Mortgages to Secure Fees

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Few lawyers in private practice can practice very long without encountering the unenviable task of dealing with a client who is unable to pay his or her legal fees. For those clients who are cash poor, but balance sheet solvent, the prospect of taking a mortgage, an assignment or some other security interest in the client’s property may be considered as security for unpaid fees and/or those to be incurred in the ongoing legal matter. Most lawyers would presumably view such a mortgage or security interest transaction as an extension of, or corollary to, the fee agreement with the client. Fewer lawyers would recognize that a mortgage transaction securing their fees constitutes a "business transaction with a client" triggering additional unique professional obligations to clients.

As a threshold matter, taking a consensual or contractual security interest in client property is not permissible under any circumstances if the property is the subject matter of, or involved in, litigation that the lawyer is handling for the client. See Rule 1.8(j), Minnesota Rules of Professional Conduct (MRPC). The basis for this prohibition is that the lawyer's interest in the subject matter of litigation may interfere with his or her professional judgment.

Rule 1.8(j) does provide an exception permitting lawyers to secure their fees by acquiring a lien "granted by law." An example of a lien "granted by law" would be an attorney's lien asserted upon client property affected by the litigation pursuant to the Minnesota Attorney Lien Statute. See Minn. Stat. sec. 481.13. Nevertheless, when the property is the subject matter of the litigation, the "lien granted by law" exception does not authorize mortgages, assignments or other security interests given by the client on that property. See e.g. Wolfram, Modern Legal Ethics, sec. 9.6.3 Attorney Liens (West 1986) (contractual security interest is not to be regarded as lien granted by law to secure fees). See also, American Law Institute, Restatement of the Law Governing Lawyering--Proposed Final Draft No 1.

Section 55(4) and comment (i) (March 29, 1996); and In re May, 538 P.2d 788 (Idaho 1975) (lawyer suspended for securing fees by taking assignment in divorce client's property, which was at issue in the divorce litigation).

The explanation for the Rule's differing treatment of statutory attorney liens and mortgages or security interests is that one is clearly more onerous upon clients than the other. In Minnesota, the amount of a statutory attorney lien must be determined through the District Court after notice to all parties. This procedure provides the client with an opportunity to contest the reasonableness of the fees claimed due by the lawyer. See e.g., Minn. Stat. sec. 481.13, subd. 3. By contrast, a mortgage typically involves a note in which the client has already acknowledged indebtedness for the amount claimed due. Hence there is no opportunity to contest the reasonableness of the fees. In short, an attorney lien is merely an unestablished claim by the lawyer, whereas a mortgage is an acknowledgment by the client of an amount already due.

Lawyers may obtain contractual security interests, including mortgages, upon client property that is not the
subject matter of the litigation without violating Rule 1.8(j). However, the transaction giving rise to the contractual security interest (e.g., mortgage) is subject to the same scrutiny as a business transaction with a client because the lawyer is acquiring a "security or other pecuniary interest adverse to [the] client." See Rule 1.8(a). See also, Section 55(4) of the Restatement of the Law Governing Lawyering (acquisition of security interest in client property is a business transaction subject to scrutiny sec. 207); and Los Angeles County Bar Association Ethics Opinion 492 (1/26/98) (requiring lawyers who take security interest in client property to comply with rule on business transactions with clients).

Business transactions with clients impose specific ethical obligations that if ignored can result in professional discipline, regardless of whether the lawyer financially benefits from the transaction. See e.g., Grievance Committee v. Botwick, 627 A.2d 901 (Conn. 1993). The ethical requirements for Minnesota lawyers are set forth in recently amended Rule 1.8(a), MRPC (effective Aug. 1, 1999). These requirements include: (1) the client is notified in writing by the lawyer that independent counsel should be considered and is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and (2) the transaction and terms on which the lawyer acquires the [security] interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client.

A final requirement imposes new affirmative obligations upon lawyers. The lawyer must obtain the client's consent to the transaction (e.g., mortgage or security interest) in a document that is separate and apart from the transaction documents (e.g., mortgage note and agreement). In addition, this separate consent document must disclose: (1) whether the lawyer is representing or otherwise looking out for the client’s interests in the transaction; (2) the nature of the lawyer’s conflicting interests, if any; and (3) the reasonably foreseeable risks for the client from any conflict.

Like any other professional conduct standard, a lawyer's failure to consider the business transaction requirements can result in professional discipline.

For example, failure to disclose that independent counsel should be considered served as basis for lawyer discipline where the lawyer attempted to secure fees with a promissory note and a deed of trust. Hawk v. State Bar, 754 P.2d 1096 (Cal. 1988). Moreover, the fair and reasonable standard was applied in the discipline of a lawyer for taking a security interest in the client's home for a greater value than the fees it secured. Disciplinary Counsel v. Levin, 517 N.E.2d 892 (Ohio 1988). The new client disclosure and consent document required by Minnesota Rule 1.8(a)(3) constitutes another obligation needing to be fulfilled by lawyers seeking to secure their fees by obtaining a security interest in client property.