

## Memorandum

To: Rules Revision Commission  
From: Stanley W. Lamport  
Date: September 20, 2004  
Re: Rule 3-300

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This memorandum attempts to summarize issues that have arisen with respect to rule 3-300 over the years that the Commission may want to address in the rule. Mark has addressed the comparison of rule 3-300 to ABA Model Rule 1.8, which I do not propose to rehash here. I agree with Mark that we should not change the text of our rule, although I think it should be renamed. I by and large agree with Mark about the portions of the ABA Comment that we should adapt into our rule.

I do not agree with Tony's suggestion that we extend the rule to fee agreements. There is ample case law about the arms length nature of the engagement of a lawyer by a client. I do not support a rule that would beg the question – how many lawyers does it take to hire a lawyer.<sup>1</sup>

I suggest that the Commission consider the following issues.

### 1. Transactions that Are Outside the Scope of the Rule

In Formal Opinion 1994-141, COPRAC stated the following:

“[T]he Supreme Court has directed the application of rule 3-300 and its predecessor, rule 5-101, to transactions in which there exists an actual or potential conflict of interest between the lawyer and the client. (See *Rose v. State Bar* (1989) 49 Cal.3d 646, 662-663 [262 Cal.Rptr. 702].) In light of the principles on which the rule is founded, it is apparent that **the rule is intended to apply to transactions that arise out of the lawyer-client relationship or the trust and confidence reposed by the client in the lawyer as a result of the lawyer-client relationship.** (See *Beery v. State Bar, supra*, 43 Cal.3d 802, 813; see also L.A. Cty. Bar Assn. Formal Opn. No. 477.)

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<sup>1</sup> Answer: Endless. The client would have to hire a lawyer to review the fee agreement of the lawyer hired to review the fee agreement and so on until someone in the chain agrees to do the work without charging a fee

Thus, the rule will ordinarily not apply when a lawyer purchases a meal at a restaurant owned by a client or when the client pays for parking in a parking lot owned by the lawyer, since these transactions do not typically involve the fiduciary relationship.” (Emphasis added.)

The highlighted text is a good test for distinguishing the kinds of transactions the rule covers. I suggest that we add the highlighted text into the Discussion.

## 2. What Is an Adverse Pecuniary Interest – The *Fletcher* Problem

Both rule 3-300 and Model Rule 1.8 use the phrase “ownership, possessory, security or other adverse pecuniary interest.” Back in the early 1990s COPRAC struggled with whether a lawyer’s financial interest in the subject matter of a representation was an adverse pecuniary interest or whether the other pecuniary interest had to be of the same kind as an ownership, possessory or security interest. Similar problems have cropped up in the malpractice cases.

Until recently, I was of the view that an adverse pecuniary interest is a situation where the lawyer can summarily extinguish the client’s interest in property without court scrutiny. (*Hawk v. State Bar* (1988) 45 Cal.3d 589, 599-601 (deed of trust on client property); *Read v. State Bar* (1991) 53 Cal.3d 394 (deed of trust on client property); *Ames v. State Bar*, (1973), 8 Cal.3d 910 (lawyer purchase of deed of trust on client property). It also applies when a lawyer takes title to or possession of a client’s property as security or for the client’s benefit. *Brockway v. State Bar* (1991) 51 Cal.3d 51, 64 (acquiring title to client’s property as security); *Conner v. State Bar* 50 Cal.3d 1047 (acquisition of client property to avoid foreclosure); *Morgan v. State Bar* (1990) 51 Cal.3d 598, 605-606 (1990) (lawyer’s use of client’s credit cards); *Sugarman v. State Bar* (1990) 51 Cal.3d 609, 616 (“loan” by which lawyer obtained control of client’s funds).)

I also understood the rule had been held to apply when a lawyer acquires an interest in an obligation owed to a client or acquires an interest in an entity indebted to a client. (*Rodgers v. State Bar* (1989) 48 Cal.3d 300 (client’s loan to a third party secured by lawyer’s property); *Kapelus v. State Bar* (1987) 44 Cal.3d 179, 193-194 (lawyer’s acquisition of a non-recourse interest in a partnership indebted to the client).) Although I question whether these cases are properly analyzed as an adverse pecuniary interests rather than as business transactions, we are probably stuck with how the Supreme Court characterized them.

The Supreme Court clouded the field considerably in *Fletcher v. Davis* (2004) 33 Cal.4th 61, in which the Court held that a lawyer’s charging lien was a security interest that is subject to rule 3-300. That, in itself, is not a startling conclusion. However, in deciding the case,

the Court was pulled into a discussion about whether the security interest was an adverse pecuniary interest. In addressing this argument the Court stated:

Defendants Davis and Fischbach argue that Fletcher's charging lien was adverse to Master Washer because, under *Ames, supra*, 8 Cal.3d at page 920, it was "reasonably foreseeable" that its acquisition by Fletcher could become detrimental to the client. However, Fletcher and the Court of Appeal use a different test. They contend that *Hawk* modified the "reasonably foreseeable" test such that only those transactions that permit the attorney to summarily extinguish the client's interest in the property are deemed adverse, relying in particular on this sentence from *Hawk, supra*, 45 Cal.3d at page 600: "Again, acquiring the ability to summarily *extinguish* the client's interest in property is what makes the acquisition 'adverse.' "

Fletcher and the Court of Appeal have misread *Hawk*, which nowhere criticized *Ames* and instead acknowledged explicitly that "[w]e have also said that an attorney who has obtained an interest in the property of a client where it is reasonably foreseeable that his acquisition may become detrimental to the client, even though his intention is to aid the client, has acquired an interest adverse to a client." (*Hawk, supra*, 45 Cal.3d at p. 599; see also *Connor v. State Bar* (1990) 50 Cal.3d 1047, 1057.) That standard was triggered, we explained, when an attorney's " 'personal financial interest was in conflict with [his client's] interest in obtaining full repayment of its loan' " (*Hawk, supra*, at p. 599), when counsel had "acquired an interest in the subject matter of the litigation for which they had been retained" (*id.* at p. 600), and when a secured note "can be used to summarily extinguish the client's interest in the property." (*Ibid.*) Fletcher's proposed test would define only the last of these transactions as adverse. Plainly, the single sentence seized on by Fletcher merely described the adverse interest presented in that case. It did not purport to define what makes an interest adverse in all circumstances.

The Court's analysis blurs the distinction between rule 3-300 and rule 3-310(B)(4). In light of the Court's discussion rule 3-300 and rule 3-310(B)(4) both apply when a lawyer acquires an "adverse" interest during the attorney-client relationship. Rule 3-310(B)(4) alone would apply when the lawyer has a pre-existing interest.

I think we need to address this in the Discussion, First, I suggest that we note the security interest cases. Second, I suggest we add a sentence to the Discussion addressing *Fletcher* ( such as "rule 3-300 applies when a lawyer acquires a security interest in part of a client's recovery in a matter"). Third, I recommend that we add something to the end of rule 3-310 cross referencing members to rule 3-300.

### 3. Advance Fees

The first paragraph of the Discussion states:

“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. Such an agreement is governed, in part, by rule 4-200.”

Read literally, the paragraph would require 3-300 compliance for advance fees that are held as security for the payment of attorney fees to be incurred. No court to my knowledge has held that an advance falls within the scope of the rule. In light of *Fletcher*, such an arrangement may be outside the scope of the rule since it is not “adverse” as the term is used in that case. We should address it in the Discussion.

While we are at it, the last sentence of the first paragraph of the Discussion is ambiguous. The first sentence refers to two types of fee agreements – a fee agreement and a fee agreement that confers an ownership, possessory, security, of other pecuniary interest adverse to a client. It seems apparent that the “such an agreement” language in the second sentence refers to the simple fee agreement. However, the last antecedent rule of construction would have the “such an agreement” language refer to the agreement that confers an adverse pecuniary interest. The paragraph is needlessly ambiguous and should be clarified.