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Business Transactions with Clients

by Grace M. Giesel

Occasionally, attorneys find themselves entering into business transactions in general and contracts in particular. Sometimes the arrangement is the client's idea. Sometimes the arrangement is the attorney's idea. While such transactions are not prohibited, they are subject to special rules as the result of the fiduciary nature of the attorney-client relationship and the supposed dominant powers of persuasion of attorneys. As one court has stated, "Attorneys wear different hats when they perform legal services on behalf of their clients and when they conduct business with them. As to the latter, the law presumes the hat they wear is a black one."[1]

The constraints on business transactions with clients take two forms. First, the Rules of Professional Conduct contain specific requirements for any such transaction. Second, the law of contracts supplements the professional conduct standards by applying a presumption of undue influence to any contract between attorney and client other than the initial fee agreement. The result of the presumption is that often courts refuse enforcement of attorney-client contracts. An attorney contracting with a client, wishing to avoid bar discipline and seeking to create an enforceable contract, would be well-served by keeping both the professional responsibility requirements and the contract doctrine in mind.

Rule 1.8(a)

The Kentucky Rules of Professional Conduct Rule 1.8(a) states that an attorney may enter into a business transaction with a client if

(1) the "transaction and terms" are "fair and reasonable" to the client;

(2) the "transaction and terms" are "fully disclosed to the client";

(3) the "transaction and terms" are "transmitted in writing to the client in a manner which can be reasonably understood by the client";

(4) the client has "reasonable opportunity to seek the advice of independent counsel"; and

(5) "the client consents in writing."[2]

Rule 1.8(a) generally does not apply to the initial fee agreement. Rule 1.5 provides a separate set of requirements for that initial arrangement.[3] ABA Formal Opinion 00-418 has clarified, however, that Rule 1.8(a) does apply if, in the initial arrangement, the attorney is taking stock in the client as a means of payment.[4] Rule 1.8(a) also applies to a transaction in which the attorney gets a contractual security interest to secure a fee.[5]

Fee Agreements

Courts generally consider any modification of a fee agreement as a business transaction with a client and therefore subject to Rule 1.8(a). For example, an Indiana attorney agreed to represent a client on an hourly basis. The work involved recovering assets that belonged to an estate. After the attorney realized that the asset recovery was a simple task, the attorney insisted that the client agree to a contingency fee arrangement that would insure that the attorney would be paid handsomely. In addition to finding that the fee was unreasonable and thus violative of Rule 1.5, the rule governing the reasonableness of fees, the Indiana Supreme Court also found that the attorney violated Rule 1.8(a) by renegotiating the fee unfairly at a time when the attorney-client relationship was in place. The second fee agreement was unfair, important facts were not disclosed, and counsel did not give his client the opportunity to consult with independent counsel. Indiana suspended the attorney from the practice of law for six months.[6]

Outside the fee context, Rule 1.8(a) seems fairly straightforward. Yet, attorneys do step afoul of it. Sometimes the situation involves affirmative wrongdoing on the part of the attorney. In these cases the attorney acts with a bad or selfish motive and does not make appropriate disclosures or take other steps to protect the client.[7] Other cases seem to reflect negligence rather than affirmatively improper motive.[8] Kentucky has had occasion to discipline attorneys for violation of Rule 1.8(a).[9]

Undue Influence

Going hand in hand with Rule 1.8(a) but independent of it is the contract doctrine which states that any contract between an attorney and client is presumed to be the result of undue influence and thus voidable at the option of the client. In the Kentucky case of *Hunt v. Picklesimer*,[10] an attorney and a client entered into a contract which provided that the attorney would receive a one-half interest in the property that might be gained in a particular litigation already in progress. The agreement provided that the property was payment for legal services already rendered and yet to be rendered. The agreement was in writing and was signed by the parties. Yet, the facts as stated by the court illustrated quite an unsavory turn of events on the part of the attorney after the agreement. The Kentucky court stated: "Even where a conveyance by a client to his attorney is fair upon its face, it is presumptively invalid, and the burden of establishing its fairness is upon the attorney."[11]

BGJ Associates, LLC v. Wilson

Courts across the United States are uniform in their application of this rule. Unfortunately, there have been many cases in which the rule has been relevant. A typical case is the California matter of *BGJ Associates, LLC v. Wilson*.[12] In *BGJ* the attorney and the client entered into an oral agreement to form a joint venture for the purchase of real estate. After the joint venture was formed, the attorney presented the client with an operating agreement for the joint venture. The client realized that the operating agreement was not in his interest and engaged independent counsel who confirmed the client's suspicions. The client ultimately rethought his involvement with the original attorney and refused to participate in the joint venture. The attorney claimed that the client orally had agreed to the arrangement. The attorney asked the court to enforce the oral agreement. The California Court of Appeal initially noted that the attorney, by entering into a contract with a client without full disclosure, without transmitting the terms of the deal in writing to the client, and without obtaining client consent in writing, had violated the California rule that parallels Kentucky's Rule 1.8(a). The attorney argued that the fact that the client had eventually obtained independent counsel removed the rule's re-

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Undue Influence

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quirement that the client consent in writing. The court refused this argument noting that each requirement of the rule stands alone and independent of the other requirements.

The *BGJ* court then noted that a violation of the professional responsibility rule did not answer the question before the court, the enforceability of the oral joint venture contract. The court then stated the usual rule of law as follows:

> [a] transaction between an attorney and client which occurs during the relationship and which is advantageous to the attorney is presumed to violate that fiduciary duty and to have been entered into without sufficient consideration and under undue influence.[13]

The court continued:

> While an attorney is not prohibited from having business transactions with his client, yet, inasmuch as the relation of attorney and client is one wherein the attorney is apt to have very great influence over the client, especially in transactions which are a part of or intimately connected with the very business in reference to which the relation exists, such transactions are always scrutinized by courts with jealous care, and are set aside at the mere instance of the client, unless the attorney can show by extrinsic evidence that his client acted with full knowledge of all the facts connected with such transaction, and fully understood their effect; and in any attempt by the attorney to enforce an agreement on the part of the client growing out of such transaction, the burden of proof is always upon the attorney to show that the dealing was fair and just, and that the client was fully advised.[14]

In looking at the particular facts before it, the court noted that when an attorney seeks to enter into a contract with a client, the attorney must give his client "'all that reasonable advice against himself that he would have given him against a third person.'"[15] Because the attorney could not make such a showing, the presumption of undue influence could not be refuted and thus the court did not enforce the contract.

An attorney who has entered into a contract with a client such as a modified fee agreement or a loan to a client and who hopes to have that contract enforced must heed the teachings of Rule 1.8(a) and the undue influence presumption. Such an attorney should carefully abide by the requirements of Rule 1.8(a) so as to avoid attorney discipline issues. Abiding by Rule 1.8(a) will also assist the attorney in proving a lack of undue influence although there is no guarantee that a court will enforce a contract between an attorney and a client even if the attorney follows Rule 1.8(a).

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Endnotes

1 *Mayhew v. Benninghoff,* 62 Cal. Rptr. 2d 27 (Cal. App. 1997).

2 Kentucky Supreme Court Rule 3.130 (1.8(a)). This same framework applies as well to any situation in which the attorney "acquire[s] an ownership, possessory, security or other pecuniary interest adverse to a client." See also Restatement (Third) of the Law Governing Lawyers § 126.

3 Kentucky Supreme Court Rule 3.130 (1.5).

4 ABA Op. 00-481 (2000).

5 See ABA Op. 02-427 (2002).

6 *In re Hefron*, 771 N.E.2d 1157 (Ind. 2002).

7 See, e.g., *In re Wolterbeek*'s Case, 886 A.2d 990 (N.H. 2005) (as a result of selfish motives, attorney did not inform client of conflict of interest regarding the acquisition of client's property by a partnership in which attorney was a member).

8 See, e.g., *In re Disciplinary Action Against Healy*, 706 N.W.2d 749 (Minn. 2005) (attorney made a loan to a client without informing the client of the possibility of independent legal advice and without written client consent).

9 See *Underhill v. KBA*, 937 S.W.2d 193 (Ky. 1997) (attorney received a public reprimand for failing to give a client the opportunity to seek independent advice and in failing to obtain the client's written consent). See also *Heist v. KBA*, 951 S.W.2d 326 (Ky. 1997) (attorney disbarred for many violations, including a violation of Rule 1.8(a)); *KBA v. Banks*, 847 S.W.2d 58 (Ky. 1993) (attorney disbarred for many violations, including a violation of Rule 1.8(a)).

10 162 S.W.2d 27 (Ky. 1942).

11 *Id.* at 30.

12 113 Cal. App. 1217 (2003).

13 *Id*. at 1227 (quoting *Lewin v. Anselmo*, 56 Cal. App. 4th 694, 701 (1997)).

14 *Id.* (quoting *Felton v. LeBreton*, 469, 28 P. 490, 493-94 (Cal. 1891)).

15 *Id*. at 1229 (quoting *Beery v. State Bar*, 739 P.2d 1289, 1294 (Cal 1987)).

Leadship Academy Deadline Fast Approaching

The deadline to apply for the Louisville Bar Association Leadership Academy is fast approaching. Applications must be submitted to the Bar Center by May 15, 2006. Tuition is $950, which covers 25 hours of CLE credit (including 4 hours of ethics), lunches, and printed materials. A limited number of scholarships are available.

Complete and submit the application package by May 15, 2006. The Steering Committee will review applications and notify participants no later than June 1, 2006. You can obtain an application online at *www.loubar.org/leadershipacademy.htm* or by contacting Kelly Hass at 583-5314 or *khass@loubar.org.*

Program Dates

Friday, July 21, 2006	***8:30 a.m.—5 p.m.***	***Leadership for Lawyers (Retreat)***
Friday, August 18, 2006	***8:30 a.m.—5 p.m.***	***Leadership through Service***
Friday, September 15, 2006	***8:30 a.m.—5 p.m.***	***Ethics, Justice and Values***
Friday, October 20, 2006	***8:30 a.m.—5 p.m.***	***Legal Ethics and Professionalism***
Friday, November 17, 2006	***8:30 a.m.—5 p.m.***	***Economics of Law—Personal and Professional***
Friday, December 15, 2006	***12 Noon—2 p.m.***	***Academy Induction & Luncheon***