May 1, 2006

Business Transactions with Clients

Grace M. Giesel
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 clients’ 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, “A attorneys wear different hats when they perform the roles of the attorney-client relationship and the attorney’s idea. While such transactions are sometimes the arrangement is the client’s idea. In these cases the attorney acts with an improper motive.8 Kentucky has had occasion to discipline attorneys for violation of Rule 1.8(a).9

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 a hourly basis. The work involved recovering assets that belonged to an estate. A few 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.8

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. 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 to be sold to the client and then to be recorded 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.”10

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 rules re-
Undue Influence
(continued from page 1)

requirement 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.10

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.11

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.”12 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. A biding 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).

Grace M. Giesel is the Distinguished Teaching Professor and James R. Merritt Professor at the University of Louisville Louis D. Brandeis School of Law.

Endnotes

2 Kentucky Supreme Court Rule 3.330 (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 3.330 (1.5).
6 In re Hefron, 771 N.E.2d 1257 (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 clients 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 clients 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.
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)).