

Los Angeles County Bar Association Professional Responsibility and Ethics Committee

Formal Opinion No. 507
October 15, 2001

Accepting Percentage of Prospective Profits as Attorney Fees for Preparing and Prosecuting Patent Application

Summary

It is not unethical for a lawyer to accept as fees for preparing and prosecuting a patent application an interest in any proceeds such patent may bring. Moreover, the Committee does not regard such a fee agreement as requiring compliance with Rule 3-300 of the California Rules of Professional Conduct (Avoiding Interests Adverse to a Client). Nevertheless, in entering into such an agreement, a lawyer should be mindful of Rule 4-200 (Unconscionable Fees for Legal Services) and, because a lawyer's fees in such an arrangement are also inherently contingent in nature, must comply with California Business & Professions Code § 6147 (Contingency Fee Contracts).

Authorities Cited

Brobeck, Phleger & Harrison v. Telex Corp., 602 F.2d 866 (9th Cir. 1979)
Hawk v. State Bar of California, 45 Cal. 3d 589 (1988)
Tarver v. State Bar of California, 37 Cal. 3d 122 (1984)
Cetenko v. United Calif. Bank, 30 Cal. 3d 528 (1982)
Bushman v. State Bar of California, 11 Cal. 3d 558 (1974)
Setzer v. Robinson, 57 Cal. 2d 213 (1962)
Passante v. McWilliam, 53 Cal. App. 4th 1240 (4th Dist. 1997)
Ramirez v. Sturdevant, 21 Cal. App. 4th 904 (1st Dist. 1994)
Alderman v. Hamilton, 205 Cal. App. 3d 1033 (2d Dist. 1988)
In re Silverton, 2001 Calif. Op. LEXIS 4, ___ Cal. State Bar Ct. Rptr. ___ (May 22, 2001)
Cal. Bus. & Prof. Code § 6147
Cal. Rules of Professional Conduct 3-300
Cal. Rules of Professional Conduct 3-310
Cal. Rules of Professional Conduct 4-200
Cal. State Bar Form. Op. 1989-116
Los Angeles Co. Bar Ass'n Form. Op. 496 (1998)

Facts and Issues Submitted

A new client seeks to retain a lawyer to prepare and prosecute an application for a patent. Instead of an hourly or flat fee, however, the client proposes to pay the lawyer a contingent fee measured by a percentage (in this case five percent) of the "net profits" from any licensing of the patent. The lawyer's interest in such profits will not be secured, the issuance of the patent is by no means certain, and the size of any future profits is unknown at the time the new client seeks to retain the lawyer. May the lawyer accept the proposed engagement on the foregoing terms, and, if so, what must he or she do to comply with the California Rules of Professional Conduct and the applicable sections of the California Business & Professions Code?

Discussion

Except as noted below, "the negotiation of a fee agreement is an arm's-length transaction." Ramirez v. Sturdevant, 21 Cal. App. 4th 904, 913 (1st Dist. 1994) citing Setzer v. Robinson, 57 Cal. 2d 213, 217 (1962). This inquiry involves the negotiation of a form of contingent fee at the outset of the lawyer-client relationship, which is distinguishable from the negotiation of a new fee arrangement after the formation of that relationship, the latter being governed by different rules. No California statute, case, or ethics rule expressly prohibits the fee arrangement proposed above.

1. Compliance with Rule 3-300 (Avoiding Interests Adverse to a Client)

Rule 3-300 prohibits a lawyer from entering into a fee agreement by which he acquires an ownership, possessory, security, or other pecuniary interest adverse to a client, unless several conditions are met. See Discussion to Rule 3-300; see also Cal. State Bar Form. Op. 1989-116. An interest is considered "adverse" to a client if, under the circumstances, a lawyer has acquired "the ability to summarily extinguish the client's interest in property" without judicial intervention. Hawk v. State Bar of California, 45 Cal. 3d 589, 600 (1988). The Committee believes that the ethical concern hinges on the summary nature of the means by which the lawyer may extinguish the client's interest in the property. Thus, in an inquiry considering whether civil rights plaintiffs could give their lawyer a priority lien on their recovery in one case to satisfy the unpaid fees they owed that lawyer in another, this Committee noted that Rule 3-300 was inapplicable where the client's right "would not be summarily extinguished without due process of law." Los Angeles Co. Bar Ass'n Form. Op. 496 (1998).

Although based on facts distinguishable from those in this inquiry, the State Bar Court in In re Silverton, 2001 Calif. Op. LEXIS 4, ___ Cal. State Bar Ct. Rptr. ___ (May 22, 2001), recently considered the case of a lawyer who, as part of his initial retainer agreement, contracted with a client to keep for himself any sums resulting from a compromise of claims from the client's medical providers. The court concluded that the State Bar's allegations that the lawyer thus obtained a "pecuniary interest adverse" to the client, if proved, could show "the requisite adverse interest" that invokes the requirements of Rule 3-300. Id. at *6. Refusing to say, "as a matter of law, that no violation of rule 3-300 occurred," the court remanded the case for an evidentiary hearing for "a full understanding of what, if anything, was conveyed by that agreement." Id. at *7. The court cautioned that the lawyer's arrangement with his client would run afoul of Rule 3-300 to the extent that he acquired an exclusive right to a portion of the settlement attributable to the medical expenses and, upon negotiating a compromise of the medical claims, put himself in a position to extinguish his client's interest in that property. Id. at 10.

The Committee construes the fee agreement in the inquiry as giving the lawyer a contractual right to be paid a contingent fee in the future, the amount of which will be determined based on the proceeds that the client's patent may later generate. This agreement is not one that assigns the lawyer an ownership interest in the patent or its profits, the rights to which the lawyer could enforce against third parties or to the detriment of the client's ownership interest in the patent. Therefore, the lawyer does not acquire any "ability to summarily extinguish the client's interest" in such proceeds but, rather, obtains only a contractual right to be paid a fee measured by a percentage of such proceeds. To enforce that right, the lawyer would have to pursue a claim for fees in a civil action (or arbitration) if the client fails to pay the fee after it becomes due. As was the case in this Committee's Opinion No. 496, the client here remains "free to oppose the existence, the amount and/or the enforceability of the [lawyer's fee] in the independent action."

While they may not necessarily trigger the application of Rule 3-300, the Committee recommends caution when entering into these types of fee arrangements because of a potential divergence of interests. For example, throughout the preparation and prosecution of a patent application, an attorney retains considerable discretion to determine the breadth of the inventor's claims. In general, an application with narrowly drafted claims should be easier to prosecute successfully, whereas an application with broader claims, while potentially resulting in the grant of correspondingly broader property rights to the inventor, is often riskier and more challenging to prosecute. Because the lawyer and client may have differing opinions as to how broad the claims should be, the Committee believes that, since it is the lawyer who can control how the claims are drafted and/or prosecuted, the lawyer's pursuit of his own interests under a contingent

fee agreement may be detrimental to the client's. The Committee does not regard the inherent adversity in such an agreement as constituting an adverse pecuniary interest within the meaning of Rule 3-300 or under the Supreme Court's ruling in *Hawk*. However, the lawyer must fulfill other duties to the client, including providing competent representation, providing full disclosure, and allowing the client to make informed ultimate decisions in the matter.

2. Prohibition of Rule 4-200 Against Unconscionable Fee Agreements

Under Rule 4-200(A), a lawyer may not enter into an "agreement for, charge or collect an illegal or unconscionable fee." The term "unconscionable" is unique to California law and has been defined, with respect to attorney fees, as "so exorbitant and wholly disproportionate to the services performed as to shock the conscience." *Bushman v. State Bar of California*, 11 Cal. 3d 558, 563 (1974); *Tarver v. State Bar of California*, 37 Cal. 3d 122, 134 (1984). Unless the parties contemplate that the fee will be affected by later events, the "conscionability" of a fee is determined on the basis of facts and circumstances existing at the time the agreement is made, not when it is sought to be enforced. Rule 4-200(B); *Brobeck, Phleger & Harrison v. Telex Corp.*, 602 F.2d 866, 875 (9th Cir. 1979) (applying California law); *Cetenko v. United Calif. Bank*, 30 Cal. 3d 528, 532 (1982).

3. Written Contingency Fee Agreement and Compliance With Business & Professions Code § 6147

A contingency fee agreement must be in writing. Cal. Bus. & Prof. Code § 6147(a). "In order to protect clients and to assure fee agreements are fair and understood by clients, the Legislature enacted numerous statutes specifically delineating the required contents of most attorney fee agreements. (Bus. & Prof. Code, §§ 6146-6148.)" *Alderman v. Hamilton*, 205 Cal. App. 3d 1033, 1037 (2d Dist. 1988). Though it is not necessarily grounds for discipline, failure to comply with the contingency fee agreement statute "renders the agreement voidable at the option of the plaintiff" (although the lawyer is still entitled to collect "a reasonable fee"). Cal. Bus. & Prof. Code § 6147(b). Under the fee agreement proposed above, because the lawyer will not receive any payment unless both the patent application succeeds and the invention is commercially exploited — two significant elements of contingency — the fee agreement must comply with all of the statutory requirements set forth in section 6147(a) of the California Business & Professions Code. This opinion is advisory only. The Committee acts on specific questions submitted *ex parte*, and its opinion is based on such facts as are set forth in the inquiry submitted.