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New York State Bar Association
Committee on Professional Ethics

Opinion 1156 (11/1/2018)

Topic: Securing fee obligation with mortgage against divorce client's property

Digest: For a lawyer to take a mortgage against a client's property to secure a fee in a divorce matter, the lawyer must comply with all the requirements of Rules 1.5(d)(5) and 1.8(a), including approval by the court.

Rules: 1.0(f) & (g); 1.5(a) & (d)(5), 1.8(a)

FACTS

1. The inquirer represents a client in a domestic relations matter that resulted in a judgment of divorce. The inquirer's legal services for the client are almost complete, although the representation continues. The client owes the inquirer legal fees for the services provided to date.

2. The client is not readily able to make timely payment of the fees owed to the inquirer. The client is sole owner of a house in New York State which the client intends to sell as soon as possible, a transaction consistent with the client's rights under the divorce judgment. The client has requested that the inquirer defer payment of the outstanding legal fees until the client sells the house, with the fees to be paid from the sale proceeds.

3. Discussions between the client and the inquirer have led to a tentative understanding, which the inquirer would like to incorporate into a written agreement, to be signed by both parties as a revision of the original retainer agreement. The proposed revision would provide: (1) that the inquirer would accept a specified amount – significantly less than the amount currently owed – in full payment of the fee obligation; (2) that the inquirer would take a mortgage against the house in the amount of the reduced fees; and (3), recognizing that the client may not be able to sell the house immediately, the inquirer would charge no interest on the fee balance for approximately seven months, after which interest at a low rate would start to accrue.

QUESTION

4. In a divorce matter in which there is a judgment, may an attorney and a client, without court approval, amend the retainer agreement to give the attorney a mortgage against property of the client in order to secure the client's obligation to pay accrued legal fees in that matter?

OPINION

5. Legal fees are always subject to certain general provisions of the New York Rules of Professional Conduct (the "Rules"), among them Rule 1.5(a), which prohibits fees that are excessive. The conduct proposed in this inquiry is subject to those general provisions, but also to two more specific ones as discussed below.

Business transactions with clients under Rule 1.8(a)

6. Rule 1.8(a) is triggered when three conditions are met: (i) there is a "business transaction" between lawyer and client; (ii) they have "differing interests therein"; and (iii) the client "expects the lawyer to exercise professional judgment therein for the protection of the client."

7. When those conditions are met, then Rule 1.8(a) requires that the transaction be "fair and reasonable to the client"; that the terms of the transaction be fully disclosed in writing in a manner that can be reasonably understood by the client; that the client be advised in writing of the desirability of seeking, and is given a reasonable opportunity to seek, the advice of independent legal counsel on the transaction; and that the client, in a signed writing, give informed consent to the essential terms of the transaction and the lawyer's role therein, including whether the lawyer is representing the client in the transaction.

8. The facts of the current inquiry meet the three conditions that trigger application of Rule 1.8(a). First, the proposed agreement would constitute a "business transaction." An amendment to a retainer agreement, made during the course of representation, can constitute a business transaction in some circumstances, as we have previously discussed. See N.Y. State 910 ¶¶ 19-26 (2012) (listing factors bearing on whether a retainer amendment constitutes a business transaction).

9. Moreover, "[w]hen a lawyer acquires by contract a security interest in property other than that recovered through the lawyer's efforts in the litigation, such an acquisition is a business or financial transaction with a client and is governed by the requirements of paragraph (a)." Rule 1.8, Cmt. [16]; see Rule 1.8, Cmt. [4C] ("The requirements of the Rule ordinarily must be met ... when the lawyer accepts an interest in the client's business or other nonmonetary property as payment of all or part of the lawyer's fee"); N.Y. State 1104 ¶ 4 (2016); N.Y. State 910 ¶ 16 (2012); ABA Op. 11-458; ABA Op. 02-427; N.Y. City 1988-7 (interpreting predecessor provisions). Hence, the proposed revision is a business transaction between a lawyer and a client governed by Rule 1.8(a).

10. The second condition of Rule 1.8(a) is met also. In reaching their agreement, the inquirer and the client will have occasion to negotiate terms that may be more favorable to one or the other. For example, the provisions for interest on unpaid balances may be more or less stringent. There could also be terms relating to possible foreclosure on the mortgage. Thus, the parties have "differing interests" in the transaction, as that term is defined in Rule 1.0(f).

11. The final condition is that client expects the lawyer to exercise professional judgment therein for the protection of the client. The client may well be an unsophisticated party not versed in contracts or negotiations over legal fees. Under these circumstances, it is foreseeable

that the client will expect the inquirer to act in the client's interest. See N.Y. 1104 ¶ 6 (2016) ("Here, the client may be looking to the lawyer's professional judgment to understand the significance of the proposed mortgage and promissory note to the services for which the lawyer is being engaged."); N.Y. City 1988-7 ([I]t would be unrealistic to conclude that a client would not expect his or her lawyer to exercise professional judgment for the client in drafting the mortgage agreement.").

12. Because the three conditions are met, the inquirer is subject to the requirements of Rule 1.8(a). The first requirement is that the transaction be fair and reasonable to the client. The inquiry does not include the text of the proposed agreement. As summarized to us, the proposed agreement does not sound obviously unfair in any way, but the inquirer would have to consider all the terms – such as the details relating to interest and possible foreclosure – to determine that the transaction is fair and reasonable to the client.

13. Similarly, the inquirer would need to consider the entire text to assess compliance with the requirement that the agreement be written in a manner that can be reasonably understood by the client. As discussed above, it is also necessary that the written agreement include certain specific provisions. It must describe not only the essential terms of the transaction but also the inquirer's role therein, and whether the inquirer is representing the client in the transaction. Finally, the writing must advise the client of the desirability of seeking, and the client must be given a reasonable opportunity to seek, the advice of independent legal counsel on the transaction.

Security interest in a domestic relations matter under Rule 1.5(d)(5)(iii)

14. In a "domestic relations matter," a lawyer may not take any fee if "the written retainer agreement includes a security interest, confession of judgment or other lien without prior notice being provided to the client in a signed retainer agreement and approval from a tribunal after notice to the adversary." Rule 1.5(d)(5)(iii).

15. This rule applies to the current inquiry even though a judgment has already been entered. "Domestic relations matter" means "representation of a client in a claim, action or proceeding, or preliminary to the filing of a claim, action or proceeding, in either Supreme Court or Family Court, or in any court of appellate jurisdiction, for divorce" and certain other subject matters, "or to enforce or modify a judgment or order in connection with any such claim, action or proceeding." Rule 1.0(g). If the representation had terminated, then applicability of the rule could have terminated as well. But if the representation continues past entry of the judgment, then there continues to be a "domestic relations matter" subject to the Rule. Ordinarily, questions about the existence and termination of an attorney-client relationship are questions of law beyond our purview. But here, the inquirer advises us that the inquirer still represents the client in connection with the divorce proceedings.

16. Because the proposed agreement includes a security interest, under this rule there must be notice to the client in a signed retainer agreement, notice to the adversary, and approval by the court. Rule 1.5(d)(5)(iii); see N.Y. State 910 (2012). "The requirements of this rule are similar to those of the applicable court rules." N.Y. State 910 ¶ 15 & n.1 (citing section 202.16 of the Uniform Rules of the Supreme Court and County Court and section 1400.5 of the Joint Rules of the Supreme Court, Appellate Division, 22 NYCRR §1400.5).

17. The proposed agreement would be a signed retainer agreement, satisfying one requirement of Rule 1.5(d)(5)(iii). The remaining requirement is that there must be approval by the court after notice to the adversary – the client's ex-spouse. The need for such notice and approval may be less sharp given the existence of a judgment in the matter; however, as discussed above, the representation continues, and based on the text and policies of the rule, we believe that its requirements continue to apply.

18. We have no occasion to discuss any ethical considerations with respect to possible execution on the mortgage. See N.Y. State 1104 ¶ 8.

CONCLUSION

19. If a lawyer representing a client in a divorce matter agrees with the client that the lawyer will take a mortgage on the client's house to secure the legal fees, the lawyer may do so only upon compliance with the requirements of Rules 1.5(d)(5)(iii) and 1.8(a), such as fairness, proper advice to the client, a sufficient writing signed by the client, notice to the adversary, and approval by the court.

(13-18)