THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 06-0006

ISSUES: Is it ethically proper for an attorney who is settling a fee dispute with a client to include a general release and a Civil Code section 1542 waiver in the settlement agreement? Does the existence of a legal malpractice claim against the attorney alter the ethical propriety of including a general release and section 1542 waiver in the settlement agreement?

DIGEST: If an attorney contemplates entering into a settlement agreement with a current client that includes a general release of a legal malpractice claim or pursues a settlement agreement with a client, the terms of which are broad enough to release a legal malpractice claim, the attorney must promptly disclose to the client the facts giving rise to the legal malpractice claim. The attorney must consider whether it is necessary or appropriate to withdraw from the representation. If the attorney does not withdraw, the attorney must:

1. Comply with rule 3-400(B) by advising the client of the right to seek independent counsel and giving the client an opportunity to do so;

2. Advise the client that the lawyer is not representing or advising the client as to the settlement of the fee dispute or the legal malpractice claim; and

3. Fully disclose to the client the terms of the settlement agreement, in writing, including the possible effect of the general release and section 1542 waiver, unless the client is represented by independent counsel.

AUTHORITIES INTERPRETED: Rules 3-300, 3-310, 3-400 and 3-500 of the Rules of Professional Conduct of the State Bar of California.[1/]

Business and Professions Code section 6068, subdivision (m).

Civil Code section 1542.

STATEMENT OF FACTS

Fact Pattern 1: Client 1 engages Attorney A to represent Client 1. During the representation, a dispute develops regarding attorneys' fees. Client 1 and Attorney A decide to settle the attorneys' fees dispute by entering into a written settlement agreement. Client 1 and Attorney A intend that Attorney A continue to represent Client 1 in the ongoing matter. Although Attorney A is not aware of any basis for a legal malpractice claim, Attorney A is concerned that Client 1 may allege that Attorney A committed legal malpractice at some future date. To resolve the fee dispute and protect against any future legal malpractice allegation regarding Attorney A's completed services, and to resolve the ongoing dispute so as to allow the continuation of the representation, Attorney A proposes a settlement of the fee dispute, memorialized by a written settlement agreement including a general release of all claims known and unknown to the date of the settlement and a

[1/] Unless otherwise noted, all rule references are to the Rules of Professional Conduct of the State Bar of California.

provision waiving Civil Code section 1542 (hereinafter "section 1542"). The proposed settlement agreement is broad enough to release any legal malpractice claim. Section 1542 provides that:

> A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor.

Client 1 is unaware of any legal malpractice by Attorney A, and has not alleged legal malpractice against Attorney A, formally or informally. Client 1 and Attorney A execute the settlement agreement, including the section 1542 waiver. Later, Client 1 files a lawsuit for legal malpractice against Attorney A with regard to services rendered before the settlement agreement was executed. At that time, Attorney A relies upon the general release and the section 1542 waiver, asserting that Client 1 released the claim for legal malpractice against Attorney A.

Fact Pattern 2: Attorney B believes that she has committed legal malpractice in a matter that she is handling on behalf of Client 2. Client 2 is delinquent in payment of attorneys' fees to Attorney B. Near the end of the engagement, Attorney B demands payment of all past due attorneys' fees. Attorney B and Client 2 decide to mediate their dispute. At the mediation, Client 2 is not represented by independent counsel. Without disclosing the potential malpractice claim to Client 2, Attorney B settles the fee dispute with Client 2, and the parties enter into a settlement agreement and mutual general release of all claims, known and unknown. Attorney B and Client 2 both intend that the settlement agreement resolve any claim for legal malpractice, and the terms of the settlement agreement are broad enough to do so. The settlement agreement includes a section 1542 waiver.

Fact Pattern 3: Client 3 engages Attorney C to represent Client 3. The representation comes to a conclusion because the case in which Attorney C represented Client 3 is resolved through a settlement. However, Client 3 has not paid Attorney C's billings for attorneys' fees in full. Attorney C sends a letter to Client 3 demanding payment of the outstanding fees. In response, Client 3 refuses to pay the outstanding attorneys' fees and asserts that Attorney C has committed legal malpractice. Attorney C disagrees that he has committed legal malpractice. Client 3 engages Attorney D to represent Client 3 in reference to the dispute with Attorney C, including the dispute concerning the payment of attorneys' fees and Client 3's legal malpractice claim against Attorney C. While Client 3 is represented by Attorney D, Client 3 and Attorney C resolve their dispute, memorializing the resolution in a written settlement agreement and mutual general release of all claims, known and unknown, which includes a section 1542 waiver. Attorney C intends that the settlement agreement resolve Client 3's claim for legal malpractice against Attorney C, and the terms of the settlement agreement are broad enough to do so.

This opinion discusses the ethical issues raised by the above scenarios. The issues include: (1) whether the attorney in each factual scenario has a conflict of interest; (2) how the attorney in each scenario must proceed in order to fulfill his or her fiduciary duties; (3) the duty of the attorney in each scenario to make disclosures to the clients, including disclosure of the facts giving rise to the legal malpractice claim and disclosure fully explaining the terms and conditions of the proposed settlement; and (4) under what circumstances the attorney must withdraw from the representation of the client.

The effect of a settlement agreement between a lawyer and a client releasing all claims, known and unknown, combined with a section 1542 waiver, is a matter of contract law. In some cases, depending on the facts and circumstances, the precise language of the release, whether the client is represented by independent counsel, and the intentions of the parties in entering into the settlement agreement, the settlement agreement may result in the client's release of the lawyer from all claims, known or unknown, including any claims that the client may have against the lawyer for legal malpractice. (See, e.g., *Winet v. Price* (1992) 4 Cal.App.4th 1159, 1168 [6 Cal.Rptr.2d 554];[2/] *Donnelly v. Ayer* (1986) 183 Cal.App.3d 978, 983-984 [228 Cal.Rptr. 764].) The enforceability of the settlement agreement, depending as it may on whether the client has independent counsel,

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[2/] Note, however, that a section 1542 waiver may not be effective to support a release where the releaser suffers from mental incapacity, or where the release is induced by fraud. (*Winet v. Price, supra,* 4 Cal.App.4th at p. 1169, fn. 6.)

whether a viable malpractice claim is concealed by the attorney from the client, and whether the client signed the release and section 1542 waiver without intending to release the attorney from liability for legal malpractice, is a legal matter of contract law that is beyond the scope of this opinion. We consider here only the ethical obligations of a lawyer entering into such an agreement with a present or former client.

DISCUSSION

1. Withdrawal from Representation

A fee dispute between a lawyer and client does not, by itself, require the lawyer to withdraw as counsel. (Los Angeles County Bar Assn. Formal Opn. No. 521.) At the initial stages of a fee dispute, withdrawal is permissive. (*Ibid.*) Prior to an attorney initiating a suit for the collection of fees against a client, the attorney should withdraw from the representation of the client. (Rule 3-700(C)(1)(f) [breach of obligation to pay fees is basis for permissive withdrawal]; *Santa Clara County Counsel Attys. Assn. v. Woodside* (1994) 7 Cal.4th 525, 548-549 [28 Cal.Rptr.2d 617] [noting in dictum the potential for the duty of loyalty to preclude an attorney's lawsuit against a current client]; Los Angeles County Bar Assn. Formal Opn. No. 476 ["an attorney should withdraw from all matters in which representation is being provided to the client prior to commencing litigation for costs or fees"]; Los Angeles County Bar Assn. Formal Opn. No. 212 [same].)

Before entering into a settlement agreement and obtaining a general release and section 1542 waiver from a client, the lawyer should consider whether it is appropriate to withdraw from the representation. In making this decision, the lawyer should consider the circumstances motivating the request for a general release and section 1542 waiver, the level of antagonism between the lawyer and client, and the degree to which withdrawal from representation would cause prejudice to the client. (Rule 3-700(A)(2).)

2. Settling Claims for Attorney's Liability

A fee dispute with a client, by itself, also does not create an ethical conflict of interest. (Los Angeles County Bar Assn. Formal Opn. No. 521.) However, where the fee dispute involves a potential claim of legal malpractice, and where the lawyer intends through the settlement agreement to obtain a release of that legal malpractice claim, or where the settlement agreement itself is broad enough to effectively release the client=s legal malpractice claim against the lawyer, a general release including a waiver of section 1542 from the client in connection with the resolution of that fee dispute is subject to rule 3-400(B). Rule 3-400(B) provides that an attorney shall not settle a *claim or potential claim* for an attorney's liability to a client for an attorney's professional malpractice unless (1) the client is informed in writing that the client may seek the advice of independent counsel regarding the settlement, and (2) the client is given a reasonable opportunity to seek that advice. (Rule 3-400(B).)[3/]

3. Duty of Loyalty B Conflict of Interest

A conflict of interest arises in scenarios involving a lawyer's settlement of a fee dispute with a client that also involves the release of a potential or actual legal malpractice claim. A member shall not accept or continue representation of a client without providing written disclosure to the client where the member has or had financial or professional interests in the potential or actual malpractice claim involving the subject matter of the representation. (Rule 3-310(B)(4).) "The primary purpose of this prophylactic rule is to prevent situations in which an attorney might compromise his or her representation of the client in order to advance the attorney's own financial or personal interests." (*Santa Clara County Counsel Attys. Assn. v. Woodside, supra,* 7 Cal.4th at

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[3/] Rule 3-400(A) provides that an attorney may not contract with a client "prospectively" limiting the attorney's liability to the client for malpractice. This provision applies to agreements limiting liability for future acts of malpractice. Because none of the fact patterns described in this opinion involve an attorney attempting to limit future liability for legal malpractice, which has not already occurred, rule 3-400(A) is inapplicable here.

p. 546.) Written disclosure to the client of the conflict of interest arising from the lawyer's financial or professional interests in the dispute is required. (Rule 3-310(B).)[4/]

Although the lawyer does not have a financial interest that creates a conflict of interest in a situation involving solely a fee dispute (Los Angeles County Bar Assn. Formal Opn. No. 521), once a potential or actual legal malpractice claim is involved, and once the attorney seeks a release from such a claim, the lawyer has a financial and professional interest in avoiding a suit for legal malpractice arising from the lawyer's representation and in minimizing the lawyer's exposure to the client. (See *People v. Bonin* (1989) 47 Cal.3d 808, 835 [254 Cal.Rptr. 298] ["Conflicts of interest broadly embrace all situations in which an attorney's loyalty to, or efforts on behalf of, a client are threatened by . . . his own interests."].) Where the attorney's interest in securing an enforceable waiver of a client's legal malpractice claim against the attorney conflicts with the client's interests, the attorney must assure that his or her own financial interests do not interfere with the best interests of the client. (See *Ramirez v. Sturdevant* (1994) 21 Cal.App.4th 904, 924 [26 Cal.Rptr.2d 554] [recognizing the conflict of interest inherent in an attorney's dual representation of the interests of the client and the attorney in settlement negotiations with a third party].) Accordingly, the lawyer negotiating such a settlement with a client must advise the client that the lawyer cannot represent the client in connection with that matter, whether or not the fee dispute also involves a potential or actual legal malpractice claim. (Rules 3-310 and 3-500.)

4. Disclosure of Facts Giving Rise to Potential Malpractice Claim to Client

A lawyer has an ethical obligation to keep a client informed of significant developments relating to the representation of the client. (Bus. & Prof. Code, ' 6068, subd. (m); rule 3-500.) Where the lawyer believes that he or she has committed legal malpractice, the lawyer must promptly communicate the factual information pertaining to the client's potential malpractice claim against the lawyer to the client, because it is a "significant development."[5/] We previously stated that:

> It would, of course, be unethical for an attorney, knowing he/she had committed malpractice, to attempt to negotiate an arbitration provision into an existing retainer agreement without fully disclosing the fact of the attorney's negligence to the client.
> (State Bar Formal Opn. No. 1989-116, fn. 4.)

5. Inapplicability of Rule 3-300

Rule 3-300 imposes certain requirements before an attorney may "enter into a business transaction with a client; or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client[.]" The requirements include: (1) a fair and reasonable transaction or acquisition and terms; (2) full written disclosure of such terms; (3) a written advisory that the client may seek advice from an independent attorney of the client's choice; (4) a reasonable opportunity to obtain such advice from an independent attorney; and (5) written consent by the client to the terms of the transaction or acquisition. (Rule 3-300(A)-(C).) While no published California authorities have specifically addressed whether an attorney's cash settlement of a fee dispute that includes a general release and a section 1542 waiver of actual or potential malpractice claims for past legal services falls within the prescriptions of this rule, it is the Committee's opinion that rule 3-300 should not apply.

First, rule 3-400(B) expressly addresses an attorney's ability to settle an actual or potential claim for malpractice by imposing the requirements set forth in Section 2, *supra*. Specifically, the client must be advised in writing that he or she may seek advice of an independent attorney of his or her choice regarding the settlement and must

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[4/] "Disclosure" means informing the client or former client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences. (Rule 3-310(A)(1).)

[5/] Note, however, that there is no ethical obligation to discuss the various types of malpractice recovery the client may obtain against the lawyer. (*Expansion Pointe Properties Ltd. Partnership v. Procopio, Cory, Hargreaves & Savich, LLP* (2007) 152 Cal.App.4th 42, 55 [61 Cal.Rptr.3d 166].)

be given a reasonable opportunity to do so. (Rule 3-400(B).) Rule 3-300, however, lacks any reference to the settlement of such claims.

Second, if the prescriptions of rule 3-300 were to apply to these circumstances, rule 3-400(B) would be rendered mere surplusage. Rule 3-400(B)'s requirements are more narrow in scope than those in rule 3-300, but are nonetheless contained within rule 3-300.[6/] Consequently, there would be no need for rule 3-400(B)'s existence if rule 3-300 also applied.[7/] (See *People v. Hawes* (1982) 129 Cal.App.3d 930, 936-937 [181 Cal.Rptr. 456] ["specific statutory provision controls a general one even where the general one standing alone would be broad enough to include the subject matter of the specific statute"].)

For these reasons, the Committee believes that the prescriptions of rule 3-300 are inapplicable when an attorney and client are negotiating a cash settlement of a fee dispute in exchange for a section 1542 release of claims, including malpractice claims for prior services rendered.

6. Application to Fact Patterns

In Fact Pattern 1, where Attorney A and Client 1 have an ongoing attorney-client relationship, and Client 1 has no independent counsel, Attorney A must advise Client 1 that Attorney A does not represent Client 1 in reference to that dispute. Attorney A must advise Client 1 in writing that Client 1 may seek the advice of independent counsel regarding the general release and section 1542 waiver, and must give Client 1 an opportunity to do so. (Rule 3-400(B).) After Client 1 has filed a lawsuit for legal malpractice against Attorney A, Attorney A should withdraw from representation of Client 1 in the ongoing, underlying matter.

In Fact Pattern 2, Attorney B has an interest in not only resolving the fee dispute favorably, but also in obtaining an enforceable release of the legal malpractice claim which Client 2 may have against Attorney B. Because Client 2's interest is adverse to that of Attorney B, Attorney B should consider whether it is appropriate to withdraw from the representation of Client 2. Because the dispute involves a legal malpractice claim, a matter beyond the compensation and hiring arrangements in the attorney-client relationship, the settlement agreement including the general release and section 1542 waiver is presumed to involve a breach of Attorney B's fiduciary duties to Client 2 (see *Ramirez v. Sturdevant, supra,* 21 Cal.App.4th at p. 917), subject to rebuttal by Attorney B. Attorney B is further obliged to fully disclose the facts pertaining to the potential legal malpractice claim to Client 2. (Rules 3-310(A)-(B) and rule 3-500.)

Attorney B must also advise Client 2 in writing of Client 2's right to seek the advice of independent counsel regarding the settlement agreement and must give Client 2 a meaningful opportunity to do so. (Rule 3-400(B).) Where the settlement takes place during a mediation, in order to comply with rule 3-400(B), the parties to the mediation may have to adjourn the mediation and reconvene in order to permit Client 2 to have a meaningful opportunity to seek independent counsel, depending upon when the advice required by rule 3-400(B) is given, and upon Client 2's desires.

[6/] The American Bar Association Model Rules of Professional Conduct also contain a provision dealing with the settlement of an actual or potential malpractice claim that corresponds to the more narrow requirements of rule 3-400(B). (ABA Model Rules, rule 1.8(h)(2).) Similarly, the Restatement (Third) of the Law Governing Lawyers requires, "for purposes of professional discipline," written advice that independent representation is appropriate when settling a malpractice claim. (Rest.3d, Law Governing Lawyers, sec. 54(4).) Only in a separate provision addressing when a client or former client may *rescind* such a settlement agreement is the lack of a Afair and reasonable@ settlement paired with the lack of independent representation. Thus, under the Restatement, this additional requirement affects the enforceability of the contract, not the lawyer=s professional duties.

[7/] This opinion does not address the situation where an attorney *obtains an interest in a client's property* for purposes of securing the attorney's past due fees. Such a situation is expressly intended to be subject to rule 3-300. (See discussion to rule 3-300.)

In Fact Pattern 3, because Client 3 and Attorney C have terminated their attorney-client relationship, and Client 3 has independent counsel (Attorney D), the obligation to keep a "client" informed of significant developments no longer applies. (Bus. & Prof. Code, sec. 6068, subd. (m); rule 3-500.) Likewise, rule 3-400, which by its terms is applicable only to "clients," is not applicable to this factual scenario because Client 3 is no longer a client of Attorney C. (State Bar Formal Opn. No. 1992-127, fn. 7 [rule 3-400 does not apply where the attorney-client relationship is terminated]; see *Donnelly v. Ayer, supra,* 183 Cal.App.3d at p. 984.) Where Client 3 is represented by Attorney D in connection with the dispute that is the subject of the settlement agreement, Attorney C may communicate directly with Client 3, even though Client 3 is represented by counsel. (Discussion to rule 2-100(A) [the rule does not prohibit a member who is also a party from communicating directly or indirectly on his or her own behalf with a represented party].)

CONCLUSION

Before entering into a settlement agreement with a current client that includes a general release and a section 1542 waiver, an attorney must promptly disclose to the client the facts giving rise to any potential or actual malpractice claim. The attorney should consider whether it is necessary or appropriate to withdraw from the representation. If the attorney does not withdraw, the attorney must comply with rule 3-400(B), advise the client that the lawyer does not represent the client in reference to the fee dispute or legal malpractice claim, and fully disclose to the client the terms of the settlement agreement, in writing, including the possible effects of the general release and section 1542 waiver, assuming the client does not have independent counsel.

This opinion is issued by the Standing Committee on Professional Responsibility and Conduct of the State Bar of California. It is advisory only. It is not binding upon the courts, the State Bar of California, its Board of Governors, any persons, or tribunals charged with regulatory responsibilities, or any member of the State Bar.