LEGAL ETHICS OPINION 1783

IN CONTEXT OF (A) FORECLOSURE SALE OR (B) A COMMERCIAL CLOSING, MAY ATTORNEY DISBURSE TO LENDER COLLECTED ATTORNEYS FEES IN EXCESS OF THOSE NECESSARY TO REIMBURSE LENDER FOR PAYMENT MADE TO LENDER AT ATTORNEY'S HOURLY RATE?

You have presented a hypothetical situation in which Lender retained an attorney to assist it with the collection of a promissory note from Borrower to Lender, secured by a deed of trust. The note provides that, upon default, the Borrower shall pay attorney's fees equal to 25% of the principal balance due on the Note as well as all of Lender's other collection expenses, whether or not there is a lawsuit and including without limitation legal expenses for bankruptcy proceedings. Borrower has defaulted. On behalf of Lender, the attorney (also the trustee under the deed of trust) is about to initiate foreclosure proceedings. Borrower is attempting to sell the property subject to the deed of trust prior to foreclosure, for an amount in excess of that owed under the note.

At either the foreclosure or the commercial sale, the attorney expects to collect all amounts owed under the note, including the 25% attorney's fees provided for under the note. The attorney expects that Lender, who has paid the attorney's periodic interim bills, based on the attorney's hourly rate, will then request that the attorney pay Lender all amounts collected for principal, interest, and attorney's fees – including the portion of the attorney's fees that exceeds the amount necessary to reimburse Lender for the interim payments it has made to the attorney. You have asked the committee to opine whether under the facts of this inquiry this attorney may disburse to Lender that portion of the collected attorney's fees in excess of the amount necessary to reimburse Lender for the actual cost of the legal services.

The appropriate and controlling disciplinary rule relative to your inquiry is Rule 5.4(a), which directs that "a lawyer or law firm shall not share legal fees with a nonlawyer," unless one of three exceptions apply[1], none of which are at all applicable in the present situation. While many of the prior Legal Ethics Opinions (LEOs) of this committee that address fee-splitting with a nonattorney involve prior DR 3-102(A), those opinions remain pertinent, as that rule is substantially similar to the present Rule 5.4(a). In reviewing prior LEOs, the committtee notes that there are several early opinions suggestive that an attorney may not distribute fees such as those in this hypothetical to clients. *See* LEO 534 (attorney may only distribute fees awarded to clients in collecting delinquent taxes where such fees do not exceed the actual cost of the legal services), LEO 835 (attorney doing collections work on installment contracts for his employer may not

[1] Those exceptions are as follows:

(1) an agreement by a lawyer with the lawyer's firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;

(2) a lawyer who undertakes to complete unfinished legal business of a deceased, disabled, or disappeared lawyer may pay to the estate or other representative of that lawyer that portion of the total compensation that fairly represents the services rendered by the deceased, disabled or disappeared lawyer;

(3) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement; and

(4) a lawyer may accept discounted payment of his fee from a credit card company on behalf of a client. (This exception is a recent addition to the Rules, to be effective January 1, 2004.)

provide to employer any collected fees in excess of actual cost of legal services), and LEO 1025 (attorney collecting on notes that include percentage attorneys fees award must not distribute to client greater than actual cost of attorney's services).

Despite the conclusions drawn in those prior opinions, in more recent opinions substantial analysis suggests that application of Rule 5.4(a) must move beyond a literal application of language of the provision to include also consideration of the foundational purpose for that provision. For example, in LEO 1563, the committee reviewed attorney's fees awards in litigation under federal civil rights legislation. The opinion concludes that a court award of attorney fees in federal civil rights legislation does not constitute legal fees for purposes of this prohibition and, therefore, their distribution to the nonattorney client is not prohibited. Similarly, in LEO 1598, the committee reviewed a local license fee that was calculated as a percentage of the attorney's fees. In concluding that the receipt by the locality of a portion of attorney's fees did not involve an improper fee-split with a nonlawyer, the committee noted that:

> The thrust of the proscription in DR 3-102(A) is that a lawyer and a nonlawyer enter into a consensual arrangement whereby fees received from one or more clients are divided between them. Payment of a gross receipts tax, in common understanding, is not a consensual arrangement.

Also, in LEO 1744, the committee reviewed an attorney's plan to distribute awarded attorneys fees to the non-profit corporation that brings legal actions on behalf of clients. The opinion notes that:

> The primary purpose of Rule 5.4 is to prohibit nonlawyer interference with a lawyer's professional judgment and ensure lawyer independence.

In that opinion, the committee found reassurance that as a court awards the fees, there is no risk of improper interference; accordingly, the opinion finds that the attorneys providing the fee awards to the nonprofit organization does not violate Rule 5.4(a)'s prohibition against fee-splitting with a nonattorney. Most recently, in LEO 1751, the committee reviewed a referral service run by a local bar organization that planned to fund the service by charging participating attorneys a percentage of their fees. That opinion identifies that the purpose of Rule 5.4(a), as stated in Comment 1 to that rule, is "to protect the lawyer's independent judgment." The opinion continues:

> The concern in Comment One to Rule 5.4(a) is not triggered by the referral service in this inquiry; nothing about a lawyer referral program of the local bar association suggests that the participating attorney's independent judgment would be in jeopardy.

The opinion permits the referral service payment plan despite that it involves attorneys providing a portion of their legal fees to the service as, regardless of the literal language of the Rule 5.4(a), the spirit or purpose of the rule was not violated.

This committee repeatedly looked to the purpose of the prohibition against Rule 5.4(a) to avoid overly literal, overly broad applications of that provision. The committee opines that the same analysis is appropriate for the scenario raised in the present hypothetical. The present scenario involves a note calling for attorneys fees in excess of the actual fee calculated by attorney. The calculation method, i.e., 25% of any unpaid portion of the principal for which collections activities were required, is in the nature of an agreed upon contract term. Such a provision seeks to provide commercial certainty for all parties. For efficiency and ease, Lender and Borrower choose not to require an itemization from the

Lender of the actual cost of legal services necessary for collection. If the attorney, in an effort to charge only a reasonable fee, determines that his actual fee is less than the agreed upon amount, that attorney may in good faith remit the excess to his client. Such adjustment of funds related to an attorney's fee are a matter to be determined by agreement between the attorney and the client, so long as the resulting fee actually received is reasonable, as required under Rule 1.5. The setting of an appropriate fee for particular work by an attorney with his client is *not* the sort of improper sharing of attorney's fees with a nonattorney addressed in Rule 5.4. The general purpose of the provision, to protect the independent judgment of an attorney from improper nonlawyer interference, is not at risk here. Lender already has the primary interest in the collections matter and already has the usual amount of influence that any client has with an attorney; such interest and influence are in the very nature of the attorney/client relationship. The parameters of that influence are governed by Rule 1.2, regarding the scope of the representation. Allowing this attorney to provide the client with the "extra" portion of this agreed upon attorney's fee provision seems an appropriate method for the attorney to ensure he receive nothing more than a reasonable fee for his work.

This committee opines that for this attorney to distribute to his client the excess of the fee paid by the Borrower over the actual cost of those services does not compromise the purpose of Rule 5.4(a); therefore, this committee opines that the contemplated fee distribution does not violate the rule.

To that extent that prior Legal Ethics Opinions 534, 835, and 1025 are inconsistent with this conclusion, those opinions are hereby overruled.

This opinion is advisory only, based only on the facts you presented and not binding on any court or tribunal.

Committee Opinion
December 22, 2003