (*Kisling* v. *Shaw*, 33 Cal. 440; 91 Am. Dec. 644; *Brock* v. *Barnes*, 40 Barb. 533; *Howell* v. *Ransom*, 11 Paige, 542; *Ford* v. *Harrington*, 16 N. Y. 289; *Evans* v. *Ellis*, 5 Denio, 643; *Dunn* v. *Dunn*, 42 N. J. Eq. 437; 1 Story's Eq. Jur. 310, 311.) In the words of Lord Eldon, he must make it manifest that he gave to his client 'all that reasonable advice against himself that he would have given him against a third person.' (*Gibson* v. *Jeyes*, 6 Ves. 278.)."

This remains the law of California. See, *e.g.*, *Beery v. State Bar*, 43 Cal.3d 802, 812 (1987). Also see *Ball v. Posey*, 176 Cal. App.3d 1209, 1214 (1986), where the court stated that the lawyer's burden of demonstrating that the client was fully informed on all matters related to any

transactions between them is based on the fiduciary duty of full and unbiased disclosure described in *Neel v. Magana, Olney, Levy, Cathcart & Gelfand,* 6 Cal.3d 176, 188-89 (1971).

The comment at the November 2009 RAC meeting that the only added burden of compliance would be for the lawyer to give the client advice to seek independent counsel is wrong for a second materials reason. Rule 1.8.1 requires that the advice to seek independent counsel must be in writing, and the lawyer must give the client a reasonable opportunity to seek that advice. Consider those two requirements within the common context of the settlement of a contingency case that takes place at the last moment or even during trial, where the lawyer agrees to reduce the contingency fee in order to obtain the client's consent to the settlement.

Conclusion: The Model Rule, the Restatement, and current California law have it right. Applying Rule 1.8.1 to all fee agreements with current clients would sweep into the area of possible discipline, and to the threat of discipline and the potential loss of all fees, countless unintended situations. Such a new requirement would be a trap for the unwary lawyer and would provide no meaningful benefit to the client. A lawyer who takes advantage of a client (or a potential client) through deceit or strong arm tactics already is subject to discipline under Rule 1.5 (unconscionable or illegal fee) and Bus. & Prof. C. § 6106. See, *e.g.*, *Matter of Van Sickle*, 4 Cal. State Bar Ct. Rptr. 980, 993 (Rev. Dept. 2006).

December 6, 2009 Lamport E-mail to RRC:

I attended the November RAC meeting at which this Rule was referred back to the Commission. The RAC's concern focused on Comments 5 and 6 and modifications to fee agreements. The RAC meeting discussion came down to whether modifications to fee agreements should be subject to the full Rule 1.8.1 protocol or whether they should be subject to something less than the full protocol. A majority of RAC voted that modifications to fee agreements should be subject to something less than the full Rule 1.8.1 protocol.

The concept on which RAC voted was not articulated clearly. However, OCTC was advocating for a requirement that clients be advised to seek the advice of independent counsel. Michael Marcus asked me to confer with the BOG members who had expressed views on the issue at the meeting. There were three members who expressed views on the issue, including Bill Hebert, with whom I was able to discuss the issue. Mr. Hebert asked for some background materials, which I supplied. He and I were able to close the loop on this issue last Friday.

Basically, it appears the Board would like to include a requirement that a lawyer who modifies a fee agreement notify the client to seek the advice of independent counsel and afford the client a reasonable opportunity to do so. I considered whether this change could be accomplished in Rule 1.8.1 and concluded that the revision should not occur in that Rule. First, it would be awkward. We would be creating a section of the Rule specifically related to fee agreement modifications that would include less than the full compliment of requirements in the Rule. Second, we would be declaring modifications to fee agreements to be business transactions (if not the acquisition of an adverse pecuniary interest), but declaring that modifications are not to be treated like other business transactions, which would require some explanation. Third, Rule 1.8.1 is not the natural place to put a special rule related to modifications to fee agreements and likely will not alert the practitioner to the requirement.

For the foregoing reasons, I have concluded that the issue should be addressed in Rule 1.5. Since that Rule deals with fees, it would be a more logical place for a rule regarding

modifications to fee agreements. Furthermore, addressing the issue in Rule 1.5 avoids the problems of including the concept in Rule 1.8.1. I discussed this concept with Bill Hebert, who responded favorably to the concept.

With these thoughts in mind, I am proposing we take the following steps:

1. Add a new paragraph (f) to Rule 1.5, which states:

> "(f) a lawyer shall not modify an agreement by which the lawyer is retained by the client unless the client is either represented with respect to the modification by an independent lawyer or is advised in writing by the lawyer to seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice."

2. Retain Comment [5] in Rule 1.8.1, which already says that modifications to agreements by which a lawyer is engaged by a client are governed by Rule 1.5, but modify the Comment as stated in 3, below.

3. Replace Comment [3] in Rule 1.5 and with Comment [6] from Rule 1.8.1. Add a new first sentence, which states, "Paragraph (f) imposes a specific requirement with respect to modifications of agreements by which a lawyer is retained by a client." I recommend that we delete the third sentence in existing Rule 1.8.1 Comment [6] and move that sentence into Rule 1.8.1 Comment [5]. I recommend that we revise what would become the third sentence of Comment [3] to Rule 1.5 as follows: "Once a lawyer-client relationship has been established, the lawyer owes fiduciary duties to the client that apply to the modification of the agreement ***that are in addition to the requirements in Paragraph (f).***"

In full Comment [3] to Rule 1.5 would state:

> "[3] Paragraph (f) imposes a specific requirement with respect to modifications of agreements by which a lawyer is retained by a client. In general, the negotiation of an agreement by which a lawyer is retained by a client is an arms length transaction. *Setzer v. Robinson* (1962) 57 Cal.2d 213 [18 Cal.Rptr. 524]. Once a lawyer-client relationship has been established, the lawyer owes fiduciary duties to the client that apply to the modification of the agreement that are in addition to the requirements in Paragraph (f). Lawyers should consult case law and ethics opinions to ascertain their professional responsibilities with respect to modifications to an agreement by which a client retains a lawyer's services. (See, e.g., *Ramirez v. Sturdevant* (1994) 21 Cal.App.4th 904, 913 [26 Cal.Rptr.2d 554]; *Berk v. Twentynine Palms Ranchos, Inc.* (1962) 201 Cal.App.2d 625 [20 Cal.Rptr. 144]; *Carlson, Collins, Gordon & Bold v. Banducci* (1967) 257 Cal.App.2d 212 [64 Cal.Rptr.915].)"

4. Revise Comment [2] in Rule 1.81 to delete the reference to Comment [6], which is being moved to Rule 1.5.

5. Revise Comment [5] as indicated above. Replace Comment [6] to Rule 1.8.1 with the last two sentences of Comment [5], which shortens Comment [5] and avoids the need to renumber the rest of the Comments.

In full Comments [5] and [6] to Rule 1.8.1 would state:

"[5] This Rule is not intended to apply to an agreement by which a lawyer is retained by a client or to the modification of such an agreement, unless the agreement or modification confers on the lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client, such as when the lawyer obtains an interest in the client's property to secure the amount of the lawyer's past due or future fees. An agreement by which a lawyer is retained by a client and modifications to such agreements are governed, in part, by Rule 1.5 [Rule 4-200]. Even when this Rule does not apply to the negotiation of the agreement by which a lawyer is retained by a client, other fiduciary principles might apply.

[6] An agreement to advance to or deposit with a lawyer a sum to be applied to fees or costs incurred in the future is not an ownership, possessory, security, or other pecuniary interest adverse to the client for purposes of this Rule. This Rule is not intended to apply to an agreement with a client for a contingent fee in a civil case."

For ease of reference, I attach redlined versions of Rules 1.5 and 1.8.1 showing the changes.

I received Bob Kehr's email and memo on this issue as I was drafting this email. I looked at Bob's memo briefly, but I have not considered it in detail and have not attempted to address it here.

December 6, 2009 Tuft E-mail to RRC List:

In the interest of brevity, I am resending my response to Ellen's memo of last fall on why we should not be attempting to craft a "one size fits all" standard on mid stream changes to fee agreements in a rule of professional conduct. There is no good reason for us to overrule Silverton, Nor is it necessary for us to agree or disagree with OCTC's position. The simple truth, as Simon's article points out, is that there is no single standard that will apply to every modification of a fee agreement; nor should there be. I am unaware of any jurisdiction that has attempted to include such a standard in a rule of professional conduct. This is not an issue that is unique to California or one that warrants a special rule. We have many other things to accomplish if we are finish the rules under our current daunting schedule. The BOD has raised legitimate concerns both with COPRAC's draft opinion and these proposed comments.

October 26, 2008 Tuft E-Memo to RRC List:

Ellen's memo on limited fiduciary duties respecting modifications of retainer agreements is useful in helping us focus on what is and is not the issue with respect to proposed Comments [5] and [6]. I do not believe anyone is claiming that the presumption of undue influence codified in Probate Code §16004 applies to fee agreements made or even modified during the representation of a client. The Rutter Group Practice Guide ¶¶ 5:31 – 5:32 makes this point clear, citing *Walton v. Broglio* and *Ramirez v. Sturdevant.* Ellen could add *Matter of Kroft* (Rev. Dept. 1998) 3 Cal. State Bar Rptr. 838 to her memo, which reaches the same conclusion.

The issue before us is whether Rule 1.8.1 [3-300] could apply to a modification of an existing retainer agreement because the modification is a business transaction between lawyer and client. *Walton v. Broglio* does not address this issue. Rather, the court construed the presumption of invalidity under former Civil Code §2235 to events that occurred <u>before</u> the adoption of rule 5-101 in 1975. In that case, Walton agreed to

represent Broglio in a criminal matter for $15,000. Broglio paid $4000 at the initial interview on July 27, 1972 and signed a promissory note for $7500 on August 10, 1972. The balance of the fee was never paid. Walton was allowed to enforce the note without having to overcome the presumption of invalidiy under §2235. Although the case might have some bearing on proposed Comment [6], it does not deal with rule 3-300 or the issue raised in Comment [5].

The court in *Ramirez v. Sturdevant* came to a similar conclusion, again, without discussing rule 3-300. The facts in *Ramirez* are significant to the court's decision. Sturdevant has successfully represented Ramirez before the Labor Commissioner for an hourly fee. Unwilling to proceed on a fee plus costs basis, Ramirez hired another lawyer to sue her former employer for wrongful termination and for "Brandt" fees. (*Brandt v. Superior Court* (1985) 37 Cal. 3d 813). She later fired that lawyer and hired Sturdevant again, who this time agreed to handle her case on a contingent fee based on gross recovery plus any attorney fees recovered. After the employer obtained summary judgment, Sturdevant said he would handle the appeal only if Ramirez agreed to pay costs and accept any settlement offer of at least $150,000. Sturdevant was successful in having the judgment reversed on appeal and settlement discussions ensued. Sturdevant was able to negotiate separate amounts for damages of $150,000, $35,000 for costs and $215,000 for attorney's fees. Ramirez agreed to the settlement, but claimed that Sturdevant was entitled to 33 1/3% of $400,000 and not 100% of the fee amount.

The court found that Sturdevant was not required to handle the appeal and was free to negotiate the terms on which he would continue to handle Ramirez's case. The court found there was substantial evidence that Sturdevant did not breach a fiduciary duty in negotiating the supplemental fee agreement even if Probate Code §16004 applied. Here again, *Ramirez* does not support Comment [5] that no provision of a modified fee agreement could ever be considered a business transaction under rule 1.8.1 [3-300].

The actual holding in *Ramirez* is significant. The court found that the original fee agreement gave Sturdevant the right to received "attorney's fees payable apart from any recovery of damages," and the complaint included a claim for "Brandt" fees. The provision in the supplemental agreement that allowed Sturdevant to settle his client's claim for an agreed amount and to separately negotiate of the amount for fees enabled Sturdevant to fashion a settlement that benefited his interests more than his client's and created a <u>potential conflict of interest</u>. The court remanded the case for an evidentiary hearing to determine whether the settlement was tainted by a conflict of interest or whether Ramirez's interests were adequately protected.

The court held "that where, as here, there is evidence that a conflict of interest arose between attorney and client which may have affected the ultimate settlement of the case, the settlement negotiations and the settlement should be examined by an impartial tribunal to determine if the client's interests have been forcefully represented. In conducting such review we place the burden of proof on the attorney to demonstrate that the attorney's own pecuniary interest did not interfere with the duty to promote the best interests of the client." 21 Cal. App.4th at 910.

This type of personal interest conflict is covered by the rules in other states but is not covered by the rules in California. Proposed Rule 1.7 provides no protection for clients or the public and no guidance for this conflict situation. Comment [5] simply

aggravates the problem by extending the lack of public protection under our rules and sets us even farther apart from other jurisdictions without adequate legal authority.

In re Silverton is a major obstacle to Comment [5]. The decision of the Review Department and the decision of the Supreme Court deserve careful reading. The findings of both courts involve three separate matters. The Hou matter involved a charged violation of rule 3-300, the other two did not. In Hou, Silverton associated with Watson in representing Janette Hou, her two children and mother in law in a personal injury case where the fee was 1/3 of the gross recovery before suit and 40% thereafter. The case against the driver of the other vehicle was settled and medical payment coverage was also obtained from the Hou's insurance company. The settlement amount and the medical payments were allocated among the clients after deducting the contingent fee. The clients still had medical bills to pay that significantly reduced their share of the recovery. At this point, Silverton made a deal with the clients that in return for paying them an additional sum ($254 to Janette Hou and $327 to Fran Hou), he would have the right to compromise their medical bills and keep the amount saved in addition to the fees and costs for handling their accident case. The Review Department determined that the arrangement was a business transaction under Rule 3-300. 36 Cal. 4th 81, at 86. The Supreme Court conducted an independent determination of the law and the facts in the case and "accept[ed] and adopt[ed] the conclusion of the Review Department that Silverton violated Rule 3-300 with respect to the Hou matter. . . " 36 Cal.4th at 89. Comment [5] flies directly in the face of the findings of the Review Department and the Supreme Court in the Hou matter.

In the Kelly and de Jonge matters, Wilma Kelly and Verna de Jonge retained Silverton separately to represent them and their children in an automobile accident case. Silverton's initial fee agreement called for the same contingent fee as in Hou. However, here, the agreement also gave Silverton the right, at his discretion, to compromise any medical bill and retain as an "additional fee" the difference between the compromised amount and the medical bill. The cases settled and the clients' share of the recovery was calculated. Kelly's net recovery was less than her medical bills; de Jonge's was slightly more. At that point, Silverton offered to pay each of his clients an additional sum out of his fee ($500 to Kelly and $493 to de Jonge) for the right to compromise their respective medical bills and keep the difference. He told Kelly and de Jonge that he already had that right under the original fee agreement. The Review Department rejected the Hearing Department's determination that Rule 3-300 was violated by the provision in the original fee agreement (presumably because of the first sentence in the discussion to Rule 3-300). However, the Review Department found that Silverton had committed an uncharged violation of Rule 3-300 in regard to the post settlement agreements with each client.

The third matter (Belinki) is substantially similar to Kelly and de Jonge and resulted in a finding of an uncharged violation of Rule 3-300 with respect to the post settlement agreement between Silverton and Belinki. The Supreme Court approved these findings and noted that from the facts developed in the record OCTC "could have - - but failed to - - charge Silverton with violating Rule 3-300 with respect to the post settlement agreements he negotiated with Kelly, de Jonge and Belinki." 36 Cal. 4th at 93, fn 4. Comment [5] is also contrary to the Supreme Court's findings in the Kelly, de Jonge and Belinki matters.

I have not been able to find case authority in California or else where that says that the rule does not apply to any mid stream change in a retainer agreement unless it amounts to an adverse pecuniary interest. We know, for example, that seeking to apply

a fee agreement arbitration provision to a dispute involving a business transaction with a client triggers the rule. *Mayhew v. Benninghoff* (1997) 53 Cal. App 4th 1365. Why should the result be different when a lawyer seeks to modify a fee agreement to add a binding arbitration provision; particularly if the new clause deprives the client of the right to a jury trial and to appellate review? Aren't these important legal rights the client enjoyed when the original contract was make and shouldn't the client have the same protections the rule affords in this situation as well? The business transaction and adverse pecuniary interest prongs of the rule are often overlapping and are not always clearly distinguishable. What policy reasons warrant the absolute position taken in Comment [5]? The Simon article is right – not all mid stream changes trigger the rule and whether a mid stream change constitutes a business transaction depends on the circumstances. *Silverton* is an illustration of circumstances that supported a finding that a post settlement transaction between lawyer and client constituted a "business transaction" under the rule.

The first sentence in Comment [5] should, therefore, be no different than the first sentence in the Discussion to Rule 3-300.

December 6, 2009 Lamport E-mail to RRC re MR 1.8(d):

I am recommending that the Commission not adopt Model Rule 1.8(d) for the reasons set forth below

ABA Model Rule 1.8(d) states:

> "(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation."

The Comment to Model Rule 1.8(d) states:

> "Literary Rights
>
> [9] An agreement by which a lawyer acquires literary or media rights concerning the conduct of the representation creates a conflict between the interests of the client and the personal interests of the lawyer. Measures suitable in the representation of the client may detract from the publication value of an account of the representation. Paragraph (d) does not prohibit a lawyer representing a client in a transaction concerning literary property from agreeing that the lawyer's fee shall consist of a share in ownership in the property, if the arrangement conforms to Rule 1.5 and paragraphs (a) and (i)."

The Model Rule carries forward concepts expressed in the Model Code. DR 5-103(A) stated in relevant part: "A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation he is conducting for a client..." EC 5-4 stated: "If, in the course of his representation of a client, a lawyer is permitted to receive from his client a beneficial ownership in publication rights relating to the subject matter of the employment, he may be tempted to subordinate the interests of his client to his own anticipated pecuniary gain. For example, a lawyer in a criminal case who obtains from his client television, radio, motion picture, newspaper, magazine, book, or other publication rights with respect to the case may be influenced, consciously or unconsciously, to a course of conduct that will enhance the value of

his publication rights to the prejudice of his client. To prevent these potentially differing interests, such arrangements should be scrupulously avoided prior to the termination of all aspects of the matter giving rise to the employment, even though his employment has previously ended."

California has not adopted a similar prohibition. Instead, literary rights arrangements between lawyers and clients have been considered under the Rule 3-300 rubric. (See *Maxwell v. Superior Court* (1982) 30 Cal.3d 606, 616, n. 6.)

Our Supreme Court addressed the conflict issues associated with literary rights agreements in *Maxwell* and rejected the conflict of interest considerations that have been used to justify the Model Rule. *Maxwell* involved an agreement by which a criminal defendant charged with a capital offense entered into an agreement to confer the ownership of his life story to his defense counsel. The agreement had extensive disclosures. It advised the client to seek the advice of independent counsel. The defendant was examined and was determined to have knowingly consented to the arrangement. Nevertheless, the trial court recused the defendant's lawyers on the grounds that the agreement created a conflict of interest.

The Supreme Court disagreed. It stated, "A life-story agreement creates no such inherent or inevitable conflict. The contract here discloses that the value of petitioner's story might benefit from a long, sensational trial leading to conviction and death. It seems not unlikely, though, that counsel's self-interests might best be served by a careful, diligent defense that avoids conviction or minimizes the penalty. A quiet strategy that succeeds may well make a better story than a flamboyant failure. Counsel's reputation, a precious professional and commercial asset, is enhanced; and the risks of professional discipline and demeaning criticism are reduced. Also, it may be commercially prudent to keep lurid facts confidential until the legal battle has ended.

Justice Files' dissenting remarks in the Court of Appeal are particularly apt: 'Although the literary rights contract is not a common experience for attorneys, the kind of 'conflict' discussed here is not at all unusual. . . . [Almost] any fee arrangement between attorney and client may give rise to a 'conflict.' An attorney who received a flat fee in advance would have a 'conflicting interest' to dispose of the case as quickly as possible, to the client's disadvantage; and an attorney employed at a daily or hourly rate would have a 'conflicting interest' to drag the case on beyond the point of maximum benefit to the client.

The contingent fee contract so common in civil litigation creates a 'conflict' when either the attorney or the client needs a quick settlement while the other's interest would be better served by pressing on in the hope of a greater recovery. The variants of this kind of 'conflict' are infinite. Fortunately most attorneys serve their clients honorably despite the opportunity to profit by neglecting or betraying the client's interest.'" (*Maxwell*, *supra*, 30 Cal.3d at 619, n. 8.)

The Court concluded that a client could give an informed consent to the conflicts of interest that could arise from a literary rights agreement.

The Court's concluding comment in *Maxwell* states, "We stress that our opinion connotes no moral or ethical approval of life-story fee contracts. We have addressed only this narrow question: May a criminal defendant (here charged with capital crimes) be denied his right to representation by retained counsel simply because of potential conflicts or ethical concerns even when he has asserted, after extensive disclosure of the risks, that he wishes to proceed with his chosen lawyers and no others? Our answer is No." (*Maxwell*, *supra*, 30 Cal.3d at 622.)

In a concluding footnote, the Court stated, "As Justice Files observed below: 'I do not disagree with EC 5-4 of the American Bar Association's Code of Professional Responsibility, which declares that the kind of contract which is here involved 'should be scrupulously avoided.' But we are here dealing with a fact and not a theory. The defendant and his attorneys have made the contract. The question now is whether this defendant, charged with four capital offenses, shall be deprived of his chosen attorneys and forced to accept the trial court's choice who, in the words of the Faretta court: '"represents" the defendant only through a tenuous and unacceptable legal fiction.'" (*Maxwell*, *supra*, 30 Cal.3d at 622, n. 13.)

Model Rule 1.8(d) imposes a unconsentable prohibition on literary right agreements based on principles that the Supreme Court did not accept in *Maxwell*. *Maxwell* demonstrates that such agreements do not always involve a conflict of interest and that a client can consent to a literary rights agreement in the face of potential conflicts. I am not aware of any particular development that would suggest that the Court would be prepared to abandon *Maxwell.* Indeed, in the Court cited *Maxwell* in its concluding footnote in *Haraguchi v. Superior Court* last year without questioning its holding.

In light of the decisional history on this point, I am not prepared to conclude that the absolute prohibition in Rule 1.8(d) is warranted. If literary rights agreements are permitted with appropriate disclosures and consents (and all the limitations that go with that), do we need a rule that says that? In my opinion, the answer is "no." These agreements are covered by Rule 1.8.1, as they confer on the lawyer an ownership, possessory, security or other pecuniary interest adverse to a client. If the Commission believes it is necessary to explain the failure to recommend adoption of Rule 1.8(d), we could add something to the Rule 1.8.1 Comment stating that it applies to literary rights agreements; however, I don't think it is necessary.

December 6, 2009 Lamport E-mail to RRC re MR 1.8(i):

I am recommending that the Commission not adopt Model Rule 1.8(d) for the reasons set forth below

ABA Model Rule 1.8(i) states:

> "(i) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:
>
> (1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and
>
> (2) contract with a client for a reasonable contingent fee in a civil case."

The Comment to Model Rule 1.8(i) states:

"Acquiring Proprietary Interest in Litigation

> [16] Paragraph (i) states the traditional general rule that lawyers are prohibited from acquiring a proprietary interest in litigation. Like paragraph (e), the general rule has its basis in common law champerty and maintenance and is designed to avoid giving the lawyer too great an interest in the representation. In addition, when the lawyer acquires an ownership interest in the subject of the representation, it will be more difficult for a client to discharge the lawyer if the client so desires. The Rule is subject to specific

> exceptions developed in decisional law and continued in these Rules. The exception for certain advances of the costs of litigation is set forth in paragraph (e). In addition, paragraph (i) sets forth exceptions for liens authorized by law to secure the lawyer's fees or expenses and contracts for reasonable contingent fees. The law of each jurisdiction determines which liens are authorized by law. These may include liens granted by statute, liens originating in common law and liens acquired by contract with the client. When a lawyer acquires by contract a security interest in property other than that recovered through the lawyer's efforts in the litigation, such an acquisition is a business or financial transaction with a client and is governed by the requirements of paragraph (a). Contracts for contingent fees in civil cases are governed by Rule 1.5 ."

Rule 1.8(i) would carve out a category of adverse pecuniary interests covered by Rule 1.8.1 (ownership interests in a cause of action or subject matter of litigation) to which a client could not consent even if the terms are fair and reasonable.

The rationale for the Rule, as explained in the Comment, is based on (i) common law prohibitions on champerty and maintenance and (ii) the potential difficulty in discharging counsel. Putting aside whether California has embraced prohibitions on champerty and maintenance, it appears to me that an acquisition of an ownership interest would not be fair and reasonable under Rule 1.8.1(a) if it would make it more difficult for a client to discharge the lawyer if the client so desires. I am not prepared to say that every acquisition of such an interest, other than the two interests excepted from the Rule, is inherently not fair and reasonable and cannot pass muster under Rule 1.8.1. The Comment to the Rule suggests that the ABA had a specific transaction in mind; but neither the Rule nor the Comment spell out what that is. The result is a rule that is overbroad (in that it would apply to acquisitions that may be fair and reasonable and could pass muster under Rule 1.8.1) and that covers a subject that is already addressed in Rule 1.8.1. Rule 1.8.1 does a much better job of distinguishing between those acquisitions that should be prohibited and those that should not.

December 6, 2009 Peck E-mail to RRC re MR 1.8(d):

For all of the reasons stated by Stan in his earlier e-mail, I do not think that we should adopt any form of ABA Model Rule 1.8(d) concerning literary or media rights. I think our new version of rule 3-300 covers the ground adequately.