



**THE STATE BAR
OF CALIFORNIA**

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**OFFICE OF PROFESSIONAL COMPETENCE,
PLANNING & DEVELOPMENT**

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MEMORANDUM

DATE: February 3, 2009
TO: Members of the Board's Regulation, Admissions & Discipline Oversight Committee
FROM: Randall Difuntorum, Director, Professional Competence Programs
SUBJECT: Proposed State Bar Formal Opinion Interim No. 05-0001 (re modifications of fee agreements)

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EXECUTIVE SUMMARY

This agenda item seeks Board Committee approval for the publication of proposed formal opinion Interim No. 05-0001 developed by the Committee on Professional Responsibility and Conduct (COPRAC).

On November 10, 2008, the proposed opinion was distributed for Board Committee approval pursuant to State Bar Board Book Tab 19, Article 2, section 6(j), which provides: "If within thirty days of circulation, no member of the Board Committee objects to publication, the formal opinion shall be published as hereinafter provided. If within thirty (30) days of circulation, any member of the Board Committee does object, the issue of whether the formal opinion shall be published shall be placed on the agenda of the next succeeding meeting of the Board Committee for decision. "

Before the expiration of the thirty-day period, Governor Heinke submitted an objection to the publication of the formal opinion for the purpose of allowing the Board Committee to discuss, and act upon, the issue of approval in a meeting.

A COPRAC representative of the Committee will attend the Board Committee's meeting. Board members with questions about this item may contact Randall Difuntorum at (415) 538-2161 or Lauren McCurdy at (415) 538-2107.

BACKGROUND

COPRAC is charged with developing the State Bar's non-binding, advisory ethics opinions. Authority to approve the issuance of an opinion is exercised the Board's Committee on Regulation, Admissions and Discipline (RAD). Proposed formal opinion Interim No. 05-0001 was drafted by COPRAC, distributed for public comment, and revised following consideration of public comments received. The question addressed in the proposed opinion is "What are the ethical ramifications associated with a modification of an attorney fee agreement?" The digest answer provides:

"Rule 3-300 of the Rules of Professional Conduct does not apply to a modification of a fee agreement unless the agreement confers on the attorney an ownership,

security, possessory, or other pecuniary interest adverse to the client. While rule 3-300 does not per se apply to a modification of a fee agreement after the attorney-client relationship has commenced, any modification of an existing fee agreement must be fair, reasonable, fully explained, and consented to by the client. A number of factors will determine whether modification of a fee agreement meets this standard.”

On November 10, 2008, proposed formal opinion Interim No. 05-0001 was distributed for RAD approval pursuant to State Bar Board Book Tab 19, Article 2, section 6(j), which provides: “If within thirty days of circulation, no member of the Board Committee objects to publication, the formal opinion shall be published as hereinafter provided. If within thirty (30) days of circulation, any member of the Board Committee does object, the issue of whether the formal opinion shall be published shall be placed on the agenda of the next succeeding meeting of the Board Committee for decision. “

Before the expiration of the thirty-day period, Governor Heinke submitted an objection to the publication of the formal opinion for the purpose of allowing the Board Committee to discuss, and act upon, the issue of approval in a meeting. The full text of proposed formal opinion Interim No. 05-0001, in the form distributed to RAD for approval, is provided as Attachment 1.

DISCUSSION

The issue presented for RAD’s action is whether to approve the publication of proposed formal opinion Interim No. 05-0001.

Among the commentators opposed to the publication of the opinion are: (1) the Office of the Chief Trial Counsel; (2) the State Bar Committee on Mandatory Fee Arbitration; and (3) the Bar Association of San Francisco Legal Ethics Committee. Among the commentators in support of the opinion are: (1) the San Diego County Bar Association; and (2) the Los Angeles County Bar Association Professional Responsibility Committee. The full text of the formal written comments received and also some informal email comments are provided as Attachment 2.

Among the arguments stated in opposition to the opinion are the following:

1. The opinion attempts to legislate a change in existing law that would be anti-consumer and anti-client.
2. One purpose of rule 3-300 is to prevent overreaching and the opinion’s interpretation of the rule should implement that objective.
3. Attorneys need clear guidance and the opinion should simply set a bright line standard that rule 3-300 applies to all fee agreement modifications.
4. The opinion’s conclusion that rule 3-300 does not apply to all fee agreement modifications is inconsistent with the law governing a lawyer’s fiduciary duties.
5. By suggesting that there are fee modifications where rule 3-300 does not apply, the opinion unnecessarily exposes lawyers to potential discipline and loss of fees.
6. State Bar disciplinary cases suggest that rule 3-300 applies to fee agreement modifications.
7. If lawyers follow the opinion then the salutary effect of a lawyer’s compliance with rule 3-300 would be abrogated, resulting in client harm that might otherwise be avoided.

Among the arguments stated in favor of the opinion are the following:

1. Neither the text of the rule nor its discussion section expressly states that rule 3-300 applies to all modification of fee agreements.
2. There is no disciplinary case that holds that all fee agreement modifications require a lawyer's compliance with rule 3-300.
3. A Rule of Professional Conduct should not be construed to impose, under penalty of discipline, that a lawyer conform to best practices or discretionary risk management policies.
4. Requiring rule 3-300 compliance for every fee modification scenario, including situations where a lawyer reduces a client's outstanding or prospective fee obligation, would dilute the importance of lawyer compliance in situations where an actual adverse interest is present and would desensitize a client to a conflicts protocol that should be reserved for true client protection circumstances.
5. Opponents of the opinion who analyze a fee modification as a rule 3-300 business transaction with a client have no logical basis for differentiating between "bad" fee modifications and "good" fee modifications.
6. The opinion will help educate lawyers about the proper application of rule 3-300 and will help courts in considering the testimony of ethics experts who might erroneously argue that rule 3-300 applies to situations that are beyond the appropriate parameters of the rule.
7. The opinion emphasizes that the existing law governing a lawyer's fiduciary duties already provides that fee agreement modifications are subject to strict scrutiny for fairness, so the only element missing from the rule 3-300 protocol is the requirement for written notice to seek the advice of an independent lawyer.

COPRAC recommends that RAD approve the publication of the opinion. Following consideration of the public comments received, the opinion was revised. Among the revisions is the addition of the following:

"While the Committee has concluded that rule 3-300 does not apply to the modification of a fee agreement as long as the attorney does not thereby acquire an adverse pecuniary interest, we caution that this opinion is advisory and not binding. No appellate court has addressed this issue. Therefore, in light of the fact that a court may disagree with our position, attorneys may wish to comply with the provisions of rule 3-300 when modifying a fee agreement with an existing client."

By adding this language, the opinion gives clear notice that lawyers should exercise professional independent judgment in determining issues of risk management when confronted with the question of whether to comply with rule 3-300 in the context of a fee agreement modification. This language also signals to judges that there is an important rule 3-300 compliance issue that calls for careful analysis and a balancing of policies. With the addition of this language, no lawyer or court should be misled into believing that COPRAC's non-binding, advisory opinion effectuates any legislative change in existing law. Instead, COPRAC's opinion will serve as secondary authority for helping the legal profession in California wrestle with a significant ambiguity in attorney professional conduct that implicates many lawyer-client relationships.

FISCAL AND PERSONNEL IMPACT

There is no unbudgeted fiscal or personnel impact associated with the Board Committee's action to approve the publication of proposed formal opinion Interim No. 05-0001.

RULE AMENDMENTS

Board Committee action to approve the publication of proposed formal opinion Interim No. 05-0001 does not effectuate any rule amendments.

BOARD BOOK/ADMINISTRATIVE MANUAL IMPACT

Board Committee action to approve the publication of proposed formal opinion Interim No. 05-0001 does not require any revisions to the Board Book/Administrative Manual.

PROPOSED BOARD COMMITTEE RESOLUTION

Should the Board Committee on Regulation, Admissions and Discipline agree with the recommendation to approve proposed formal opinion Interim No. 05-0001, adoption of the following resolution would be appropriate.

RESOLVED, following publication for comment and consideration of comments received, that the Board Committee on Regulation, Admissions and Discipline approves the publication of proposed formal opinion Interim No. 05-0001, in the form attached.

ATTACHMENT 1

**THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 05-0001**

ISSUE: What are the ethical ramifications associated with a modification of an attorney fee agreement?

DIGEST: Rule 3-300 of the Rules of Professional Conduct does not apply to a modification of a fee agreement unless the agreement confers on the attorney an ownership, security, possessory, or other pecuniary interest adverse to the client. While rule 3-300 does not per se apply to a modification of a fee agreement after the attorney-client relationship has commenced, any modification of an existing fee agreement must be fair, reasonable, fully explained, and consented to by the client. A number of factors will determine whether modification of a fee agreement meets this standard.

**AUTHORITIES
INTERPRETED:**

Rules 3-300, 3-700, and 4-200 of the Rules of Professional Conduct of the State Bar of California.^{1/}

Business and Professions Code sections 6106 and 6147.

STATEMENT OF FACTS

Fact Pattern One: Attorney represents Client, a plaintiff in pending litigation, pursuant to a written hourly fee retainer agreement. After timely payment of the first six months of invoices, which totaled \$100,000, Client fails to pay two consecutive monthly invoices. When Attorney contacts Client about the \$60,000 balance due, Client describes a deteriorating personal financial condition and an inability to pay the balance due or to continue to pay Attorney's fees. Client asks to change the hourly fee agreement to a contingency fee agreement based on a percentage of the recovery. Attorney agrees to the concept and recommends modifying the fee agreement by confirming Attorney's right to keep the \$100,000 paid by Client to date, writing off the \$60,000 balance due, and agreeing to take 25% of the net recovery. Attorney advises Client that, although the trial date is six months away, under the modified fee structure Attorney may, because of the contingency factor, receive a larger fee than under the original agreement. Client accepts Attorney's recommendation, and Attorney prepares a modified fee agreement that complies with the requirements of Business and Professions Code section 6147, which both parties sign. No advice is given by Attorney to Client to consult other counsel.

Fact Pattern Two: Pursuant to a written contingency fee agreement, Attorney represents Client in a suit against an insurance company for wrongful revocation of benefits from a disability policy of insurance. The contingency agreement provides for Attorney to advance costs and to receive 33% of the net recovery if the matter settles before trial or 40% of the net recovery after commencement of trial. After months of pre-trial litigation and extensive negotiations, the insurance company offers \$500,000 in settlement. Trial is set to commence in five weeks. Attorney recommends acceptance, but Client refuses. In response, Attorney informs Client that if she will not accept the offer, he will quit, and she will have to find another attorney. Attorney's response prompts Client to accuse Attorney of pressuring her to accept an unreasonably low settlement. With trial approaching, Client requests that Attorney remain on the case. Attorney agrees on the condition that the contingency fee is increased to 40% of any settlement, and 50% of any verdict. Client reluctantly agrees and signs the modified fee agreement prepared by Attorney, which complies with Business and Professions Code section 6147. No advice is given by Attorney to Client to consult other counsel.

^{1/} Unless otherwise indicated, all rules references are to the Rules of Professional Conduct of the State Bar of California.

DISCUSSION

The law treats the negotiation of a legal services agreement between a prospective client and an attorney as an arm's-length transaction. (*Ramirez v. Sturdevant* (1994) 21 Cal.App.4th 904, 913 [26 Cal.Rptr.2d 554]; *Setzer v. Robinson* (1962) 57 Cal.2d 213, 217 [18 Cal.Rptr. 524].) Nonetheless, while the parties deal at arm's length, rule 4-200 prohibits an attorney from entering into an agreement for an illegal or unconscionable fee.^{2/} Rule 4-200(B) lists 11 standards to determine unconscionability, which include the amount of the fee in proportion to the value of the services performed, the amount involved and the results obtained, the nature and length of the professional relationship between the attorney and the client, and whether the client gave informed consent to the fee. In addressing the enforceability of fee agreements, California courts have stated that an attorney must deal fairly and in good faith when negotiating the fee agreement with the client. *Bird, Marella, Boxer & Wolpert v. Superior Court* (2003) 106 Cal.App.4th 419, 430 [130 Cal.Rptr.2d 782]. An attorney is professionally obligated to ensure that the terms of the fee agreement are fair, reasonable, fully explained, and consented to by the client. *Severson & Werson v. Bolinger* (1991) 235 Cal.App.3d 1569, 1572 [1 Cal.Rptr.2d 531]. The Committee believes these standards apply to all fee agreements, original as well as modified.

1. Inapplicability of Rule 3-300

Rule 3-300^{3/} mandates compliance with its requirements in two situations: when an attorney (1) enters into a business transaction with a client; or (2) acquires an ownership, possessory, security, or other pecuniary interest adverse to the client. The Discussion to rule 3-300 specifies that the rule is not intended to apply to the agreement by which the client retains the attorney unless the attorney acquires one of the specified interests adverse to the client; rather, rule 4-200 governs such agreements. The Discussion leaves unanswered whether the modification of an existing retainer agreement is either (1) a "business transaction" within the meaning of the rule, or (2) results in the acquisition of a "pecuniary interest adverse to the client." We conclude that rule 3-300 is not applicable to the fee modifications in our two fact patterns because the modification of a fee agreement is not a "business transaction" within the meaning of rule 3-300, and neither of the fee modifications described above confers on the attorney the type of adverse interest contemplated by the rule.

A. Meaning of the Term "Business Transaction" in Rule 3-300

No California case has defined "business transaction" within the context of rule 3-300. In California State Bar Formal Opn. No. 1989-116 this Committee noted that "once created, the attorney-client relationship is arguably a 'business relationship' between attorney and client." Since that opinion was issued, however, case law in California and elsewhere has differentiated a business transaction between an attorney and a client from an agreement for the

^{2/} For a collection of cases, including California decisions, on the enforceability of attorney fee agreements between an attorney and an existing client, see Annotation, Validity and Effect of Contract for Attorney's Compensation Made After Inception of Attorney-Client Relationship (1967 and 2007 Supp.) 13 A.L.R.3d 701.

^{3/} Rule 3-300. Avoiding Interests Adverse to a Client.

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.

payment of money for the rendition of professional services by the attorney.^{4/} “Attorneys wear different hats when they perform legal services on behalf of their clients and when they conduct business with them.” *Meyhew v. Benninghoff* (1977) 53 Cal.App.4th 1365, 1369 [62 Cal.Rptr.2d 27]. While we find no California cases directly on point, we do find the approach of a recent out-of-state decision persuasive. In *Welsh v. Case* (Or.Ct.App. 2002) 180 Or.App. 370 [43 P.3d 445], the court noted:

Defendants cite no case, and we can find none, in which the “business transaction” at the core of this rule is the fee arrangement between the lawyer and the client. Rather, the cases apply the rule when the lawyer and a client have entered into a transaction that is unrelated substantively to the formation or structure of the lawyer-client relationship itself, for example, when a lawyer arranges to borrow money from a client, (citation omitted), lend money to a client for a business venture, (citation omitted), or receive a gift from a client, (citation omitted).^{5/}

Unlike a traditional business or financial transaction between an attorney and a client when the client may not fully appreciate the divergence of interests that may exist, a client naturally understands that in negotiating a fee, the attorney is not representing and looking after the interests of the client. The Restatement (Third) of the Law Governing Lawyers (2000), § 18, follows this approach of excluding agreements for the payment of money by clients for legal services from the special rules applicable to business and financial transactions between attorneys and clients. *Id.* at § 18, cmt. a.

The State Bar Court has never applied rule 3-300 in determining whether the modification of a fee agreement was ethical. Further, no California court considering the validity of a modification of an attorney’s fee agreement has subjected the agreement to analysis under rule 3-300. As noted below in section B of this opinion, the consistent judicial approach in California has been to scrutinize the circumstances in which the modification was entered into to ensure that the modification was fair and reasonable to the client, but not treat it as a business transaction between the attorney and the client within rule 3-300.^{6/}

^{4/} In *In re Silvertown* (36 Cal.4th 81 [29 Cal.Rptr.3d 766]), the Supreme Court adopted the Review Department’s conclusion that an attorney’s post-settlement arrangement involving a compromise of medical liens constituted a violation of rule 3-300. Although the court concluded that the arrangement was a “business transaction,” the court based its conclusion on the fact that the clients had transferred to the attorney both their ownership and possessory interest in all funds remaining after payment of their distributive share of the settlement proceeds. Further, *Silvertown* does not involve a fee modification since the attorney who entered into the arrangement with the clients was not a party to the initial fee agreement.

^{5/} The “rule” the court referenced is ABA DR 5-104(A), which provides:

A lawyer shall not enter into a business transaction with a client if they have differing interests therein and the client expects the lawyer to exercise the lawyer’s professional judgment therein for the protection of the client, unless the client has consented after full disclosure.

^{6/} Several out-of-state decisions have stated or implied that fee modification agreements are business transactions between the attorney and the client, but they are distinguishable and, in our view, unpersuasive. They either rely on more specific language in the jurisdiction’s rules of professional conduct (*In re Hefron* (Ind. 2002) 771 N.E.2d 1157, 1162-1163) (comment [i] to Indiana’s Rule 1.8(a) expressly brings renegotiated fee agreements within the Rule) or the underlying facts show that the attorney acquired an ownership or security interest in the client’s property pursuant to the modification. See, e.g., *Cotton v. Kronenberg* (Wash. 2002) 111 Wash.App. 258 [44 P.3d 878, 884] (the attorney renegotiated into a more favorable fee agreement with a client that gave the attorney an ownership interest in real and personal property of the client). In some cases, the relationship is simply assumed. See, *In re Discipline of Light* (N.D. 2000) 615 N.W.2d 164, 171 (although the court treated the renegotiated agreement as within the business transaction rule (rule 1.8(a)), the court did not specify or explain what made the modification a “business” transaction with the client).

It is the opinion of the Committee that, for the reasons above stated, a modification of a fee agreement with a client is not a “business transaction” within the scope of rule 3-300.^{7/}

B. When Does an Attorney Acquire a Pecuniary Interest Adverse to a Client?

Rule 3-300 applies whenever attorneys “knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client.” Rule 3-300 applies to both the initial fee agreement and a modification of a fee agreement “where the member wishes to obtain an interest in client’s property in order to secure the amount of the member’s past due or future fees.” See, Discussion, paragraph 3 to rule 3-300. Neither factual scenario presented above involves an attorney acquiring an “ownership,” “possessory,” or “security” interest; consequently, the critical issue is the construction of the phrase “other pecuniary interest adverse to the client.” That phrase is not defined in the rules and has not been construed by the courts. All the enumerated interests (“ownership,” “possessory,” “security”) may be “acquired” by the attorney and be held adverse to the client. See, *Fletcher v. Davis* (2004) 33 Cal.4th 61, 68-69 [14 Cal.Rptr.3d 58] (an interest will be considered adverse if it is reasonably foreseeable that the interest held by the attorney could become detrimental to the client). The issue here is whether all fee modifications necessarily fall within this category.

Longstanding rules of statutory interpretation require that words and terms should be construed in connection with each other, rather than in isolation. The rules are “noscitur a sociis” and “ejusdem generis” and roughly translate as words and terms are known by the company they keep.^{8/} Under these principles, a court will adopt a restricted meaning of a listed item if acceptance of a more expansive meaning would make other items in the list unnecessary or redundant, or would otherwise make the item markedly dissimilar to the other items in the list. *People ex rel. Lungren v. Superior Court* (1996) 14 Cal.4th 294, 307 [58 Cal.Rptr.2d 855]. In rule 3-300 the phrase “other pecuniary interest” is tied to and reflects the introductory set – “ownership, possessory, or security.” While “noscitur a sociis” and “ejusdem generis” are not inflexible rules of application, the Committee discerns no policy reasons why the rules should not be applied; rather, just the contrary. A broad construction of “other pecuniary interests” divorced from the introductory set would not only make the introductory set meaningless, but it would

^{7/} Our conclusion that the modification of an agreement by which an attorney is retained by a client is not deemed a “business transaction” within the meaning of rule 3-300 in and of itself is not undermined by the Discussion following the rule. In pertinent part, the Discussion states that “[r]ule 3-300 is not intended to apply to the agreement by which the [attorney] is retained by the client.” The statement may reasonably be read to mean that rule 3-300 is *not* intended to apply to *any* “business” agreement under which the attorney provides the client with legal services, *whether initial or modified*, but *is* intended to apply to *all other* “business” agreements between them. The statement may perhaps also be read to mean that rule 3-300 is *not* intended to apply to the “business” agreement under which the attorney *undertakes* to provide the client with legal services *initially*, but *is* intended to apply to any “business” agreement under which the attorney *continues* to provide the client with legal services *subsequently*. If the statement could reasonably be read in the latter manner as well as the former, it would be ambiguous. And if it were ambiguous, it would have to be read, in the attorney’s favor, to mean that rule 3-300 is *not* intended to apply to any “business” agreement under which the attorney provides the client with legal services, *whether initial or modified*. (See *Young v. State Bar* (1990) 50 Cal.3d 1204, 1216 [270 Cal.Rptr. 315] (holding that an attorney threatened with discipline is entitled to the benefit of every reasonable doubt); cf. *In re Tartar* (1959) 52 Cal.2d 250, 257 [339 P.2d 553] (holding that a person is “entitled to the benefit of every reasonable doubt . . . as to the true interpretation of words or the construction of language used in a statute” threatening criminal sanction). To the extent California State Bar Formal Opn. No. 1989-116 suggests that any modification of an agreement by which an attorney is retained by a client is deemed a “business transaction” within the meaning of rule 3-300 in and of itself, we decline to follow it.

^{8/} Under the rule of “noscitur a sociis” a court will adopt a restricted meaning of a listed term if acceptance of a more expansive meaning would render other items unnecessary surplusage. *People ex rel. Lungren v. Superior Court* (1996) 14 Cal.4th 294, 307 [58 Cal.Rptr.2d 855]. The principle of “ejusdem generis” is related. “Ejusdem generis” provides that when a specific class of persons or things is enumerated and then followed by a general class of persons or things, the general is construed with respect to the specific. *Harris v. Capital Growth Investors XIV* (1991) 52 Cal.3d 1142, 1159 [278 Cal.Rptr. 614].

eviscerate the distinction between fee agreements and business transactions that we recognize and adopt in this opinion.

We see nothing in either factual scenario that suggests that the attorney in modifying the fee agreement is acquiring the type of adverse pecuniary interest that triggers the disclosure and consent obligations of rule 3-300.^{9/} For purposes of rule 3-300, an “interest” is a power to impair or liquidate the client’s property. See, *Hawk v. State Bar* (1988) 45 Cal.3d 591, 601 [247 Cal.Rptr. 599]. In each of the factual scenarios considered here, no such power or interest is conveyed. The effect of the modification is that the client (a) has promised to pay more to the attorney (Fact Pattern Two), or (b) may end up being obligated to pay more to the attorney depending upon the outcome (Fact Pattern One). In either case, the only right obtained by the attorney is the right to collect payment, a debt, from the client. In neither scenario has the attorney obtained an interest that would allow him to collect disputed fees without judicial scrutiny.

We recognize that many attorneys have long assumed that a fee modification is subject to rule 3-300; however, we believe that assumption cannot be squared with the current language of the rule. Our position is further confirmed by the consistent practice of the California Supreme Court when addressing the issue of acquiring “a pecuniary interest adverse to a client.” In each instance when the court found such an interest, the interest in the client’s property secured the attorneys’ fees and permitted the attorney to use that interest to ensure payment of his fees without a contested judicial hearing.^{10/} When the attorney did not have that power, the court expressly declined to find the attorney had acquired an interest adverse to the client. *Hawk v. State Bar, supra*, 45 Cal.3d at pp. 600-601 (an unsecured promissory note that “gives an attorney only a right to proceed against the client’s assets in a contested judicial proceeding” is not an adverse pecuniary interest since it did not give the attorney an “interest in the client’s property” that could be summarily realized).^{11/} An attorney who negotiates and obtains a fee

^{9/} In the first factual scenario, the attorney does modify the fee agreement to convert an hourly fee retainer to a contingent fee agreement. While a contingent fee agreement does give the attorney an interest in the client’s cause of action, such an interest is not within rule 3-300, or every contingent fee agreement would require compliance with rule 3-300, which no court has found. Rule 3-300, official comment; cf. California State Bar Formal Opn. No. 2006-170 (opining that a charging lien contained in contingency fee agreement did not bring the agreement within rule 3-300).

^{10/} The California Supreme Court has held that the following constitute the acquisition of an adverse interest under rule 3-300 or its predecessor rule 5-101: an attorney’s purchase of a note secured by a first deed of trust on property that was the subject of the litigation the attorney was engaged to pursue (*Ames v. State Bar* (1973) 8 Cal.3d 910, 920 [106 Cal.Rptr. 489]); an attorney’s acquisition of a writ of execution against property on which his client also has a right to levy (*Silver v. State Bar* (1974) 13 Cal.3d 134, 139-140 [117 Cal.Rptr. 821]); an attorney’s acquisition from the client of a note secured by a deed of trust in real property in order to secure payment of legal fees (*Hawk v. State Bar, supra*, 45 Cal.3d at pp. 593-594); an attorney’s obtaining an ownership interest in client’s property that had a value greater than agreed upon fee (*Brockway v. State Bar, supra*, 53 Cal.3d at pp. 64-65); and an attorney’s acquisition of a charging lien to secure fees earned in an hourly fee agreement (*Fletcher v. Davis, supra*, 33 Cal.4th at pp. 71-72).

^{11/} The court distinguished a secured interest from an unsecured interest:

Hulland indicates a disapproval of fee agreements that allow the attorney to collect disputed fees without judicial scrutiny, as the note secured by deed of trust with a power of sale does. An unsecured promissory note, by contrast, gives an attorney only a right to proceed against the client’s assets in a contested judicial proceeding at which the client may dispute the indebtedness. The note allows the attorney to obtain a judgment, and to seek to enforce the judgment against the client’s assets, if any. It does not give the attorney a *present* interest in the client’s property, which the attorney can summarily realize.

Hawk v. State Bar, supra, 45 Cal.3d at pp. 600-601 (citing *Hulland v. State Bar* (1972) 8 Cal.3d 440, 450 [105 Cal.Rptr. 152]).

modification that does not convey such an interest to the attorney does not, by that fact alone, acquire an adverse pecuniary interest that triggers rule 3-300.^{12/}

While the Committee has concluded that rule 3-300 does not apply to the modification of a fee agreement as long as the attorney does not thereby acquire an adverse pecuniary interest, we caution that this opinion is advisory and not binding. No appellate court has addressed this issue. Therefore, in light of the fact that a court may disagree with our position, attorneys may wish to comply with the provisions of rule 3-300 when modifying a fee agreement with an existing client.

2. A Modification of a Fee Agreement is Subject to Close Scrutiny

The State Bar has used the term “close scrutiny” in evaluating an attorney’s conduct in seeking a fee modification. See, *In re Lindmark* (2004) 4 Cal. State Bar Ct. Rptr. 668 (a modification of a fee agreement implicates an attorney’s fiduciary duties to the client such that any modification “beneficial to the attorney will be closely scrutinized with the utmost strictness for any unfairness”).^{13/} The California Supreme Court has emphasized that the attorney bears the risk that the compensation provided by the initial fee agreement with the client is adequate for the retention.^{14/} We construe these precedents as supporting the use of a close scrutiny test when evaluating the fairness

^{12/} In California State Bar Formal Opinion 1994-135 this Committee concluded that rule 3-300 applied to a modification of a contingency fee agreement that provided for front-loaded receipt of attorneys’ fees in connection with a structured settlement to be paid out over the client’s life. This conclusion was based upon the possibility that such a modification could inhibit a client’s ability to settle or limit a client’s settlement options. We believe the factual scenario in 1994-135 is distinguishable from the factual scenarios in this opinion, which do not affect the timing of the payment of fees, and that the opinion therefore does not conflict with our conclusion. To the extent, however, that there is language in 1994-135 that can be interpreted as concluding that rule 3-300 applies to every modification of a fee agreement, we disavow those comments.

^{13/} The Restatement (Third) of the Law Governing Lawyers (2000), § 18, adopts a similar approach:

Client-lawyer fee contracts entered into after the matter in question is under way are subject to special scrutiny. 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. A lawyer, on the other hand, usually has no justification for failing to reach a contract at the inception of the relationship or pressing need to modify an existing contract during it. The lawyer often has both the opportunity and the sophistication to propose appropriate terms before accepting the matter.

Id. § 18, cmt. e. (citation omitted).

^{14/} *Grossman v. State Bar* (1983) 34 Cal.3d 73, 78 [192 Cal.Rptr. 397] (“Under a fixed fee contract, an attorney may not take compensation over the fixed fee without the client’s consent to a renegotiated fee agreement . . . even if the work becomes more onerous than originally anticipated”) (citations omitted); cf. *Reynolds v. Sorosis Fruit Co.* (1901) 133 Cal. 625, 628 [66 P. 21] (“The fact that plaintiff [attorney] made a bad bargain, and was compelled to do more than four hundred dollars worth of labor, cannot relieve him of his contract. He is precisely in the same position that any other party would be, who, having made a contract for a certain sum to do a certain thing, finds by experience that the sum is not adequate compensation”) (brackets added). In *Hawk v. State Bar* (1988) 45 Cal.3d 591 [247 Cal.Rptr. 599], which involved a business transaction between an attorney and a client, the court did use “strict scrutiny” language in quite broad terms:

In *Ritter*, we rejected the argument that failure to give the clients time to seek independent counsel is a mere technical violation, emphasizing the fiduciary nature of the relationship: “‘All dealings between an attorney and his client that are beneficial to the attorney will be closely scrutinized with the utmost strictness for any unfairness.’”

Id. at p. 598 (citing *Ritter v. State Bar* (1985) 40 Cal.3d 595, 602 [221 Cal.Rptr. 134]).

and reasonableness of a modification of a fee agreement. We also remind attorneys that, in addition, an attorney's use of duress and coercion to induce a client to enter into a modified fee agreement may constitute "moral turpitude" warranting discipline pursuant to Business and Professions Code section 6106. See, *In the Matter of Shalant* (2005) 4 Cal. State Bar Ct. Rptr. 829.

In an effort to assist California attorneys in determining whether a fee modification would be deemed fair and reasonable, the Committee suggests the following guidelines:

1. A modification requested by the client is more likely to be considered fair and reasonable than a modification requested by the attorney.
2. A modification designed to address an expansion of the services being provided is more likely to be considered fair and reasonable than a modification obtained by an attorney without a change in the services originally contracted for by the client.
3. A modification sought by the attorney at a critical juncture in the representation, when the client does not have adequate time to consider the modification proposed by the attorney, is less likely to be considered fair and reasonable than a modification obtained when the client has the opportunity to deliberate whether to agree to the modification. *In the Matter of Shalant, supra*, 4 Cal. State Bar Ct. Rptr. 829.
4. A modification that benefits the client in some substantial way is more likely to be considered fair and reasonable than a modification that simply relieves the client from the task of securing new counsel. *In re Lindmark, supra*, 4 Cal. State Bar Ct. Rptr. 668.
5. A modification that results from a client's difficulty or inability to fulfill the obligations assumed in the initial retainer agreement and is responsive to the client's financial distress is more likely to be considered fair and reasonable than a modification dictated by an attorney's unilateral demand. See, footnote 14, *infra*.
6. A modification that is sought under circumstances that suggest the attorney is retaliating against the client for the client's exercise of a right held by the client (e.g., the decision whether to accept a settlement proposal) is less likely to be considered fair and reasonable than a modification that is not triggered by the client's exercise of his/her rights.
7. If the attorney has mentioned withdrawal as a consequence of failing to agree to a modification of the fee agreement and the client thereafter agrees to a modification, whether the modification is fair and reasonable will be influenced by whether the attorney's withdrawal would have been reasonably justified in the circumstances and whether the attorney had indicated in connection with the threatened withdrawal that the attorney would provide all services necessary to prevent any reasonably foreseeable prejudice to the rights of the client as required by rule 3-700(A)(2). *Ramirez v. Sturdevant* (1994) 21 Cal.App.4th 904, 915 [26 Cal.Rptr. 554].
8. A fee modification entered into between an attorney and a sophisticated client, or a client represented by independent counsel, is more likely to be deemed fair and reasonable than a modification entered into between an attorney and an unsophisticated or unrepresented client. Rule 4-200(B)(2).

3. Application of the Close Scrutiny Standard to Fact Pattern One and Two

In Fact Pattern One above, Client has fallen behind in payments under an hourly fee agreement, and has requested that Attorney modify the terms of the representation. In that fact situation, Client requests Attorney to convert to a contingency agreement due to Client's present inability to pay fees on an hourly basis. The modification made by Attorney in that situation is an accommodation to Client's needs in which Attorney may ultimately obtain greater compensation under the contingency agreement, but will give up any further right to hourly compensation. While Client surrenders a portion of the anticipated recovery, Client also gains relief from the current balance due and future hourly fees that Client cannot pay and Attorney assumes some of the financial risk of the litigation. There is a give and take that equalizes the positions of the parties and advances the goals of Client in a fair and reasonable

manner; moreover, the possibility that Attorney may receive a higher fee as a result of the modification is explained to Client. Further, with trial still six months off, a contingency fee plus the \$100,000 already paid is not, under our factual scenarios, unconscionable. Both parties part with and receive appropriate consideration, and the attorney-client relationship continues, which is Client's goal. In this situation, the Committee believes Attorney has acted ethically and has not engaged in overreaching vis à vis Client.^{15/} The modified fee agreement is fair and reasonable and has been fully explained and consented to by Client.

Contrast this situation with the scenario described in Fact Pattern Two. There, Client has not asked for a modification. She has simply rejected a settlement offer. Attorney has reacted negatively to Client's decision and threatened to withdraw unless Client agrees to increase his percentage of any recovery. Attorney is not doing any more for Client than Attorney originally agreed to do, but is extracting a greater share of the recovery. In these circumstances, the modification is not an accommodation of Client's needs, but rather, an exertion of pressure by Attorney to alter the fee agreement to his advantage, under threat of withdrawal and in the face of the assertion of a right reserved to Client to accept or reject a settlement.^{16/} Under these circumstances, absent a continuance of the trial date and other accommodation, the threatened withdrawal is likely to violate rule 3-700(A), which requires an attorney to take reasonable steps to avoid reasonably foreseeable prejudice to the rights of the client. Obtaining a modification under these circumstances would breach an attorney's ethical and fiduciary obligations to the client. In addition, the resulting fee would likely be considered unconscionable for two independent reasons: first, the circumstances and timing of the threat to withdraw render Client's consent insufficiently voluntary to constitute "informed consent;"^{17/} and second, the increased fee is not warranted by the circumstances. See, American Bar Association Formal Opinion 04-432 (pressures, stress, and anxiety resulting from incarceration make it unlikely that consent provided by incarcerated client will be sufficiently genuine and voluntary to constitute "informed consent"); *Bushman v. State Bar* (1974) 11 Cal.3d 558, 563 [113 Cal.Rptr. 904] (agreement that results in payment "so exorbitant and wholly disproportionate. . . as to shock the conscience," would be unconscionable). Obtaining a modification under these circumstances may also violate Business and Professions Code section 6106, which prohibits acts involving moral turpitude. See, *In the Matter of Shalant, supra*, 4 Cal. State Bar Ct. Rptr. at p. 837 (attorney's conduct in pressuring a client into a modified fee agreement, shortly before client's deposition, constituted act of moral turpitude warranting discipline).

Ramirez v. Sturdevant, supra, 21 Cal.App.4th 904, is not contrary to our conclusion. In *Ramirez*, the court found a modification of a fee agreement to be valid and enforceable even though the attorney had threatened to withdraw from the representation if the client did not agree to an increased fee. *Ramirez* is distinguishable because, in exchange for an increased fee, the attorney agreed to provide additional services beyond those contemplated by the initial agreement; moreover, the attorney's withdrawal could have been accomplished without prejudicing the client's interests because the attorney agreed to prepare and file necessary papers to protect the client prior to withdrawing from the representation. *Id.* at p. 915.

Based on the foregoing, it is the Committee's view that the fee modification in Fact Pattern Two is unfair and unreasonable under the close scrutiny standard. Moreover, we believe the attorney in Fact Pattern Two has breached the ethical obligation not to charge an unconscionable fee under rule 4-200 and could be subject to discipline for moral turpitude.

^{15/} *Tidball v. Hetrick* (S.D. 1985) 363 N.W.2d 414, 417-418 (client difficulties in meeting obligations under initial fee agreement was a significant factor in treating modification as fair and reasonable).

^{16/} *Blanton v. Womancare, Inc.* (1985) 38 Cal.3d 399, 404 [212 Cal.Rptr. 151] ("law is well settled that an attorney must be specifically authorized to settle and compromise a claim, that merely on the basis of his employment he has no implied or ostensible authority to bind his client to a compromise settlement of pending litigation."); see rule 3-510 (attorney must promptly communicate written settlement offer to client in civil matter and all offers made to client in criminal matters); Business and Professions Code section 6103.5 (attorney must communicate written offer of settlement to client).

^{17/} Rule 4-200(B)(11).

CONCLUSION

We conclude that rule 3-300 does not apply to a modification of a fee agreement regardless of the circumstances in which the modification is sought and obtained, unless the modification conveys to the attorney an interest specified in rule 3-300. Considering the factors described above, we conclude that rule 3-300 is not applicable to the modifications described in the above factual scenarios.

A modification of an existing fee agreement is, however, subject to close scrutiny to determine whether it is fair and reasonable and has been fully explained and consented to by the client. In determining whether a modification is ethical, all the facts and circumstances surrounding the modification, including among others, the reason for, timing and financial impact of the modification on the attorney and the client, must be considered.

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 responsibility, or any member of the State Bar.

ATTACHMENT 2

PUBLIC COMMENTS RECEIVED FOR 05-0001
(Includes All Formal Letters and Informal Comments Received)

APPROVED (OR APPROVED WITH SUGGESTED REVISIONS)	DISAPPROVED
Wendy Mazzerella San Diego County Bar Association	Andrew I. Dilworth Bar Association of San Francisco
Joel Osman Los Angeles County Bar Association	Scott J. Drexel State Bar, Office of Chief Trial Counsel
James Ham	Daniel Reith State Bar, Comm. on Fee Arbitration
Robert Kehr	Carol Langford Joined by Zitrin, Sall, Karpman, Towery, Clements
Steven Lewis	Gerald Knapton
David Parker	John Steele
	James Towery
	Deborah Wolfe
	Richard Zitrin (2)
Totals: 6	10

PUBLIC COMMENTS RECEIVED FOR 05-0001

(Includes All Formal Letters and Informal Comments Received)

Comment Submitted By	Date Received:
Steven Lewis	5/20/2008

I think this opinion is excellent (and better than any draft I recall)!

I have one small suggestion regarding a statement on page 4 in the paragraph beginning with "We see nothing ..."

The entire paragraph appears to address both fact scenarios. However, it includes a sentence that begins: "Instead, the effect of the modification is that the client has promised to pay more to the attorney . . ." That statement appears to apply with certainty to the second scenario (assuming any recovery at all) but only potentially to the first scenario. The client may actually pay less in the first scenario depending upon outcome.

Thus, I think a little clarification could help, perhaps by changing the sentence to read something like the following:

"Instead, the effect of the modification is that the client (a) has promised to pay more to the attorney (scenario two), or (b) may end up being obligated to pay more to the attorney depending upon the outcome (scenario one). In either case, the only right obtained by the attorney is the right to collect payment, a debt, from the client."

Comment Submitted By	Date Received:
Wendy Mazzerella	5/28/2008
San Diego County Bar Association	

The Legal Ethics Committee of the San Diego Bar Association adopted the following recommendation in response to the referenced item, a copy of which is attached to this Memo and incorporated by reference: X APPROVED

Comment Submitted By	Date Received:
Deborah Wolfe	6/20/2008

I have fully reviewed the text of the proposed formal opinion 05-0001. I think as proposed, it is unfair to both attorneys and clients. Essentially the proposed change makes a rule (3-300) which is presently most often construed to require the attorney to put the interests of the client first, ahead of his/her own financial interests (which is after all an attorney's sworn duty) by fully and fairly advising the client that the change/ modification in the fee agreement will put the attorney in a more advantageous position than the original fee agreement. Both hypothetical situations require that a client who is presently looking up to the attorney, as opposed to across the table at arm's length, change an existing agreement, which both parties made when in an equal bargaining position.

The rule as proposed simply "muddies the waters" and creates room for ambiguity as to exactly what is a "fully informed and fair" fee agreement. Instead of defining specific language that is agreed to put the client on inquiry notice, the rule would now require speculation on a case-by-case basis as to whether or not fair notice has been given to a disgruntled client! It would, I believe, have the effect of leaving open to speculation and interpretation by volunteer arbitrators (State/County Bar level) and/or courts, whether or not proper notice has been given to the client for the change.

A much better approach would simply be to codify the rule under which we have all been operating, 3-300, which simply prescribes what must be done in order for a fair modification in a fee agreement, includes the appropriate language to be used, and is not subject to thousands of different and inconsistent interpretations.

As an attorney who has practiced for nearly 30 years, 20 of them being spent principally in the area of professional negligence litigation, I really see the possibility for great mischief here. Feel free to contact me if you would like to discuss my comments further.

Comment Submitted By	Date Received:
Gerald Knapton	7/09/2008

The word “pecuniary” has these meanings:

1. of or pertaining to money: pecuniary difficulties.
2. consisting of or given or exacted in money or monetary payments: pecuniary tributes.
3. (of a crime, violation, etc.) involving a money penalty or fine.

The Rule’s phrase “other pecuniary interest” is written out of any separate meaning by the draft:

Here is the Rule’s language (divided into 3 part by me for illustrative purposes):

- “A member shall not
- [1] enter into a business transaction with a client, or
 - [2] knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client,
 - [3] unless each of the following requirements has been satisfied:”

Have you read the very recent U.S. Supreme Court opinion in *District of Columbia v. Heller*, 554 U.S.____ in which the language of the 2nd amendment was considered? As you know, the 2nd amendment reads in full: “A well regulated Militia, being necessary to the security of a free State, the right of the people to keep and bear Arms, shall not be infringed.” The Court concluded that the language was to be read using normal and ordinary meaning rather than in a technical way and it did NOT allow linkage of the two parts.

I think that the same method should be used in your opinion as it construes the phrase “other pecuniary interest” with the other 3 elements. Your draft considers this phrase at page 4 and reads: “In rule 3-300 the phrase “other pecuniary interest” is tied to and reflects the introductory set – ‘ownership, possessory, or security.’ While “*noscitur a sociis*” and “*ejusdem generis*” are not inflexible rules of application, the Committee discerns no policy reasons why the rules should not be applied; rather, just the contrary. A broad construction of “other pecuniary interests” divorced from the introductory set would not only make the introductory set meaningless, but it would eviscerate the distinction between fee agreements and business transactions that we recognize and adopt in this opinion.”

So the phrase “other pecuniary interest” is just absorbed? I don’t think this is realistic or fair and it does not recognize the common usage. The attorney-client arrangement is NOT a separate business transaction. The amount of the fee to the attorney in the existing professional retention is being revised by the changes in Fact Pattern One and Fact Pattern Two in a way that has the potential to take MORE money from the client. This is a changed provision in THE most important provision in the retainer agreement that is clearly potentially adverse to the client. This should require steps (B) (may seek advice of independent lawyer) and (C) (consents in writing) to be valid.

Please reconsider and require the lawyer to advise the client in writing that the client may seek the advice of an independent lawyer and be given a reasonable opportunity to seek that advice.

Thank you for your hard work and dedication to the profession!

Comment Submitted By	Date Received:
Richard Zitrin	7/22/2008

This opinion is an absolutely outrageous attempt to legislate a change in the existing rule and the existing case law, including on fiduciary duty. Even the rules commission's extremely unfortunate modification to 3-300 (now denominated 1.8.1) acknowledges that it might make the rule inconsistent with the case law on fiduciary duty.

Just read footnote 6 if you want to see the sand upon which this opinion is based. If I didn't know better (and I think or at least hope I do), I'd think that COPRAC was trying to pave the way for the commission's ill-advised 1.8.1 to get approved.

This is a terrible, anti-consumer, anti-client measure (it can hardly be called merely an opinion) that purports to tell us what the law is rather than allow the courts to decide.

Strong opinion to follow.

Comment Submitted By	Date Received:
James Towery	7/24/2008

This squabble among California members of APRL must seem quaint to the rest of you, but out here on the left coast, these are fighting issues. And on this dispute about the COPRAC interpretation of RPC 3-300, I come down squarely with Richard, Mark and Carol, and contrary to Ellen and Steve. I think COPRAC got this dead wrong. As Dickens said (I paraphrase): "If that is what the law says, then the law is an ass." There is no good reason why 3-300 should not apply to substantive changes in fee agreements.

I come at this issue, like Carol, from the perspective of having spent many years in the fee arbitration world. I have always viewed 3-300 as an important client protection rule. On its face, it applies to liens and other possessory interests that may arise in fee agreements. But the logic of the rule applies with equal force to other aspects of fee agreements, as when an attorney makes a substantive mid-course change in the fee agreement to the lawyer's advantage. No one argues that 3-300 applies to simply annual increases in billing rates. That is a red herring. But when a lawyer decides to change an agreement from hourly to contingent, or vice-versa, in the midst of a representation with all of the attendant fiduciary duties, why should 3-300 not apply?

I understand the argument that the COPRAC opinion is simply a distillation of California case authority, and no court has expressly taken the position I advocate here. But COPRAC should not take such a narrow view of its role.

There are very sound policy reasons to apply 3-300 in these circumstances.

California attorneys need rules that are simple and clear and provide good guidance. Consumers need protection from the occasional greedy attorney. I hope COPRAC withdraws this ill-considered opinion. More importantly, I hope the Rules Revision Commission gets this right.

Comment Submitted By	Date Received:
Richard Zitrin	7/25/2008

I commend David Parker for his willingness to speak and take enemy fire. Trust that these are words, not bullets. Here's my response to some of David Parker's comments:

1. "Let's be fair, people. Fair to clients and lawyers alike."

No, let's be fair to clients and the public first. Rule 1-100 of the Rules of Professional Conduct:

"The following rules are intended to regulate professional conduct of members of the State Bar through discipline. They have been adopted TO PROTECT THE PUBLIC AND PROMOTE RESPECT AND CONFIDENCE IN THE LEGAL PROFESSION."

They are not written to protect and promote lawyers' interests. They must be fair to clients FIRST AND FOREMOST, not equally to clients and lawyers.

2. For those who think Rule 3-300 should apply to fee agreements or at least renegotiated fee agreements, please, by all means, express your views to California's Commission for the Revision of the Rules of Professional Conduct....

I have, along with 13 other CA ethics professors, strongly opposing the changes to 1.8.1. We have been joined by five of the brightest leading lights of the national ethics bar.

3. Fewer still address the entire Opinion, including its emphasis on "close scrutiny," its invocation of fiduciary duty tenets....

No, in fact we're paying attention to the existence of fiduciary duty, and the fact that this opinion could -- if accepted as authority -- place the case law on fiduciary duty at odds with the rule, an absurd result. (1.8.1 as proposed would do that too, and the law profs' letter to the Commission makes that clear.)

4. Some of our colleagues argue that just because Rule 3-300 does not apply to agreements "by which the member is retained" does not mean it does not address modifications to such agreements.

And COPRAC apparently has the view that just because Rule 3-300 has the "by which the member is retained" language it means, somehow, that it indeed does not address such modifications. That's called legislating.

Here's the proof of legislating: Footnote 6, telling us to ignore State Bar Opn. 1989-116. No wonder, because here is what Opn. 116 says:

"Rule 3-300 addresses potential conflicts between attorney and client. It prohibits an attorney from entering into a business relationship with a client or acquiring an ownership, possessory, security or other pecuniary interest adverse to the client unless certain precautions are taken. ALTHOUGH, ONCE CREATED, THE ATTORNEY-CLIENT RELATIONSHIP IS ARGUABLY A "BUSINESS RELATIONSHIP" BETWEEN ATTORNEY AND CLIENT, BEFORE IT IS FIRST CREATED, IT IS BETWEEN ATTORNEY AND PROSPECTIVE CLIENT RATHER THAN RATHER BETWEEN ATTORNEY AND CLIENT. The negotiations by which the attorney-client relationship is INITIALLY created are presumed to be at arms length.

"Because an arbitration provision is not an ownership, possessory, security or other pecuniary interest, rule 3-300 has no application to such a provision. Therefore, a retainer agreement ****INITIALLY**** creating the attorney-client relationship which does not involve any interest of the attorney governed by rule 3-300, may ethically contain an arbitration requirement...."

Enough said.
(All the CAPS here are my emphasis.)

Lauren, please add this as an additional comment to the proposed new ethics opinion jointly submitted by the following people, whom I believe are all known to you. This comment is in the form of an APRL post written in response to a post from David Parker, whom I believe is a COPRAC member, earlier today. This comment is jointly submitted by:

Diane Karpman
Carol M. Langford
Robert Sall
James E. Towery
Mark Tuft
Richard Zitrin

I believe you have enough identifying information about each of us (all ethics and attorney conduct experts, three former COPRAC chairs and one former State Bar president) but if you do not, please have Audrey H. get in touch and we will provide it.

Comment Submitted By	Date Received:
James Ham	7/28/2008

I write to comment on COPRAC Proposed Interim Opinion No. 05-0001. I am a former member of COPRAC, and have been on the Los Angeles County Bar Association's Professional Responsibility and Ethics Committee ("PREC") for over 23 years, serving on numerous of its subcommittees, including the committees evaluating reciprocal admission and the ABA Ethics 2000 project. I am a former chair of PREC and currently serve as its Vice-Chair. Throughout my 27 years of practice, I have been involved with legal ethics and have provided advice and representation to attorneys. A significant part of my current legal practice involves the representation of lawyers in State Bar disciplinary proceedings.

It is very important for the members of COPRAC to appreciate that they are, first and foremost, interpreting disciplinary rules, the violation of which may result in attorney discipline. Consequently, the rules should, and legally must, articulate clear standards so as not to lead to disciplinary prosecutions based on vague proscriptions of conduct. Ethics rules are not the place to articulate fuzzy, aspirational goals, or the hopes and desires of many of us for the wide adoption of "best practices" by the entire legal community.

A small but vocal minority of lawyers have objected to Proposed Interim No. 05-0001, complaining that the opinion is purportedly "anti-client." However, this small minority of objectors is seeking to insert aspirational ethics goals into a disciplinary rule that must have clear cut standards for what constitutes a violation. The rule has clear limits, which those opposed to Proposed Interim No. 05-0001 wish to supplant with ambiguous, fuzzy proscriptions of all kinds of conduct clearly falling outside of the plain language of Rule 3-300.

Rule 3-300 has a long, established history. As the Official Discussion states, the rule does not apply to the formation of attorney client fee agreements. Furthermore, the rule has only limited application to mid-stream attorney-client fee agreement negotiations. While lawyers must conform to fiduciary duty standards when engaged in mid-stream attorney-client fee agreement negotiations, Rule 3-300 applies only where an attorney seeks to acquire an ownership, possessory, security, or other pecuniary interest adverse to a client.

Thus, Rule 3-300 applies only where a lawyer seeks to acquire an ownership, possessory, security or other pecuniary interest, which means, for example, the acquisition of client debt, a security interest in client property, such as a promissory note and deed of trust, or to an asset pledge, or a lien. The Rule also applies when a lawyer proposes to enter into a business transaction with the client, such as partnering to purchase real property, or to open or jointly invest in a business.

The small group of vocal opponents to Interim 05-0001 claims that Rule 3-300 applies to any mid-stream modification of the lawyer-client fee agreement, including proposals to add an arbitration clause, to increase or decrease an evergreen retainer fee, or to any other innumerable circumstances. These vocal opponents believe that the requirements of fiduciary duty are not enough, and that Rule 3-300 should apply to everything. It is clear, however, that Rule 3-300 has specific limits. The views expressed by those opposed to Interim 05-0001 would expand the rule to the point that it could not act as a disciplinary rule, because the rule would be inherently vague and ambiguous, and fail to give fair notice of what is prohibited. As earlier stated, the Rules of Professional Conduct are no longer a place to announce aspirational *desires*; *they are the place where conduct constituting a disciplinable offense is defined*. Thus, the proposed COPRAC opinion is exactly correct.

Opponents of Interim 05-0001 overlook how Rule 3-300 is abused by some so-called “ethics experts” who testify regularly against lawyers in court. Some of these “experts” will claim that Rule 3-300 applies to virtually any lawyer-client negotiation, and clearly abuse the purpose and scope of Rule 3-300. Hopefully, this COPRAC opinion will educate, and reign in, those who seek to expand Rule 3-300 into environments where it does not belong.

If Rule 3-300 is interpreted broadly, as those opposed to Interim 05-0001 would have it, then Rule 3-300 must be interpreted to apply to all varieties of mid-stream fee agreement modifications, including the practice of many law firms which raise *their hourly rates on an annual basis*. *There is no logical or legitimate basis for “carving out” annual fee increases from Rule 3-300 under the view offered by those who disagree with the conclusion of Interim 05-0001*. It is not enough that the fee agreement may give the lawyers the right to raise their fees on an annual basis. If Rule 3-300 applies, as the opponents of Interim 05-0001 say, then annual fee increases, which are determined unilaterally by law firms, constitute the acquisition of a pecuniary interest (i.e., a higher hourly rate) adverse to a client. Thus, if COPRAC expands Rule 3-300 beyond regulating adverse pecuniary interests as defined earlier in this letter, then the slope becomes very slippery, and slides right into annual fee increases and all sorts of other unintended consequences.

Some opponents argue that annual hourly fee increases are not within the scope of Rule 3-300, relying on *Severson & Werson v. Bollinger* (1991) 235 Cal.App.3d 1569. However, Rule 3-300 was not mentioned in the Severson opinion. There is no indication that Rule 3-300 was considered, argued or raised in that case. Thus, Severson does not hold that annual hourly rate fee increases are exempt from Rule 3-300, and under the view held by those opposing Interim 05-0001, the inevitable result would be that such rate increases would, of logical necessity, be governed by Rule 3-300. Obviously, this was never intended or expected, and falls well beyond the strict limits of Rule 3-300.

COPRAC should apply a real world perspective to these issues, and remember that the rules are disciplinary rules, not aspirational goals. Rules like Rule 3-300, if not carefully and clearly defined, become disciplinary “drop guns” which can be used to discipline unsuspecting attorneys, or abused to proffer dubious “ethics expert” opinions in cases where lawyers are accused of negligence. The Rules must be clear. It helps no one when ethics experts go into court and assert that Rule 3-300 applies to all kinds of fee negotiations that simply do not involve the acquisition of an ownership, possessory, security, or other pecuniary interest adverse to a client. Hopefully, COPRAC’s Interim 05-0001 will help guide us all in understanding the scope of Rule 3-300.

Comment Submitted By	Date Received:
Robert Kehr	7/28/2008

I support the conclusion reached in Formal Opinion Interim No. 05-0001 that the modification of a retainer agreement normally is not governed by Rule 3-300. However, I believe there are significant aspects of its reasoning that require careful reconsideration.

The introductory paragraph to the Discussion section cites the Cooley case for the proposition that a lawyer does not have a confidential relationship with a potential client. The proposed opinion does not define what is meant by a “confidential relationship”, but I take the intended meaning to be that a lawyer owes no fiduciary duties to a potential client. Here are four examples of why that is not correct:

- Lawyers can owe a duty of confidentiality to potential clients. The evidentiary aspect of this is stated in the definition of “client” contained in Evidence Code §951.
- Lawyers have an affirmative obligation to non-clients to prevent a person’s confusion over whether the lawyer represents the person. See *Butler v. State Bar*, 42 Cal.3d 323, 329 (1986): “The attorney’s duty to communicate with a client includes the duty to communicate to persons who reasonably believe they are clients to the attorney’s knowledge at least to the extent of advising them that they are not clients.” *Butler* was followed in *Gadda v. State Bar*, 50 Cal.3d 344, 353 (1990); *Matter of Kaplan*, 3 Cal. Bar. Ct. Rptr. 15 (1996), and its principle has been restated in at least three COPRAC opinions (Cal. State Bar Opns. 2003-164, 2003-161, and 1995-141), and I think in two or three opinions of the Professional Responsibility and Ethics Committee of the L.A. County Bar Assn.¹
- Under Rule 3-300, a lawyer is subject to discipline for entering into a fee agreement with a potential client that amounts to a business transaction, even though that agreement is made before the formation of a lawyer-client relationship.² Thus, I believe that the proper reading of the business transactions prong of Rule 3-300 requires a distinction between ordinary fee agreements (hourly, contingency, flat, and some combination of the first three), which are not covered by the Rule, and fee agreements that amount to business transactions, which are covered by the Rule and by the Probate Code. In this latter category I would place an agreement under which a lawyer agrees to provide legal services in return for the potential client’s house, stock certificates, jewelry, or other non-cash asset. I think this also is expressed in your reference to Restatement §18, which you describe as distinguishing “... agreements for the payment of money”
- A lawyer is subject to discipline under Rule 3-300 for entering into an agreement with a client that confers on the lawyer an adverse pecuniary interest, such as a lien on the client’s asset to secure the payment of fees.

¹ The language of *Butler* speaks of the lawyer’s “knowledge”, but this is clarified in *Matter of Kaplan*, 3 Cal. State Bar. Ct. Rptr. 547 (1996). After quoting *Butler*, the Court treated the lawyer’s good-faith belief that there was no lawyer-client relationship as irrelevant to the inquiry. The opinions instead made two inquiries: did the person have a reasonable belief in the existence of the relationship and did the lawyer have notice of fact that should have alerted him to the person’s belief. This gives what I believe is the proper reading of *Butler* - the standard is not the lawyer’s actual knowledge in the subjective sense, but facts from which the lawyer reasonably should have recognized the person’s belief. The lawyer was disciplined for this under §6068(m). This means that the Supreme Court categorized the lawyer’s conduct as a failure to keep the (potential) client “... reasonably informed of significant developments”, which is a clear statement of a fiduciary obligation to a non-client. *Butler* also is given this broader reading in Cal. State Bar Opns. 2003-164 at n.7, 2003-161, and 1995-141.

² Both the ABA Model Rules and the Restatement suggest that any agreement that an attorney receive a non-cash asset for legal services should be considered a business transaction between lawyer and client. The Restatement 3rd, the law governing lawyers §126 which makes explicit in Comment a that its equivalent of Rule 3-300 applies “... when a lawyer takes an interest in the client’s business as payment of all or part of a legal fee.” ABA Formal Opinion 00-418 (7/7/00); District of Columbia Bar Legal Ethics Comm. Op. 300, 7/25/00; Utah Opinion 98-13 (12/4/98); Mississippi 230 (11/16/95) and 202 (9/4/92); and Missouri Informal Decision 980195. Comm. on Prof. Ethics, etc. v. Humphreys, 524 N.W.2d 396, 399 (Iowa 1994) [stock for services in forming a corporation treated as a business transaction whether or not an attorney- client relationship existed before the fee agreement; conclusion follows from lack of facts as to existence of relationship while citing *Mershon* in which the relationship already existed].

I therefore believe that the first paragraph of the Discussion is wrong, and that the error might well create problems in other contexts. My concern about that paragraph, however, is not simply a matter of tidiness, as important as that is. I believe the paragraph is inconsistent with the conclusion reached by the proposed opinion. I will return to that analytical problem in a moment, but I think it is essential to begin with the applicable text. The Rule 3-300 Discussion excludes from the scope of the Rule the agreement by which the lawyer is retained. It does not limit the exclusion to the agreement by which the lawyer “initially is retained” in a matter or to the agreement by which the lawyer “is retained by a client in a first matter”. Thus, the Discussion exclusion applies equally to an initial retainer agreement, to a modification of an initially retainer agreement, and to a subsequent retainer agreement on a new matter after the initial formation of a lawyer-client relationship (perhaps whether or not the initial lawyer-client relationship still is in existence) - in each case unless³ the agreement amounts to a business relationship between the two or confers on the lawyer a pecuniary interest adverse to the client - because each of these agreement is an agreement by which the lawyer is retained.⁴

This reading of the Rule 3-300 Discussion is supported by the language of Probate Code §16004(c) (previously found in the same words as Civ. C. §2235). That section says the following in a provision governing conflicts for fiduciaries: “(c) A transaction between the trustee and a beneficiary which occurs during the existence of the trust or while the trustee's influence with the beneficiary remains and by which the trustee obtains an advantage from the beneficiary is presumed to be a violation of the trustee's fiduciary duties. This presumption is a presumption affecting the burden of proof. This subdivision does not apply to the provisions of an agreement between a trustee and a beneficiary relating to the hiring or compensation of the trustee.” (emphasis added). The concluding sentence also does not distinguish between initial fee agreements, modifications of initial fee agreements, and new fee agreements that are made while an earlier fiduciary relationship continues to exist on a separate matter. I therefore believe that there is no textual support for the application of Rule 3-300 to any fee agreement unless the agreement amounts to a business transaction or confers an adverse pecuniary interest.

I now want to address the analytical issue that I suggested earlier in this letter. I previously identified certain situations in which a lawyer has fiduciary duties to someone who is not yet a client (some of which are situations in which the person might never become a client). One of these is pertinent here. This is the fact that a lawyer can violate Rule 3-300 with respect to his or her dealings with someone who is not yet a client. Thus, a lawyer owe the same duties to those who have not yet become clients that lawyers owe to clients with respect to business transactions and adverse pecuniary duties.⁵ I further believe that the applicable fiduciary duty is the duty of full and candid disclosure. This was the basis for Butler, supra at 329, quoted above, and is captured in the quote from Matter of Kaplan set out in n. 1, above.

The duty of candor is a fundamental obligation of lawyers. The fiduciary duty of lawyers “... embraces the obligation to render a full and fair disclosure to the beneficiary of all facts which materially affect his rights and interests. “Where there is a duty to disclose, the disclosure must be full and complete, and any material concealment or misrepresentation will amount to fraud. ...[citation omitted] Thus, as we stated in *Amen v. Merced County Title Co.* [citation omitted], ‘Cases in which the defendant stands in a fiduciary relationship to the plaintiff are frequently treated as if they involved fraudulent concealment of the cause of action by the defendant. The theory is that although the defendant makes no active misrepresentation, this element 'is supplied by an affirmative obligation to make full disclosure, and the non-disclosure itself is a "fraud."’” *Neel v. Magana, Olney, Levy, Cathcart & Gelfand*, 6 Cal.3d 176, 188-89 (1971). See, also, *Beal Bank v. Arter & Hadden, LLP*. 42 Cal.4th 503, 514 (2007), *Health Maintenance Network v. Blue Cross of So. Cal.*, 202 Cal. App.3d 1043, 1062 (1988), *Johnson v. Haberman & Kasso*, 201 Cal. App.3d 1468, 1477 (1988), *Hobbs v. Bateman Eichler, Hill Richards, Inc.*, 164 Cal. App.3d 174, 201 (1985), *Reynolds v. City of Los Angeles*, 76 Cal. App.3d 882, 891 (1978), and

³ See *Hunnicut v. State Bar*, 44 Cal.3d 362, 371-72 (1988) [“Since the duty of fidelity and good faith arising out of the confidential relation of attorney and client is founded, not on the professional relation per se, but on the influence which the relation creates, such duty does not always cease immediately upon the termination of the relation but continues as long as the influence therefrom exists.” and *Beery v. State Bar*, 43 Cal.3d 802, 812 (1987).

⁴ The Discussion to Rule 3-300 does not refer to the business transaction possibility, presumably because this didn’t become a focus of attention until the dot.com glory days made stock for fees a hot issue and lead to the ethics opinions listed in the preceding footnote, the earliest of which was issued in 1992.

⁵ I refer here to the retainer agreement, but one can imagine situations in which there is a parallel transaction with a non-client that is not part of a fee agreement but nevertheless is found to be governed by Rule 3-300.

Moreover, lawyers long have had the obligation to make full and candid disclosure to their clients before entering into business transactions with them. This is found in the *Felton v. LeBreton*, 92 Cal. 457, 469-70 (1891) line of cases. This duty easily is understood as part of the duty of candor.

Given that the duty of candor exists with respect to all fee agreements - initial, modified, and subsequent (at least if the lawyer-client relationship still is in existence) - I know of no principled reason for what I believe would be the novel argument that there is more than one kind of fiduciary duty of candor. The concept is unitary and therefore applies equally to potential and actual clients. Rather, the argument for applying Rule 3-300 to all fee modifications, and presumably to all retainer agreements for subsequent matters, is that there is no fiduciary duty to non-clients but there is to current clients. This is wrong, and the duty of candor is a single duty owed in the same way to all persons to whom it is owed.

Finally, I want to address a few smaller points in the proposed opinion (although I generally will avoid drafting discussion because of my hope that the proposed opinion will be substantially rewritten):

- There is a reference in the first paragraph of section A to the “official comment ” to Rule 3-300. It is the official discussion;
- The reference to Fletcher in first paragraph of section A.2. omits the timing element that I believe is essential to understanding when a lawyer’s interest is an adverse pecuniary interest within the meaning of Rule 3-300. The draft picks this up in the fourth paragraph of section A.2. “without a contested judicial hearing” and “summarily realized”, but I would not leave any explanation of the Fletcher opinion without that key element.
- I strongly object to the first two guidelines in section B. I believe that the vast majority of hourly fee modifications are nothing more than a law firm’s increase of rates for long-term clients because of inflation or because an associate’s greater experience warrants a fee increase. No lawyer who represents a client over an extended period should have a fee increase subject to any special scrutiny because the firm has raised its billing rates or its billing rates for particular firm lawyers.

I apologize that this letter is incomplete, but I am out of time and hope it covers the necessary.

Comment Submitted By	Date Received:
David Parker	7/28/2008

Having read with the interest the string of posts on these two listservs decrying or defending COPRAC’s proposed Opinion 05-0001 (“Opinion”), and speaking as an individual, and not on behalf of COPRAC, I offer my defense of the proposed Opinion which is now out for public comment (read: flogging).

Here is the concern as I understand it: In a shocking and naked attempt to protect lawyers at the expense of their clients, COPRAC insists that renegotiated fee agreements must not simply avoid being “unconscionable” under Rule 4-200, but actually must be “fair, reasonable, fully explained, and consented to by the client”, in compliance with the attorney’s fiduciary duties to the client, and toward that end will be “subject to close scrutiny.” And if the revised terms create in the lawyer an “adverse interest” as repeatedly defined by the California Supreme Court, most recently in *Fletcher v. Davis* (2004), it must also comply with Rule 3-300.

No wonder so many are upset!

I realize this post will engender a new round of commentary, but urge you all to re-read the proposed COPRAC Opinion in its entirety before returning with another volley. It seems to me the comments posted by some of the objectors have gone far beyond the reach of the underlying facts and the conclusions set forth in the draft opinion.

Let's be fair, people. Fair to clients and lawyers alike. Ethics opinions, like legal opinions authored by lawyers, exist in a context. That context, as it applies here, includes: (1) the facts of the inquiry (which, contrary to the hypothetical in one post did not include establishing a lien where one did not exist in the original fee agreement or add a binding arbitration clause); (2) the issues addressed (as set forth in the opinion: "What are the ethical ramifications associated with a modification of an attorney fee agreement?") ; (3) the applicable rules (which are the California Rules of Professional Conduct, for better or worse, including the actual rule and the official Discussion thereto, both having endorsed by the California Supreme Court upon enactment and which are binding on California lawyers); (4) relevant authority interpreting the applicable rule, primarily judicial (California appellate courts and California State Bar Court) and (5) the actual text of the opinion, in its entirety (not simply a one sentence footnote in an eight page opinion, as some righteously target).

For those who think Rule 3-300 should apply to fee agreements or at least renegotiated fee agreements, please, by all means, express your views to California's Commission for the Revision of the Rules of Professional Conduct which is undertaking a full scale rewrite of the Rules of Professional Conduct in our state. However, the fact remains that COPRAC is obliged to express its views on the current state of law, which includes the current rules, the State Bar Act contained in California's Business and Professions Code, and case law. COPRAC is not an advocacy body, though our members, in their individual capacities, freely express their views on changing the rules.

COPRAC's proposed Opinion has been the subject of prolific commentary in recent days, primarily by a number of distinguished and rather impassioned colleagues here in California. Notably, however, few posts discuss the actual language of the rule in question, Rule 3-300 (which is quite narrow compared to Model Rule 1.8), much less the case law, to the extent it exists (there is in fact scant authority as relates to renegotiated fee agreements and no court in California has ever concluded that Rule 3-300 applied per se to renegotiated fee agreements), and virtually all ignore the relevant official Discussion ("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."). Critics seem to resort to the "logic" of the Rule, rather than the Rule itself, which seems to be another way of saying that the rule should be expanded.

There can be no legitimate argument that fee agreements, per se, are covered by the rule; they are clearly excluded as set forth in the above quoted Discussion. Instead, California long ago opted to provide clients with protection by way of a rule against unconscionable terms and fees (Rule 4-200), imposition of statutory requirements governing the fact and content of fee agreements (Business & Professions Code Sections 6147 and 6149) and by making clear that fundamental fiduciary tenets govern the attorney-client relationship at every turn, including renegotiated terms of compensation. Along the way, State Bar Court decisions have applied a "close scrutiny" standard which COPRAC by this Opinion embraces.

Some of our colleagues argue that just because Rule 3-300 does not apply to agreements "by which the member is retained" does not mean it does not address modifications to such agreements. For these adherents, they necessarily implant a word in the quoted Discussion that members of COPRAC did not see ("... first retained..."). By this proposed Opinion, COPRAC holds to the view the plain language of the Discussion makes clear that a fee agreement is not a "business transaction" (noting in the Opinion that no Court has yet interpreted the expression), and "fees" or more precisely the client's obligation to pay fees, while within the broad definition of "pecuniary", does not create in the lawyer an "adverse interest." The definition of the term "adverse interest" is supplied most recently by California Supreme Court in *Fletcher v. Davis* (an interest will be considered adverse if it is reasonably foreseeable that the interest held by the attorney could become detrimental to the client). This is hardly a shocking conclusion, given that it accords with the views of the Restatement. In short, neither prong of Rule 3-300 applies to fee agreements or renegotiated fee agreements, or even the obligation to pay fees, though it could apply to individual provisions in a fee agreement such as a charging lien, deed of trust, pledge of stock, assignment of rights, etc. Of course, those denouncing the Opinion fail to point out that the facts of the inquiry did not involve any of these recognized adverse interests.

The issue has been presented and resolved in an analogous context, California's Probate Code section 16004, which creates a rebuttable presumption of undue influence/constructive fraud in any "transaction" between a trustee and beneficiary (which covers all fiduciaries, including attorneys and is not limited to "business transactions" but any transaction that confers a benefit on the trustee). In a very interesting

parallel, like the Discussion to Rule 3-300, this statute excludes “provisions of an agreement between a trustee and a beneficiary relating to the hiring or compensation of the trustee.” The Court of Appeal in *Walton v. Broglio* held that renegotiation of a lawyer fee agreement does not trigger the presumption of undue influence in Section 16004.

Fewer still address the entire Opinion, including its emphasis on “close scrutiny,” its invocation of fiduciary duty tenets, and its reliance on the protection afforded by Rule 4-200. When all of the shouting dies down, can someone explain how these combined restrictions do not provide sufficient “consumer protection”? What’s inadequate about “fair and reasonable,” judged by a “close scrutiny” standard designed to find out whether the attorney “fully explained” the changes and the client then consented? After all, the proposed Opinion invokes two of the three elements of Rule 3-300 itself, omitting only the written admonition that the client may wish to consult a lawyer.

So is that what it boils down to? That the critics of the Opinion want the independent counsel admonition? Really, what else would Rule 3-300 do that the protective standards employed by the Opinion do not?

Finally, does anyone seriously dispute the conclusions reached by COPRAC in the two “fact patterns” presented by the inquiry? For the convenience of those who stopped reading after the “Digest,” the fact patterns are found right below that section on p. 1 and are analyzed in the Opinion at pp. 7-8.

Now pardon me while I duck and cover!

Comment Submitted By	Date Received:
John Steele	7/29/2008

I'm sorry that my vacation plans prevent me from attending the August meeting. I want to share a few thoughts about 05-0001.

I've seen reactions on the APRL listserv that are mirrored in some of the comments that Lauren forwarded. I wonder how closely some of the commenters read the draft. The draft is the best resolution of the issue.

1. Neither the rule nor the discussion expressly says that 3-300 applies to all modifications of fee agreements. The first paragraph of the discussion implies that the key terms of art in the rule ("business transaction" and "pecuniary interest") simply do not apply to fee agreements -- and they certainly don't apply to the original fee agreement. And we know that the core meanings of those terms apply to very different kinds of agreements -- for example, to buying stock in the client or forming a partnership with the client (business transaction) or to taking a lien (pecuniary interest). The comments to MR 1.8(a) strongly suggest that the terms of art have those traditional meanings. To my knowledge, no California court has ever held that all modifications are either "business transactions" or "pecuniary interests."

Some commenters have urged us to do "public policy" and declare that all modifications fall under 3-300. I do not understand us to be a public policy body in the sense of wielding plenary or legislative powers. I agree that in some cases where there is interpretive doubt we can steer away from interpretations that implement poor public policy choices. But I don't see sufficient ambiguity in the rule to give us a free hand here. More fundamentally, to declare that all modifications fall under 3-300 could easily void hundreds -- thousands? -- of existing contracts where clients and lawyers modified contracts and the magic words of 3-300 were not used. Without any notice to the bar, we would be retroactively opening the door to discipline allegations, to clients walking out on their contractual obligations, and worse. How is that sound public policy? Hence I cannot support any opinion declaring that all modifications fall under 3-300.

2. There has been some support for the idea that "good" modifications don't fall under 3-300, while "bad" ones do. A couple of the well-known California ethicists who have criticized the draft have sounded this theme. They say, in essence, "of course, no one is suggesting that 3-300 applies to all modifications." There is some intuitive appeal to that approach. But in the APRL discussions and in the

comments Lauren forwarded, I have yet to see anyone offer a clear definition of how to separate the two categories. I don't think there is one. Initially, my sentiments pushed me to the opposite result in 05-0001. But, despite my efforts to do so, I cannot defend any distinction under 3-300 that appeals to an intuitive sense of good modifications and bad ones. Many modifications are some type of blended compromise.

3. The only principled distinction remains the one drawn in the first paragraph of the discussion and in the draft opinion: modifications fall under 3-300 if they involve business transactions with the client or pecuniary interests. Otherwise, that particular rule doesn't govern. Hence we turn to the principles found in the second half of the draft.

4. The draft opinion has strong pro-client language. It adopts a standard that I believe is tougher than 3-300, because the modification must be "fair and reasonable" and is subject to "close scrutiny." Rule 3-300 does not adopt a close scrutiny standard. I have yet to see any of the critics acknowledge this aspect of the draft. I would have no problem modifying the draft to emphasize that aspect of the opinion if others felt it would be useful.

5. Institutionally, I see no problem with issuing an opinion that we think is correct, even if there is criticism. It is perhaps our unfortunate lot to point out that neither the rule nor the case law says that all modifications fall under 3-300 and that the text of the rule cannot be stretched that far. It may be our job to point out that, as so often happens, California simply lacks an express rule on "modifications."

It's worth noting that the ABA has two rules, 1.5 and 1.8, which might have regulated "modifications," but neither one expressly does. Further, MR 1.8 has no less than 10 substantive sub-paragraphs regulating all sorts of deals with clients, but not one of them is devoted to the topic of modifications. (Tellingly, the extensive comments regarding 1.8(a) do not mention modifications.) I draw two conclusions from that. First, there is no great shame in us pointing out that the CRPC don't have a rule on point. In fact, we might modify the opinion to directly address that. Second, there is a distinct possibility that neither California nor the ABA have adopted a simple, express rule because no simple rule adequately resolves the issues at hand.

If our opinion prompts the RRC to act, or prompts the ABA folks to address the gap in the Model Rules, then we'll all be better off with a prospective rule that gets a full public airing. But I predict that anyone who wants to adopt a broad reading will have a whale of a time thinking through the implications of such a rule, and that anyone trying to distinguish between good modifications and bad ones will have a whale of a time drawing a defensible distinction.

Finally, I trust that we will continue to address this issue in good faith, and not be swayed by the emotional content of some of the criticism. That is why I have not specifically addressed those comments.

Comment Submitted By	Date Received:
Daniel Reith	7/30/2008
State Bar, Committee on Fee Arbitration	

I am writing as vice chair on behalf of the State Bar Standing Committee on Mandatory Fee Arbitration to express the unanimous position of its members in attendance at its regular meeting on July 25, 2008, regarding the proposed formal opinion on modification of an attorney fee agreement. We considered this subject in accordance with the charge of the Board of Governors that we "review policies, procedures, guidelines and the law relating to mandatory fee arbitration, attorney's fees and fee agreements and recommend appropriate amendment, change or modification."

We support the view expressed in the proposed formal opinion that after the attorney-client relationship has commenced, any modification of an existing fee agreement requires close scrutiny due to the fiduciary duty owed by the attorney to the client, and that such modification must be fair, reasonable, fully explained, and consented to by the client. However, we encourage the State Bar Standing Committee on Professional Responsibility (COPRAC) to reconsider its position that Rule 3-300 of the Rules of Professional Conduct does not per se apply to such a modification.

We believe that the proposed formal opinion unnecessarily exposes attorneys to potential discipline and

loss of fees, exposes clients to ill-considered modifications of fee agreements when better alternatives exist, and exposes courts and arbitrators to the increasing need to decide whether such modifications should be upheld on a case by case basis rather than imposing the requirement that proposed fee agreement modifications be permitted only upon compliance with Rule 3-300, which includes advising the client to consult other counsel and giving the client the opportunity to do so before agreeing to the proposed modification. Absent a reversal of its position on applicability of Rule 3-300, we urge (hat the proposed formal opinion be withdrawn.

It is our view that Rule 3-300 applies to modifications of attorney-client fee agreements for two reasons in all cases, and a third where the modification is a contingent fee agreement and the attorney acquires a charging lien against the recovery for payment of fees and costs.

First, Rule 3-300 requires compliance with its provisions if an attorney enters into a "business transaction" with a client, and should apply to a modification of a fee agreement with an existing client. That was the conclusion expressed in California State Bar Formal Opinion No. 1989-116, and the proposed formal opinion offers no reason for its declination to follow this precedent. The absence of precedents is no reason to reach a conclusion as to what the law on a subject is, as witness *Fletcher v. Davis* (2004) 33 Cal..4th 61, which held that an attorney's charging lien in a non-contingent fee case is a security interest and is therefore invalid unless the attorney has complied with Rule 3-300. That unanimous opinion caught the vast majority of practitioners by surprise, due in no small part to the lack of case law on the subject in this state. Certainly a lay person would consider modification of a fee agreement to be a business transaction in which the attorney has an existing fiduciary duty to the client.

Second, Rule 3-300 requires compliance with its provisions if an attorney acquires a "pecuniary interest adverse to a client", and we submit that such an acquisition occurs when an attorney obtains a modification of the contracted for fees or the attorney's duties as provided in the client's original contract. The client has a pecuniary interest in the performance of that agreement at the fees and costs provided in it, and the modification of those rights represents a pro tanto transfer of the client's existing pecuniary interest to the attorney. Whether acquisition of the pecuniary interest is ultimately considered to be adverse is beside the point, as the court in *Fletcher v. Davis*, supra, noted that the test of adversity is whether it is "reasonably foreseeable" that it could become detrimental to the client.

This is certainly the case in both of the fact patterns offered in the proposed formal opinion. In Fact Pattern One, the client might be better off seeking an immediate settlement and paying his outstanding fee balance to his attorney, contracting for modification on more favorable terms, or declining the write-off of outstanding fees and hiring another attorney on a contingent fee basis more favorable to the client. In Fact Pattern Two, the client might be better off to accept with regret the withdrawal of the attorney, hire another attorney to take over the case, owe nothing until a recovery is achieved, and either pay nothing to the first attorney for withdrawing without cause, as occurred in *Rus, Miliband & Smith v. Conkle & Olesen* (2003) 113 Cal.App.4th 656, or have both attorneys divide one contingent fee, as occurred in *Fracasse v. Brent* (1972) 6 Cal.3rd 784, and other cases. No doubt the client would be better able to assess the wisdom of accepting an attorney's proposal to modify a fee agreement if the client consulted other counsel, and the client would have to be advised to do so by the current attorney if Rule 3-300 applied to fee agreement modifications involving a change in the fees or responsibilities of the attorney. Third, the proposed formal opinion notes in its footnote 8 that in its "first factual scenario" the attorney had modified the fee agreement to convert it from an hourly fee retainer into a contingent fee agreement, and observes that a contingent fee agreement gives the attorney an interest in the client's recovery, but declares that such an interest is not adverse and therefore does not fall within Rule 3-300. The footnote asserts no court has found that a charging lien in a contingency fee case requires compliance with Rule 3-300, and cites California State Bar Formal Opn No. 2006-170, also authored by COPRAC, as authority for the proposition that Rule 3-300 does not apply. This statement ignores the actual state of the law on the subject. *Fletcher v. Davis*, supra, held that an attorney having an hourly fee agreement may not have a charging lien against the recovery for any unpaid fees or costs without compliance with Rule 3-300 in obtaining that lien, and the reasoning in that unanimous opinion would indicate that the same rule might apply in a case involving a contingency fee agreement. The Supreme Court stated in footnote 3 of that opinion that it was not deciding whether Rule 3-300 would apply in a contingent fee case, but this footnote can be neither encouraging nor discouraging on the issue of whether the rule will or will not be applied when the appropriate case comes before the court, as surely one will.

California State Bar Formal Opn. No. 2006-170 noted the unsettled state off the law on whether Rule 3-300 might apply to a charging lien in a contingency fee case, and suggested that the timid might want to

comply with the rule even though the opinion concluded it did not apply. No such caution is contained in this proposed formal opinion, so that it encourages a disregard of Rule 3-300 without warning the attorney of the risks of discipline or loss of fees that may be involved. A reading of the facts in *Fletcher v. Davis* would be a lesson to any attorney who might think of bypassing compliance with Rule 3-300 in obtaining a charging lien that is ultimately held invalid and leaves the attorney with no recovery for fees earned.

For the foregoing reasons, the State Bar Standing Committee on Mandatory Fee Arbitration recommends that the proposed formal opinion be revised as suggested above or withdrawn.

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

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.

We 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 *Hunnecutt 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 *Hunnecutt 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.

Comment Submitted By	Date Received:	
Joel Osman	Los Angeles County Bar Association	7/31/2008

On Monday, July 28, 2008, the Los Angeles County Bar Association Professional Responsibility Committee ("PREC") held a special meeting to discuss COPRAC's Proposed Interim No. 05-000 1 (Modification of an Attorney Fee Agreement). After full discussion, PREC voted to advise COPRAC that PREC agrees with the analysis and conclusions reached in Proposed Interim No. 05-0001. PREC does recommend that COPRAC consider slightly revising the proposed opinion, so that it emphasizes, in the summary and early in the opinion that attorneys are subject to strict fiduciary duties when negotiating modifications to attorney-client fee agreements during the course of the representation.

PREC notes that the Rules of Professional Conduct are, first and foremost, disciplinary rules, the violation of which may result in attorney discipline. Consequently, it is important that the rules articulate clear standards so as not to lead to disciplinary prosecutions based on vague proscriptions of conduct. Ethics rules are not the place to articulate fuzzy, aspirational goals, or the hopes and desires of many for the wide adoption of "best practices" by the entire legal community.

PREC understands that some lawyers, including some members of our committee, oppose the conclusions reached in Proposed Interim No. 05-0001, on the grounds that the opinion fails to protect the public or is allegedly "anti-client." PREC disagrees. Proposed Interim No. 05-0001 correctly analyzes the scope, breadth, and application of Rule 3-300, and goes to great lengths to remind attorneys of the strict scrutiny that will be given to mid-transaction modifications of attorney client fee agreements. In this context, it is inappropriate to attempt to expand the reach of Rule 3-300 by reading into that rule the existence of aspirational ethics goals that are not true to the text of the rule. Disciplinary rules, such as Rule 3-300, must have clear cut standards defining a violation. Rule 3-300 has such clear limits, which should not, by fuzzy interpretation, be expanded to conduct that clearly falls outside the plain language of Rule 3-300.

Rule 3-300 and its predecessor have a long, established history. As the Official Discussion states, the rule does not apply to the formation of attorney client fee agreements. The rule has only limited application to mid-stream attorney-client fee agreement negotiations. While, as the draft opinion clearly states, lawyers must conform to fiduciary duty standards when engaged in mid-stream attorney-client fee agreement negotiations, Rule 3-300 applies & where an attorney seeks to acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, which means, for example, the acquisition of client debt, a security interest in client property, such as a promissory note and deed of trust, or to an asset pledge, or a lien. The Rule also applies when a lawyer proposes to enter into a business transaction with the client, such as partnering to purchase real property, or to open or jointly invest in a business or other venture. PREC believes the proposed COPRAC opinion correctly analyzes the scope and reach of Rule 3-300. Rule 3-300 together with other rules such as Rule 4-200 and the fiduciary duties imposed upon attorneys negotiating modifications to their attorney-client fee agreement provide full and complete protection to the public. Nothing in COPRAC's Proposed Interim 05-0001 detracts from or limits that protection.

Some opponents of the conclusions reached in Interim No. 05-0001 argue that Rule 3-300 applies to virtually any kind of mid-stream modification to the lawyer-client fee agreement, including proposals to add an arbitration clause, to increase or decrease an evergreen retainer, to change the timing of payment, or to any other circumstances not involving the acquisition of an ownership, possessory, security or other pecuniary interest. These opponents contend that the requirements imposed upon attorneys as fiduciaries are not enough, and that Rule 3-300 should apply without exception to any fee agreement modification. It is clear, however, that Rule 3-300 has very specific limits.

PREC also notes that Proposed Interim 05-000 1 will have the salutary effect of reminding practitioners of the limits of Rule 3-300. There are some who assert that Rule 3-300 applies to virtually any lawyer-client negotiation. Proposed Interim 05-0001 will help educate, and limit, improper application of Rule 3-300 in situations where it does not apply.

Proposed Interim 05-0001 is also correctly decided from a policy standpoint. If Rule 3-300 were to be interpreted broadly to apply to attorney-client fee agreement modifications beyond the acquisition of an ownership, possessory, security or other pecuniary interest, then Rule 3-300 would necessarily apply to

all varieties of mid-stream fee agreement changes, including the practice of many law firms which raise their hourly rates on an annual basis. There is no logical or legitimate basis for "carving out" annual fee increases from Rule 3-300 under the reasoning of proponents of an expanded reading of Rule 3-300. It is not enough that a fee agreement may give a lawyer the right to raise their hourly rates on an annual basis. If Rule 3-300 applies, as many opponents of Interim 05-0001 contend, then annual fee increases, which are determined unilaterally by law firms, would also constitute the acquisition of a pecuniary interest (i.e., a higher hourly rate) adverse to a client. Thus, if COPRAC expands Rule 3-300 beyond its expressly stated limits, then the slope becomes extremely slippery, and slides right into annual fee increases and all sorts of other unintended consequences.

Some attorneys who interpret Rule 3-300 broadly argue that annual hourly fee increases would not fall within the scope of Rule 3-300, pointing to *Severson & Werson v. Bollinger* (1991) 235 Cal.App.3d 1569. However, Rule 3-300 is not mentioned in the *Severson* opinion. There is no indication that Rule 3-300 was considered, argued or raised in that case. Thus, *Severson* clearly does not hold that annual hourly rate fee increases are exempt from Rule 3-300, and under the view held by those opposing Interim 05-0001, the inevitable result would be that such rate increases would, of logical necessity, be governed by Rule 3-300. Obviously, this was never intended or expected, and falls well beyond the strict limits of Rule 3-300.

COPRAC should apply a real world perspective to these issues, and remember that the rules are disciplinary rules, not aspirational goals. Rules like Rule 3-300, if not carefully and clearly defined, result in a disciplinary mine field ensnaring unsuspecting attorneys, or are misused by experts who provide opinions in cases where lawyers are accused of negligence. The Rules must be clear. Hopefully, COPRAC's Interim 05-000 1 will help guide us all in understanding the scope of Rule 3-300.

Comment Submitted By	Date Received:
Andrew I. Dilworth	8/1/2008
Bar Association of San Francisco	

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 Formal 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.

First, COPRAC's blanket opinion that all modifications of fee agreements with a client are not "business transactions" covered by Rule 3-300 contradicts existing case law and dilutes the scope of the rule. Contrary to COPRAC's conclusion that neither the State Bar Court nor any California court have found that a modification of a fee agreement is a business transaction within the meaning of Rule 3-300, both the State Bar court and the California Supreme Court have held that a modification to a fee agreement constituted an improper business transaction in violation of the provisions of Rule 3-300. (*Silverton I*, 4 State Bar Ct. Rptr. 252 (Rev. Dept. 2001); *Silverton II* (2004 WL 60709 (Rev. Dept. 2004); *In re Silverton*, 36 Cal.4th 81 (2005) (post settlement supplement to original contingent fee agreement entitled "Authorization to Compromise Doctor's Bill" wherein the client would receive a small additional settlement payment and, in return, the client would convey to attorney the right to retain as an additional fee the difference between any medical bill and the compromised amount of any such bill)). COPRAC's conclusion that all modifications to fee agreements do not constitute business transactions with clients inappropriately excludes modifications like the one at issue in *Silverton*.

A blanket rule is unwarranted as it cannot possibly address the myriad of modifications to fee agreements that attorneys could enter into with clients. The Committee agrees that in negotiating an initial fee agreement, the client may not expect the lawyer to exercise professional judgment to protect the client's interest. However, once the client has developed a confidential relationship with the lawyer, it is reasonable for the client to expect that the lawyer will not take advantage of them in negotiating mid-stream changes to fee agreements. Although negotiating the initial fee agreement is generally an arm's length transaction, once there is an attorney-client relationship, clients are more vulnerable to, and may feel obligated to accept, mid-stream changes to an existing retainer agreement.

As COPRAC acknowledges in a footnote, but dismisses, other courts have found that mid-stream modifications that increase the lawyer's Fee and lessen the client's recovery may constitute a "business transaction" that creates a conflict of interest between the lawyer and the client. See, e.g., *Nairnan v. New York University Hospitals Ctr.*, 351 F. Supp 2d 257,264 (2005); *In re Thayer*, 745 N.E. 2d 207 (Ind. 2001) (lawyer violated rule 1.8(a) by representing a client under a 40% contingent fee agreement, but on settlement, presenting the client with a revised agreement calling for a 50% contingent fee purportedly to prevent medical providers and others from attaching the settlement proceeds). The Committee urges COPRAC to further consider the reasoning of these and other opinions.

Second, COPRAC's extremely narrow definition of "other pecuniary interest adverse to a client" dilutes the current scope of Rule 3-300. Specifically, the opinion appears to limit this definition to situations where interest in the client's property secured the attorneys' fees and permitted the attorney to use that interest to ensure the payment of his or her fees without a contested judicial hearing. The inclusion of "other pecuniary interest" in the current Rule 3-300 would be unnecessary and redundant if it is interpreted so narrowly.

Finally, the Committee agrees with COPRAC's conclusion that modifications of fee agreements should be subject to close scrutiny and evaluated under the close scrutiny standard set forth in the proposed opinion. While the Committee agrees that Pattern Two is unfair and unreasonable under this standard, we do not agree that Rule 3-300 should not be considered in evaluating this factual scenario based on the incorrect conclusion that all modifications to fee agreements are *per se* not business transactions. Indeed, the attorney's post-settlement modification to increase a contingent fee percentage is similar to the modifications that the California Supreme Court and other courts have found constitute business transactions.

This letter is intended to address our principle concerns but does not convey all of our comments on Proposed Opinion Interim NO. 05-0001. We encourage COPRAC in considering these comments to contact representatives of the Committee who have studied the issues and the proposed opinion.

We hope these comments will engender further discussion of these important issues.

Comment Submitted By	Date Received:
Carol Langford	8/5/2008
Joined by Richard Zitrin, Robert Sall, Diane Karpman, Jim Towery, Sachi Clements	

Attached are my comments to Proposed Opinion 05-0001. Joining me in my comments are Richard Zitrin, Robert Sall, Diane Karpman, and Jim Towery. Note that I have also attached e-mail comments from the APRL website that show that other highly-regarded lawyers in the ethics field are concerned about this draft Opinion as well.

Please review these comments and forward them on to COPRAC. Feel free to call or e-mail me with any questions or comments.

The following is a comment on Proposed Formal Opinion Interim No. 05-0001, issued by the State Bar Standing Committee on Professional Responsibility and Conduct (COPRAC). Joining in this opinion are several esteemed lawyers who practice in the field of legal ethics, including Richard Zitrin, Jim Towery, Diane Karpman, and Robert Sall. Also joining in this opinion is Sachi Clements, a member of the University of San Francisco Law Review. My background in ethics is as follows: I have served as the Chair and Special Advisor to the State Bar Committee on Professional Responsibility and Conduct, in addition to being a member for several years. I have also chaired the Law Practice Management & Technology Section of the Bar and the Council of Section Chairs. I am currently an adjunct professor at the University of San Francisco School of Law and Hastings College of the Law teaching courses in legal ethics, and I have a full-time practice specializing in legal ethics and attorney conduct.

The focus of my comment will be on COPRAC's interpretation of Rule 3-300 of the Rules of Professional Conduct and its conclusion that the rule does not apply to fee modifications. This comment will demonstrate that the plain language of the Rule, fiduciary principles, and public policy all support a finding that rule 3-300 should apply to such modifications. When interpreting legislation, courts first look to the plain meaning of the statute to give words their ordinary and contemporary meaning. *Raghavan v. Boeing Co.*, 133 Cal. App. 4th 1120, 1135 (2d Dist. 2005). If the language of the statute is clear and unambiguous, the court will not impose its own interpretation. *Id.* Rule 3-300 states that 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 certain requirements are met. In its proposed opinion, COPRAC determined that a fee modification does not constitute an adverse pecuniary interest subject to rule 3-300.

However, the plain language of the rule suggests otherwise. The word "pecuniary" means "relating to money." Merriam-Webster Online Dictionary (Merriam-Webster 2005) (available at <http://www.merriam-webster.com>). The word "interest," in the context of the rule, commonly means "a right, title, or legal share in something." *Id.* The word "adverse" commonly means "opposed to one's interests." *Id.* Modifications of fee agreements where the lawyer is potentially obtaining more money from a client and the clients obtains less would fall well within the plain language of rule 3-300. This is consistent with the interpretation of adverse pecuniary interests by California courts as an interest reasonably foreseeable to have a detrimental effect on the client. *Ames v. State Bar*, 8 Cal. 3d 910,920 (1973).

The fiduciary duty of a lawyer to his client also supports the inclusion of fee agreement modifications in Rule 3-300. The negotiation of an initial fee agreement is an arms-length transaction, and the attorney is free to negotiate as he wishes, as long as issues of duress and unconscionability are not present. *Ramirez v. Sturdevant*, 21 Cal. App. 4th 904,913 (1st Dist. 1994). However, once the attorney-client relationship has begun, the attorney has a fiduciary duty to put the client's interests above his own. Modifications of fee agreements occur when the attorney has a heightened responsibility to ensure he is acting in his client's best interest. Thus the attorney should have to take more steps to protect the client when modifying an existing fee agreement than creating an initial fee agreement.

In *Ritter v. State Bar*, 40 Cal.3d 595, 602 (1985), an attorney and his clients entered into an agreement to modify their original fee contract. The clients agreed to provide a loan to the attorney, and the attorney agreed to lower his percentage of a recovery in the case. The court emphasized the lawyer's fiduciary duty in holding that he violated rule 3-300 by failing to advise his clients to seek independent counsel, *Hawk v. State Bar*, 45 Cal.3d 589,598-599 (1988). A lawyer has the same fiduciary duty to his client whether the fee modification involves a loan or property interest, or whether it involves a simple rate increase or a change in the basis of the fee. Thus rule 3-300 should apply to all types of fee

modifications that could potentially harm the client's interests.

Proponents of the exclusion of fee modifications from Rule 3-300 cite *Ramirez* as their supporting authority. *Ramirez*, 21 Cal. App. 4th 904 (1st Dist. 1994) In that case, Ramirez hired Sturdevant to pursue a wrongful termination action on a contingency fee basis. After summary judgment was granted in favor of the defendant, Ramirez asked Sturdevant to appeal the case. Sturdevant agreed on the condition that Ramirez pay a monthly fee and appellate and post judgment costs, in addition to the contingency fee. The court held that the agreement was valid, despite the fact that Sturdevant did not advise Ramirez to seek independent counsel. *Id.* at 918.

Some have interpreted this decision to mean that modifications of fee agreements need not comply with the requirements of Rule 3-300. However, *Ramirez* does not support this interpretation. The subsequent agreement between Ramirez and Sturdevant was not a modification of an existing agreement, but a new agreement altogether. Since the court found that Sturdevant was under no duty to represent Ramirez in the appeal, the first agreement was already complete. This left Sturdevant free to negotiate the terms under which he would take on the second representation for the appeal. *Ramirez*, 21 Cal.App.4th at 916. Thus the agreement was governed by the rules applicable to initial fee agreements rather than modifications of fee agreements.

The purpose of Rule 3-300 is to "protect the public and to promote respect and confidence in the legal profession. *Fletcher v. Davis*, 33 Cal.4th 61,72 (2004) (quoting *Chambers v. Kay*, 29 Cal.4th 142, 158 (2002)). This purpose would be furthered by making fee modifications subject to the requirements of rule 3-300. Consider the following examples of fee modifications. An attorney initially agrees to accept payment from a client on an hourly basis. Halfway through the representation, he realizes that the case is worth much more than he expected and gets his client to agree to a contingency fee of 30% for the same exact work. In another example, the attorney signs on to a contingency fee initially. When he later realizes the case's low value, he switches to an hourly fee. In both of these examples, the lawyer is modifying the fee agreement to his advantage. If Rule 3-300 did not apply to modifications of fee agreements, the lawyer would have no duty to advise the client to seek independent counsel or even explain the new deal in writing because Business & Profession Code Sections 6147 and 6148 do not compel a writing, nor do the Rules. However, clients would be able to avoid such transactions that are not to their benefit by simply contacting an independent lawyer.

Not all lawyers will act to their clients' peril of course, but some may take the opportunity, either intentionally or unintentionally, and not all get caught. The burden of the 3-300 precautions is relatively small, while the risk of harm is great for both clients and attorneys, who have to face angry clients in court. Rule 3-300 would benefit clients by protecting them against disadvantageous modifications, while also protecting attorneys by giving them clear ethical rules to follow. Considering many attorneys in California already believe a fee modification is subject to rule 3-300, maintaining this as the rule would prevent confusion among practicing attorneys. It serves to protect both clients and attorneys, without any real recognizable drawbacks.

The new agreement must be fair and reasonable anyway, as the proposed opinion states. It takes little effort then to comply with Rule 3-300 by putting the deal in writing and getting the client's signature; the Rule only requires that the client be advised to seek counsel, not actually do it. Any argument that compliance is a burden is thus disingenuous.

I have attached comments from the APRL listserv from several esteemed lawyers on this issue. Please feel free to call or e-mail me with any questions or comments.

< BELOW ARE ATTACHMENTS TO MS. LANGFORD'S COMMENT LETTER >

The court stated that "an attorney must avoid circumstances where it is reasonably foreseeable that his acquisition may be detrimental, i.e., adverse, to the interest of his client."

In *Ames v. State Bar*, 8 Cal.3d 910, 920 (1973), the court defined an adverse interest as an interest reasonably foreseeable to be detrimental to the interests of the client.

< **NOTE:** Ms. Langford attached Richard Zitrin's comments from 7/25/08 which can be found on page 4. >

David, let me cast the first tomato. While Diane and I may be the few on PREC who are opposed to this opinion, I think there should be pause when folks such as Mark Tuft, Richard Zitrin, Carol Langford, Jim Towery, Jim Arden, Bill Hodes, Diane (and, not to be humble, myself) are so concerned about it. The focus of your discussion is not on the ethics of fee modification, but rather the enforceability of a fee modification. We need to stay focused on the ethics, that is, specifically, the application of Rule 3-300. Just because there are other means of addressing unconscionability or enforceability or coercion does not mean that Rule 3-300 should be interpreted to be inapplicable. To reach its conclusion, COPRAC had to stretch pretty far back into legal doctrines such as Lord Tenterden's Rule to discard the plain words of the discussion section, literally interpreting half of them to be inapplicable. It is not COPRAC's function to make law. There is no court decision anywhere that says Rule 3-300 does not apply to a fee modification that confers upon the lawyer a pecuniary interest adverse to the client.

My comment on the APRL list serve did (unlike others) focus on the language of the rule. I'll repeat that comment here: I join with Richard Zitrin, Mark Tuft, Carol Langford and Jim Towery on this one. Rule 3-300 speaks in the alternative in that it applies either to business transactions with the client, or to knowingly acquiring an ownership, possessory, security or pecuniary interest adverse to a client. The key word there is "or". The definition of pecuniary is relatively simple -- it is anything of or concerning money. So, the rule does not just cover business transactions. It should not be interpreted to wholly discard modifications to fee agreements.

While there is the official comment and plenty of case law to support that the initial fee agreement is at arm's length and not covered by the rule (unless it confers an ownership or security-type interest), things are different once the attorney client relationship already exists. Now there is a fiduciary duty. The conversion of the fee arrangement from hourly to contingency (which is the fact pattern in the draft opinion) is one in which the attorney acquires a pecuniary interest adverse to a client. I would expect the lawyer to comply with Lord Eldon's Rule -- to give all advice to the client against himself or herself that the lawyer would give the client against a third person. This includes the advice to consult with another lawyer.

When COPRAC, in order to discard the plain meaning of an entire phrase in the official comments, has to reach back to Lord Tenterden's Rule (the doctrine of *ejusdem generis*) to interpret Rule 3-300 COPRAC is delving too far into the area of attempting to make law. Ethics experts in California have been debating this controversial issue for many years, and we obviously do not agree. Until there is a controlling case or a rule change, this draft opinion needs to be shelved.

I am not inserting the word "initial" into the official discussion of the retention agreement. Instead, I am focusing on the meaning of "pecuniary" and "adverse" and the plain and unambiguous meaning of the word "or". It does not have to be a business transaction for the rule to apply. Rule 3-300 applies whenever the attorney acquires a pecuniary interest adverse to an existing client, and I fail to see how the dramatic increase in a fee or the conversion from hourly to contingency would not satisfy that requirement.

There is no question that Rule 3-300 could be better written than it is. I read and well understand your suggestion that I plead the case to RRC, but take your own medicine. COPRAC does not get to eliminate words from the official discussion that it does not like, to force a particular conclusion that it wants to reach. I served on COPRAC, and remember the general principle that the Committee, no matter how well respected, does not make law. Where the language is ambiguous, COPRAC should not create a strained or forced interpretation, instead it should address its concerns to RRC, just like you have asked the rest of us to do.

Don't take any of this personally. You know I have the deepest respect for everything about you except your view on this opinion.

Rob K. Sall
The Sall Firm, APC

A small point in the direction of David and Daniel's comments. The draft seems to me a closely reasoned analysis of the text COPRAC has to work with. As a matter of interpretive craft, I think it is quite well done. As a matter of policy, my sentiments are with Richard. But the text of the CA rules does not embody every fiduciary principle. There is something to be said for amending the text of the rules to bring it more closely into line with such principles rather than creating potential notice problems by interpreting the text aggressively. - DM

Diane, not certain if I am among the public APRL opponents. Please add me to list. Among other things, I have served a cumulative 451- years on ethics, professionalism and professional responsibility committees, commissions, task forces atc of the ABA, NYSBA, Assoc of the Bar of the City of New York and NY County Lawyers Assoc, personally involved in every single ABA proceeding in legal and judicial ethics since 1980, i.e. from the first publication of the Kutak Model Rules Discussion Draft in January 1980, including Kutak; 1984-86 ABA Stanley Commission on Professionalism, 1987-90 Model Judicial Code revision, 1997-2002 Ethics 2000 (ABA Board of Governors liaison to Comm to Evaluate MRPC) and most recently advisor to Code of Judicial Conduct Commission. And all of the NY State reviews of same; just appointed to NYSBA Committee to review our Code of Judicial Conduct. - Seth

I will sign the letter you propose. No one is suggesting that all mid stream changes benefit the lawyer at the client's expense or that lawyers are always motivated by self interest. The point is the draft opinion tells lawyers they can ignore the rule in modifying existing contracts with clients unless the modification amounts to an adverse pecuniary interest in the same way as in the original agreement. That is not good advice and could get lawyers in hot water.

In *Ramirez v. Sturdevant*, the lawyer was no longer obligated to represent the client at the time the retention agreement was renegotiated. In addition, the appellate court remanded the case with instructions to evaluate whether the lawyer had a conflict of interest in negotiating the settlement that resulted in his fee. - Mark Tuft.

I join with all of you, once there is a fiduciary relationship everything changes and a lawyer acts are their peril. That's why this is a poor opinion and going to get lots of lawyers in trouble. I expressed that at the end of the LACBA Ethics Comm. meeting, and felt as if there were rotten fruit available - I would be the target. Why don't we all join together and write a single letter objecting to the opinion, with all of our signatures it would have some weight. Very Best, Diane (who wishes Rob had been at that meeting we could have been scorned together ...)
- Diane Karpman

I think Robert Sall has stated the rationale exactly correctly--once there is already a client-lawyer relationship, further financial dealings must satisfy what we call Rule 1.8(a) here in the interior. (And if it involves fees, it must satisfy BOTH Rule 1.8 AND Rule 1.5.) That's why I was surprised to see some California folks give up a little too easily for my taste even on increasing hourly rates on January 1. Clear-thinking firms put this into the fee agreement from Jump Street, and so there is no change at all--it is just a contract term being carried out. If a firm has a set hourly rate in Year One, without an escalator clause, I don't think it can charge more in Year Two (or Three) until the client has agreed to a NEW fee agreement that has the Year Two rate in it, plus an escalator clause for Years Three and later. - Bill Hodes

I join with Richard Zitrin, Mark Tuft, Carol Langford and Jim Towery on this one. Rule 3-300 speaks in the alternative in that it applies either to business transactions with the client, or to knowingly acquiring an ownership, possessory, security or pecuniary interest adverse to a client. The key word there is "or". The definition of pecuniary is relatively simple -- it is anything of or concerning money. So, the rule does not just cover business transactions. It should not be interpreted to wholly discard modifications to fee agreements. While there is the official comment and plenty of case law to support that the initial fee agreement is at arm's length and not covered by the rule (unless it confers an ownership or security-type interest), things are different once the attorney client relationship already exists. Now there is a fiduciary duty. The conversion of the fee arrangement from hourly to contingency (which is the fact pattern in the draft opinion) is one in which the attorney acquires a pecuniary interest adverse to a client. I would expect the lawyer to comply with Lord Eldon's Rule -- to give all advice to the client against himself or herself that the lawyer would give the client against a third person. This includes the advice to consult with another lawyer. When COPRAC, in order to discard the plain meaning of an entire phrase in the official comments, has to reach back to Lord Tenterden's Rule (the doctrine of *ejusdem generis*) to interpret Rule 3-300 COPRAC is delving

too far into the area of attempting to make law. Ethics experts in California have been debating this controversial issue for many years, and we obviously do not agree. Until there is a controlling case or a rule change, this draft opinion needs to be shelved. - Rob Sall

This squabble among California members of APRL must seem quaint to the rest of you, but out here on the left coast, these are fighting issues. And on this dispute about the COPRAC interpretation of RPC 3-300, I come down squarely with Richard, Mark and Carol, and contrary to Ellen and Steve. I think COPRAC got this dead wrong. As Dickens said (I paraphrase): "If that is what the law says, then the law is an ass." There is no good reason why 3-300 should not apply to substantive changes in fee agreements. I come at this issue, like Carol, from the perspective of having spent many years in the fee arbitration world. I have always viewed 3-300 as an important client protection rule. On its face, it applies to liens and other possessory interests that may arise in fee agreements. But the logic of the rule applies with equal force to other aspects of fee agreements, as when an attorney makes a substantive mid-course change in the fee agreement to the lawyer's advantage. No one argues that 3-300 applies to simply annual increases in billing rates. That is a red herring. But when a lawyer decides to change an agreement from hourly to contingent, or vice-versa, in the midst of a representation with all of the attendant fiduciary duties, why should 3-300 not apply? I understand the argument that the COPRAC opinion is simply a distillation of California case authority, and no court has expressly taken the position I advocate here. But COPRAC should not take such a narrow view of its role. There are very sound policy reasons to apply 3-300 in these circumstances. California attorneys need rules that are simple and clear and provide good guidance. Consumers need protection from the occasional greedy attorney. I hope COPRAC withdraws this ill-considered opinion. More importantly, I hope the Rules Revision Commission gets this sight. - Jim Towrey

Of course 3-300 does; and if it doesn't, it should. Almost without exception, all engagement/retainer letters I've seen contain the proviso that the lawyer/firm may change billing rates at year-end and will notify client in writing. That is not the equivalent of changing an hourly billing arrangement into a contingent one where the matter has become an apparent 'lock'. - Seth

I have difficulty with the conclusion that 3-300 blanketly does not apply to fee agreement modifications. 3-300, entitled "Avoiding Interests Adverse to a Client," purports to regulate every "transaction" and, or, "other pecuniary interest." Why distinguish attorney-client fee agreements from every other attorney-client transaction or pecuniary interest? Both the logic and the authority for separating fee agreements from "other pecuniary interests" escape me. How can a fee agreement not represent pecuniary interests? ...
- Jim Arden

Jim, those cases you discuss are not the ones litigated. I have seen a lot of cases wherein the lawyer thinks the case is not as good as he originally thought and wants more money, or where a fee agreement is changed so that the client can provide services instead of money and somehow the client always ends up screwed. I just testified in such a case in Orange County. I do not understand why lawyers would be so reluctant to advise the client to go to another lawyer, and put the terms in writing. Why is that so hard?
- Carol Langford

In most states an attorney automatically has a lien on the funds provided for a retainer. There is case law on this subject. - Hon. Samuel L. Bufford

Ellen, what rule would apply when the lawyer changes the fee agreement to the lawyer's advantage and is not an adverse pecuniary interest? Certainly not our conflicts rule which doesn't cover most personal interest conflicts or require client consent.

Before we get too far afield, I should clarify the point raised in my last missive. The mid stream change to add a binding arbitration clause was meant to be an example of modifications to existing contracts between lawyer and client that, depending on the circumstances, could trigger the business transaction prong of the rule. I do not disagree with Jim that we may need to know more in a particular case. However, because the client has both legal and contractual rights under the contract, it is possible that the business transaction prong of the rule could apply in certain situations. And that is the problem with the opinion. It tells lawyers they don't need to be concerned with the business transaction prong of the rule regardless of the modification and its impact on the legal or contractual rights of the client. It also suggests that the adverse pecuniary interest prong applies to a modification in the same way it applies to the original contract. Clearly, not every modification to a fee agreement will trigger the rule, and many do not, but the reverse is also true. It is not helpful, in my opinion, to tell lawyers that there is a one size fits all answer to midstream changes to fee agreements. Prof. Simons made this point some years ago in a short article for a New York bar

publication and I think he got it right. In response to Steve, I believe there are several cases in other jurisdictions that have applied the business transaction prong to modifications in fee agreements. Also we have an existing State Bar opinion suggesting that the rule applies to a change in an existing agreement to have the lawyer's fee paid up front when a structured settlement occurred in the case. (Such a provision would not have triggered the rule had the lawyer included it at the outset). In Silverton, the State Bar argued that the particular modification constituted a business transaction with a client. – Mark Tuft

Friends: I think the position we take is that at the time a claim arises the client should decide in consultation with the client's new lawyer. If the client wants arbitration the client can seek it. If not the client goes to court. There are reasons a client might prefer arbitration but the client is clueless on that point at the time the prospective clients hires the lawyer, a time when it is clearly in the lawyer's interest to snare an agreement to arbitrate. - Larry Fox

This opinion is an absolutely outrageous attempt to legislate a change in the existing rule and the existing case law, including on fiduciary duty. Even the rules commission's extremely unfortunate modification to 3-300 (now denominated 1.8.1) acknowledges that it might make the rule inconsistent with the case law on fiduciary duty. Just read footnote 6 if you want to see the sand upon which this opinion is based. If I didn't know better (and I think or at least hope I do), I'd think that COPRAC was trying to pave the way for the commission's ill-advised 1.8.1 to get approved. This is a terrible, anti-consumer, anti-client measure (it can hardly be called merely an opinion) that purports to tell us what the law is rather than allow the courts to decide. Strong opinion to follow. - Richard