THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION NO. 2002-159

ISSUE: Is it ethically permissible for a lawyer to: (1) to tell a potential client of the possibility of financing the legal representation by taking out a mortgage loan on the client's real property and (2) to refer the client to an independent broker who might arrange the financing, where the resulting loan funds are placed in an escrow account which is not controlled by the lawyer and from which the funds are disbursed to the lawyer for fees and costs for work performed on behalf of the client?

DIGEST: A lawyer may refer a potential client to a broker for a real property loan to pay for attorney's fees and costs so long as the lawyer does not provide legal representation or receive compensation with regard to the referral or the resulting loan or escrow transactions, and has no undisclosed business or personal relationship with the broker.

AUTHORITIES INTERPRETED: Rules 1-320, 3-300, 3-310, and 4-100 of the Rules of Professional Conduct of the State Bar of California.

Business and Professions Code sections 6068, subdivision (e), 6148, and 6200 et seq.

STATEMENT OF FACTS

A lawyer has been consulted by a potential client who seeks representation by the lawyer. The potential client presently is not able to pay for the legal services. The potential client owns real estate which can be encumbered as security for a loan, the proceeds of which could be used to pay for legal services. The lawyer provides the potential client with the name of a licensed broker, who she says might be able to arrange such a loan as one possible method for financing the legal representation. The lawyer also states in writing to the potential client that she neither is advising the potential client concerning alternative methods for financing legal representation nor recommending the use of the particular broker. The lawyer further states in writing that she does not represent the broker, the lender, or the prospective client in the loan transaction, and that she does not represent any of them or the escrow company with regard to the escrow in which the lender and the prospective client agree to place the loan proceeds. None of the participants compensate the lawyer with regard to the referral, the loan, or the escrow. Further, the lawyer does not condition her representing the client on the client having the recommended broker arrange the financing. The lawyer sends statements each billing cycle to the escrow account, seeking disbursements of funds to compensate the lawyer for attorney's fees and costs during the billing cycle; and the lawyer simultaneously sends a copy of each bill to the client. After the client has a reasonable amount of time to object to the lawyer's bill, the funds then are released for payment of legal services according to the fee agreement between the attorney and the client.

DISCUSSION

I. The Proposed Escrow Arrangement Does Not Require Compliance With Rule 3-300

Rule 3-300 of the Rules of Professional Conduct of the State Bar of California governs a lawyer's business transactions with a client.[1/] Rule 3-300 prohibits a lawyer from entering into a business transaction with her client,

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

and from knowingly acquiring an ownership, possessory, security, or other pecuniary interest adverse to her client, unless she first complies with the requirements set out in the rule.[2/]

Rule 3-300 does not apply to the referral and escrow arrangement described in the hypothetical. First, the lawyer has not entered into a business transaction with the prospective client because she is not a direct or indirect party to the loan, the broker is independent of the lawyer, and the lawyer does not benefit from the loan transaction in violation of rule 3-300. (E.g., *Rodgers v. State Bar* (1989) 48 Cal.3d 300, 313 [256 Cal.Rptr. 381] [lawyer violated former rule 5-101, the predecessor of current rule 3-300, by not disclosing to client conservator that a third party to whom lawyer recommended conservator loan money was another client and former business partner of lawyer, where proceeds of loan were used to pay off legal fees second client owed lawyer]; *Rose v. State Bar* (1989) 49 Cal.3d 646, 662-663 [262 Cal.Rptr. 702] [lawyer violated former rule 5-101 where he recommended that the client lend money to a third party for investment in a venture in which lawyer received a 25 percent interest]. See also Cal. State Bar Formal Opn. No. 1995-140 [lawyer paid referral fee by life insurance agent for referring client to agent will be deemed to have entered into a business transaction with the client].) The lawyer in the hypothetical, however, has received no such financial benefit–she has no interest in the broker's business and is receiving no payment for referring the potential client to the broker.[3/]

Moreover, the lawyer has not obtained a "pecuniary interest adverse to a client" merely by the deposit of the loan proceeds in an escrow account. The first sentence of the discussion accompanying rule 3-300 states the rule is "not intended to apply to the agreement by which the member is retained by the client, unless the agreement confers on the member ownership, possessory, security, or other pecuniary interest adverse to the client."[4/] Here, the lawyer

---

[2/] Rule 3-300 provides:

> A member 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 which should reasonably have been understood by the client; and
> >
> > (B) The client is advised in writing that the client may 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.

[3/] Although the lawyer does receive some benefit from the escrow arrangement--she is assured that there are funds available to pay her fees and costs--this is no different from the benefit the lawyer receives by requiring an advanced fee and placing it in her trust account. The lawyer, by requiring an advanced fee, does not thereby come within rule 3-300. (Rule 3-300, discussion.) The situation would be quite different, however, if the broker were to compensate the lawyer for referring clients to the broker. Then, the lawyer would be "soliciting a client's participation in a business transaction in which the lawyer will receive a financial benefit," and the lawyer will be deemed to have entered into a business transaction with her client to which rule 3-300 would apply. In that case, the lawyer would have to follow a specific protocol, including obtaining written consent from the client. (See Cal. State Bar Formal Opn. No. 1995-140.)

Compensation may be in a form other than monetary. For example, the broker could compensate the lawyer by referring clients to the lawyer as a quid pro quo for the lawyer referring business to the broker. In that event, not only would the lawyer's conduct in referring clients to the broker be governed by rule 3-300, but the lawyer would also violate rule 1-320(B) , which provides that a lawyer "shall not compensate, give or promise anything of value to any person or entity for the purpose of recommending or securing employment of the member . . . by a client, or as a reward for having made a recommendation resulting in employment of the member . . . by a client." See also Bus. & Prof. Code § 6152 (prohibiting running and capping).

[4/] See also California State Bar Formal Opinion Number 1995-140, footnote 5, which notes that this is an important exception to the general applicability of the rule.

will not acquire any pecuniary interest in the funds until after performing the legal services and after the process for paying the lawyer is completed.

The loan and escrow arrangement gives the lawyer assurance that she will be paid her fees and costs; even assuming that this assurance amounts to a "pecuniary interest," it is not "adverse" within the meaning of rule 3-300. In applying rule 3-300 and its predecessors, the California Supreme Court has held that a lawyer acquires a pecuniary interest adverse to the client where it is reasonably foreseeable that it may be detrimental to the client's interests. (*Hawk v. State Bar* (1988) 45 Cal.3d 589, 599-600 [247 Cal.Rptr. 599].) Because almost any financial transaction can be adverse to a client if he or she has to pay money, the California Supreme Court has developed a more precise definition: a lawyer's pecuniary interest is "adverse" to the client within the meaning of rule 3-300 if the lawyer acquires the ability to extinguish a client's interest in the property, without the possibility of judicial intervention, whether or not the lawyer ever acts to do so. (*Connor v. State Bar* (1990) 50 Cal.3d 1047, 1058 [269 Cal.Rptr. 742]; *Hawk v. State Bar*, *supra*, 45 Cal.3d at p. 600; *In the Matter of Fonte* (Review Dept. 1994) 2 Cal. State Bar Ct. Rptr. 752, 759-760.) For example, in *Connor*, *supra*, under an agreement with the client, the lawyer took full title to the client's property. Thus, the lawyer extinguished any rights the client had in the property. (*Connor v. State Bar*, *supra*, 50 Cal.3d at p. 1058). Similarly, in *Hawk*, *supra*, a lawyer who secured payment of fees by acquiring a note secured by a deed of trust on the client's property was held to have acquired a pecuniary interest adverse to the client because the deed of trust gave the lawyer the power of sale in a nonjudicial foreclosure procedure. (*Hawk v. State Bar*, *supra*, 45 Cal.3d at p. 600.)

The statement of facts shows that the lawyer does not have the ability to extinguish the client's interest without judicial intervention. The mere deposit of funds in escrow does not extinguish the client's interest. It is the escrow holder, not the lawyer, who is in possession of the funds. The lawyer may only acquire payment for her services or for the costs advanced by her after satisfying the terms of the fee agreement and meeting the escrow requirements. Where the escrow instructions require the lawyer to submit to the client for the client's review a billing in compliance with Business and Professions Code section 6148, where the client has an opportunity to contest the billing, and where the disputed portion of the billing will remain in escrow or the lawyer's trust account until the dispute is resolved, there is no violation of rule 3-300 because the lawyer is unable to extinguish the client's right to control the payment of fees.

In summary on the facts presented, unless the lawyer has a financial interest in the broker or receives some form of compensation from the broker for referring a potential client, rule 3-300 does not apply.

II. The Proposed Escrow Arrangement Does Not Require Compliance with Rule 4-100

Rule 4-100 is the primary professional standard regulating lawyers' handling of client funds. Rule 4-100(A) requires, with certain exceptions, that any "funds received or held for the benefit of clients" by a lawyer must be deposited in the lawyer's client trust fund account.[5/] Under rule 4-100(B), "the client's funds, securities or other properties" which are received by the lawyer or which "come into the possession of the" lawyer are subject to certain requirements regardless of whether the funds, securities, or properties are deposited in a trust account. These

---

[5/] Rule 4-100(A) provides:

> (A) All funds received or held for the benefit of clients by a member or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable bank accounts labeled "Trust Account," "Client's Funds Account" or words of similar import, maintained in the State of California, or, with written consent of the client, in any other jurisdiction where there is a substantial relationship between the client or the client's business and the other jurisdiction. No funds belonging to the member or the law firm shall be deposited therein or otherwise commingled therewith except as follows:
>
> (1) Funds reasonably sufficient to pay bank charges.
>
> (2) In the case of funds belonging in part to a client and in part presently or potentially to the member or the law firm, the portion belonging to the member or law firm must be withdrawn at the earliest reasonable time after the member's interest in that portion becomes fixed. However, when the right of the member or law firm to receive a portion of trust funds is disputed by the client, the disputed portion shall not be withdrawn until the dispute is finally resolved.

requirements include: (1) a notice requirement, (2) a requirement to maintain specified records, and (3) a requirement to render appropriate accounts to a client.[6/] The precise issues here are first whether rule 4-100(A) requires that the loan proceeds be placed in the lawyer's trust account rather than the escrow account and second, even if the proposed arrangement does not activate rule 4-100(A)' s deposit requirement, whether it nevertheless triggers rule 4-100(B)' s notice, record-keeping, and accounting requirements.

Under our facts, we do not need to address the rule 4-100 requirements because the loan proceeds are never "received or held" by the lawyer. Instead, they are placed by the lender directly in the escrow account. The lawyer receives funds only after she has performed legal services and has otherwise complied with the terms of her fee agreement with the client. When the lawyer has performed legal services and received fees from the escrow account pursuant to the process agreed upon by client and lawyer, the fees are fixed and earned. Under these circumstances, the earned fees belong to the lawyer and should not be placed in the client trust account.[7/]

In summary, we note that because the loan proceeds are not "received or held" by the lawyer and have not "come into the possession of the" lawyer, the proposed escrow arrangement does not appear to violate rule 4-100. We caution, however, that our conclusion rests on the fact that the commercial escrow holder is truly independent from the lawyer. We have assumed that the lawyer cannot access any of the escrow funds until she has earned a fee or accrued costs on the client's behalf, has properly documented her fees and costs, and has submitted her documented request to the escrow holder with notice to the client.[8/]

III. The Proposed Escrow Arrangement Does Not Require Written Disclosure Under Rule 3-310(A)

Rule 3-310 requires disclosure where the lawyer has a legal, business, financial, professional, or personal relationship with a party in the same matter (rule 3-310(B)(1)) or has a business, financial, or professional interest in the subject matter of the representation (rule 3-310(B)(4)).[9/] Neither of these provisions, however, applies to this

---

[6/] Rule 4-100(B) provides:

> (B) A member shall:
>
> (1) Promptly notify a client of the receipt of the client's funds, securities, or other properties.
>
> (2) Identify and label securities and properties of a client promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable.
>
> (3) Maintain complete records of all funds, securities, and other properties of a client coming into the possession of the member or law firm and render appropriate accounts to the client regarding them; preserve such records for a period of no less than five years after final appropriate distribution of such funds or properties; and comply with any order for an audit of such records issued pursuant to the Rules of Procedure of the State Bar.
>
> (4) Promptly pay or deliver, as requested by the client, any funds, securities, or other properties in the possession of the member which the client is entitled to receive.

[7/] Rule 4-100(A) provides that, except for "[f]unds reasonably sufficient to pay bank charges" and funds that are subject to a dispute between lawyer and client, "[n]o funds belonging to the member or the law firm shall be deposited" in the lawyer's trust account "or otherwise commingled" with funds held for the client.

[8/] Our conclusion on the applicability of rule 4-100 is limited to the facts presented. These facts do not include a situation where the client disputes a disbursement that is received by the lawyer. The ethical obligations of the lawyer in such circumstances, including any obligation to deposit disputed funds into a trust account under rule 4-100(A) or to render an appropriate accounting to the client under rule 4-100(B), are beyond the scope of this opinion.

[9/] Rule 3-310(B) provides in part:

> (B) A member shall not accept or continue representation of a client without providing written disclosure to the client where:

independent broker and escrow arrangement.

Rule 3-310(B)(1) does not apply to our facts. The lawyer does not have any relationship with the broker. Although the lawyer may refer potential clients to the broker to arrange financing, the lawyer is under no legal obligation to do so. Moreover, there are no facts suggesting that the lawyer and broker are engaged in either a formal or an informal business relationship. The broker is not a witness or a party to the subject matter of the representation, the lawyer receives no compensation from the broker for referring potential clients, and the lawyer does not represent the potential client in the transaction among broker, lender, and client.[10/] urther, rule 3-310(B)(4) is not applicable. Our facts are distinctly different from the facts posed in California State Bar Formal Opinion Number 1995-140, where we concluded that an insurance agent's payment of a commission to an estate planning lawyer as compensation for the lawyer's referring clients to the agent did trigger rule 3-310(B)(4)'s disclosure requirements. We reasoned that the lawyer has a business or financial interest in that representation because the lawyer stands to obtain compensation from the insurance agent if the client decides to purchase insurance from the insurance agent with whom the lawyer has made the referral arrangement. Rule 3-310(B)(4)'s written disclosure requirement is directly implicated because the lawyer in the hypothetical has an interest in the client's representation and may well compromise that representation "in order to advance the attorney's own financial or personal interests." (See *Santa Clara County Counsel Attys. Assn. v. Woodside* (1994) 7 Cal.4th 525, 546 [28 Cal.Rptr.2d 617].) Unlike the situation presented in Formal Opinion Number 1995-140, the lawyer here is not compensated for the referral.[11/]

> (1) The member has a legal, business, financial, professional, or personal relationship with a party or witness to the same matter; or
>
> . . .
>
> (4) The member has or had a legal, business, financial, or professional interest in the subject matter of the representation.

[10/] With respect to this, the lawyer must be careful not to inadvertently mislead the prospective client into believing the lawyer represents the client in the identification of financing alternatives, in deciding to use a particular loan broker, or in the loan or escrow transactions. An attorney-client relationship may result from an express or implied contract. Except when created by court appointment, the attorney-client relationship may be found to exist based on the intent and conduct of the parties and the reasonable expectations of the potential client (*Flatt v. Superior Court* (1994) 9 Cal.4th 275, 281, fn.1 [36 Cal.App.2d 537]; *Hecht v. Superior Court* (1987) 192 Cal.App.3d 560, 565 [237 Cal.Rptr. 528]; *Fox v. Pollack* (1986) 181 Cal.App.3d 954 [226 Cal.Rptr. 532] [absent some objective evidence of an agreement to represent, it is not sufficient that plaintiffs "thought" defendant was their attorney]). Even if the possible client has not paid or promised to pay the attorney, an attorney-client relationship may be found to exist where she has communicated confidential information to the attorney (*People ex rel. Dept. of Corporations v. SpeeDee Oil Change Systems, Inc.* (1999) 20 Cal.4th 1135, 1148 [86 Cal.Rptr.2d 816]; *Miller v. Metzinger* (1979) 91 Cal.App.3d 31, 39-40 [154 Cal.Rptr. 22]; *Perkins v. West Coast Lumber Co.* (1900) 129 Cal. 427; L.A. Cty. Bar Assn. Formal Opn. No. 449). Under our facts, the lawyer has given the prospective client the name of a licensed broker and stated that the broker might be able to arrange a loan to finance legal representation by the lawyer. In such situations, a prospective client might assume from a lawyer identifying a single broker that the lawyer has investigated the broker and in essence is advising the prospective client that it is safe to enter into a loan transaction and to do so through that broker. On the other hand, the fact that the prospective client has had no previous professional relationship with the lawyer, and the absence of any facts indicating that the prospective client has disclosed confidential information to the lawyer, argue against an attorney-client relationship having been formed. Nevertheless, while not necessarily required, to avoid creating a reasonable expectation in the prospective client to the contrary, here the lawyer has stated in writing to the prospective client that she does not represent the prospective client with regard to the identification of financing alternatives, the selection of the broker, or the resulting loan or escrow transactions.

[11/] California State Bar Formal Opinion Number 1995-140 is further distinguishable because the estate planning lawyer had a financial interest "in the subject matter of the representation." The lawyer was preparing an estate plan which required the availability of liquid funds to pay estate taxes at the time of the client's death. Referring clients to an agent for a life insurance policy that would provide those funds was thus central to the actual subject matter of the representation. Unlike that situation, however, financial arrangements for paying the lawyer's legal fees will usually be independent of the purpose for which the lawyer is retained.

Finally, rule 3-310(F), which prohibits a lawyer from accepting "compensation for representing a client from one other than the client" unless certain conditions are met, does not apply to this situation. Subdivision (F) applies only where the funds of a third party are being used to pay the lawyer. It is intended to avoid the situation where the lawyer's duty of undivided loyalty to her client could be affected by the involvement and interests of a third party paying the attorney's fees and costs. Here, that risk does not appear to exist where the third party is an escrow agent who does not own the loan proceeds, but only is responsible for holding and disbursing the client's own funds.[12/]

In summary, because the lawyer does not represent adverse interests, have a relationship with a party in the same matter, or have an interest in the subject matter of the representation, rule 3-310 is inapplicable.

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.

[12/] Although the lawyer's duty of undivided loyalty to her client does not appear threatened, there is a possibility that the lawyer's billing statements could disclose confidential client information to the escrow agent in violation of the lawyer's duties under Business and Professions Code section 6068, subdivision (e). The lawyer must be careful in submitting the billing statements not to reveal any protected client information without the client's consent. If the client gives such consent, the lawyer should caution the client concerning the possibility of waiving the attorney-client privilege. (Evid. Code § 912.)