PROFESSIONAL LIABILITY UPDATE

ATTORNEYS' FEES
FIDUCIARY DUTY

By Jennifer A. Becker

***Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135**

The First District holds that an attorney engaging in ongoing serious ethical violations is not entitled to quantum meruit fee recovery.

R. Thomas Fair began representing Karl E. Bakhtiari when he sought legal advice about real estate investments. Fair and Bakhtiari went into business together and operated under an oral agreement. For over a decade Fair and Bakhtiari formed partnerships where Fair performed legal services in exchange for substantial compensation and profit distributions. Fair never complied with California Rule of Professional Responsibility 3–300, which requires informed written consent, as well as a fair and reasonable transaction.

Litigation followed the demise of the relationship. At trial the court found that Fair's violation of Rule 3–300 raised a presumption of undue influence under Probate Code § 16004 (c) that Fair failed to rebut. Although each business transaction was fair and reasonable, the material terms and conditions of the transactions were not fully explained to and understood by Bakhtiari. Thus all business agreements between Fair and Bakhtiari were void and unenforceable.

On appeal Fair argued he should have been permitted to amend his complaint to recover *quantum meruit* attorney's fees. *Quantum meruit* is the principle that the law implies a promise to pay for services performed under circumstances disclosing that they were not gratuitously rendered. *Quantum meruit* is not available where an entire contract is prohibited by statute or public policy.

Fair's breach of Rule 3-300 implicated its statutory complement, Probate Code § 16004. Probate Code § 16004(a) precludes a trustee from using trust property for the trustee's profit or from taking an interest adverse to the trust. Subsection (c) presumes that such a transaction is a violation of the trustee's fiduciary duties.

Fair asserted that he rebutted the presumption because the trial court found that each business transaction was fair, reasonable and successful, and therefore Bakhtiari did not incur damages. However damages are only required where a client seeks tort damages. Where the client seeks forfeiture of fees under the Probate Code, damages are not required. Fee forfeiture deters attorney misconduct and recognizes that damage caused by attorney misconduct is often difficult to assess. It prevents fiduciaries from profiting from their breach and disloyalty. Fee forfeiture does not reflect the harm the clients suffer from the tainted representation, but the decreased value of the representation itself.

Moreover, the damage to Bakhtiari was not from the individual investments but from disproportionate back-end interests and profits Fair claimed at trial. Independent counsel would have advised Bakhtiari that profits should have been distributed in accordance with the parties' ownership interests.

The Court rejected as specious Fair's argument that he did not obtain an "advantage" from Bakhtiari within the meaning of Probate Code § 16004 and that any harm was remedied when the trial court declared the agreements void. Rule 3–300 and § 16004 make the underlying agreements "voidable, not void" at the election of the client. While the agreements existed, they conferred significant financial advantages to Fair. Fair acquired ownership interests in the business entities and claimed back-end compensation. The advantage gained by a fiduciary need not be an unfair advantage before the statutory presumptions are raised.

Nor did Fair rebut the presumption of undue influence under § 16004. The agreement was not fair and reasonable as to Bakhtiari and there was no evidence that Fair informed Bakhtiari of the perils of entering into the venture. The attorney must give reasonable advice against the attorney that the client would have received from independent counsel. The business transactions were not fully explained to and understood by Bakhtiari, and there were many material terms on which there was no agreement. In discussing missing material terms, Fair never gave advice against himself to Bakhtiari. The parties' failure to reach agreement was due in part to Fair's failure to comply with the requirements of rule 3–300. There is a difference between the type of violations that may render an agreement voidable, but still allow the attorney compensation for the reasonable value of his or her services, and the type of violation that precludes such recovery. Where services are rendered under a contractual compensation arrangement that is unenforceable as against public policy, but the subject services are not otherwise prohibited, *quantum meruit* may be allowed. For example, an attorney was entitled to the reasonable value of his services even though his fee splitting agreement was unenforceable under Rule 2-200 because there was no informed, written, client consent. However, where a rule violation prohibits the exact conduct the attorney is seeking compensation for, such as engaging in conflicting representation or accepting professional employment adverse to the interests of a client, no recovery is allowed.

The trial court found that Fair acquired an ownership interest adverse to his client without informed written consent, and created an inherent conflict of interest. The services that followed were intertwined with those unenforceable business transactions. Fair's proposal to establish the value of his services through testimony and evidence about the history of the parties' negotiations and agreements relating to the value of his services, was tantamount to enforcing the voided business agreements.

The purpose of Rule 3–300 is to absolutely prohibit attorneys from entering into business transactions with clients, absent full written disclosure and written client consent. Allowing *quantum meruit* recovery could significantly undermine the rule if an attorney can establish the reasonable value of services through the parties' understanding of voided agreements. If the value of services can be established by the success of the prohibited businesses, the Rule serves no deterrent effect.

Fair's rule violation was not limited to the inception of the business relationship with Bakhtiari. All services rendered by Fair in furtherance of the business relationship constituted a continuing rule violation and thus permeated his business relationship with Bakhtiari.

The Court of Appeal was unmoved by Fair's argument that he should be allowed recovery because his conduct did not amount to fraud, as in other cases involving denial of attorney compensation. Fair's violations were serious acts of impropriety inconsistent with the character of the profession, and incompatible with the faithful discharge of his duties.

Fair urged the court to sever the legal services from the voided agreements, arguing that since he was not seeking to recover his ownership interests in the businesses he should be compensated for the services. The common law doctrine of severability of contracts can separate illegal portions and enforce valid provisions. This prevents parties from gaining undeserved benefit or suffering undeserved detriment. The doctrine is equitable and fact specific and has been applied in the attorney fee contract context.

The trial court acted within its discretion in voiding all the business agreements in their entirety. Thus, the doctrine of severance did not apply as there was no lawful portion of the agreements themselves that could be severed. Fair's services were part and parcel of the un-enforceable business transactions and could not be separated from them.

It is possible to sever unlawful provisions from a fee agreement and allow recovery. For example, a court can sever a charging lien inserted in an hourly fee contract without compliance with rule 3-300, but still allow the attorney to recover the reasonable value of services. This could not be done in the Fair-Bakhtiari agreement because the entire agreement was voided. Moreover, the business relationship was tainted by the failures to disclose and to obtain written client consent, and undue influence and breach of fiduciary duty pervaded the relationship.

There are certain statutes that specifically allow recovery of the reasonable value of services, despite a statutory violation. There was no statute that applied to Fair's violations.

Comment: There are myriad rule violations that do not involve harm to clients and will not deprive an attorney of a fee. However, courts will not assist attorneys whose ethical violations strike at the integrity of the profession.