

L.A. COUNTY BAR ASSOCIATION PROFESSIONAL RESPONSIBILITY AND ETHICS COMMITTEE

FORMAL ETHICS OPINION NO. 499

MARCH 9, 1999

CHARGING INTEREST ON COSTS ADVANCED ON BEHALF OF A CLIENT

SUMMARY

The California Rules of Professional Conduct nowhere prohibit a lawyer from charging interest on costs advanced on behalf of a client to cover the period from when the costs are paid by the lawyer until they are ultimately billed to the client. Accordingly, the propriety of such an interest charge is a matter of contract between lawyer and client.

AUTHORITIES CITED

California Rules of Professional Conduct 3-300 and 4-200
California Business & Professions Code Section 6147
State Bar Formal Opinion 1980-53
Los Angeles County Bar Formal Opinions 370 and 374
San Diego County Bar Association Formal Opinion 1983-1
San Francisco Bar Association Informal Opinion 1970-1
Alderman v. Hamilton, 205 Cal. App. 3d 1033, 252 Cal. Rptr. 845 (2d Dist. 1988).
In re Harney, 3 Cal. State Bar. C. Rptr. 266 (April 4, 1995).
Hawk v. State Bar of California, 45 Cal. 3d 589, 247 Cal. Rptr. 599 (1988).
Hunnecutt v. State Bar of California, 44 Cal. 3d 362, 243 Cal. Rptr. 699 (1988).
Kroff v. Larson, 167 Cal. App. 3d 857, 213 Cal. Rptr. 526 (6th Dist. 1985).
Ojeda v. Sharp Cabrillo Hosp., 8 Cal. App. 4th 1, 10 Cal. Rptr. 2d 230 (4th Dist. 1992).
Severson & Werson v. Bolinger, 235 Cal. App. 3d 1569, 1 Cal. Rptr. 2d 531 (1st Dist. 1991).

QUESTIONS SUBMITTED

May a lawyer ethically charge interest as a matter of course on costs advanced on behalf of a client to cover the period from when the costs are paid by the lawyer until they are ultimately billed to the client? If not as a matter of course, may a lawyer ethically do so where the client has agreed to such charge pursuant to a written retainer agreement?

DISCUSSION

The Committee interprets the inquiry to ask not about the ethicality of charging interest on costs advanced when they have already been billed to the client and become past due, but, rather, about the ethicality of charging interest from the time they are paid by the lawyer until the time they are billed. As to the former query, the Committee has previously stated that it is not improper for a lawyer, with the prior agreement of the client, to impose a reasonable interest charge on delinquent balances of fees and costs. Los Angeles

County Bar Association Formal Opinions 370 (January 17, 1978) and 374 (April 28, 1978); see also State Bar Formal Opinion 1980-53 (stating that attorney may ethically charge client interest on past due receivables provided that client has given informed written consent in advance of charge); San Diego Formal Opinion 1983-1 (same); Legal Ethics Committee of the Bar Association of San Francisco Informal Opinion 1970-1 (noting absence of ethical prohibition against imposing service charge or interest charge to clients whose bills have not been paid within thirty days).¹

The California Rules of Professional Conduct are silent on the subject of this inquiry.² Rule 4-210 of the California Rules of Professional Conduct specifically permits a lawyer to advance costs on behalf of a client (even in non-litigation contexts) where such costs may be recoverable by the client in the future. But, in limiting the definition of costs advanced to all reasonable expenses of litigation or reasonable expenses in preparation for litigation or in providing any legal services to the client, subsection (A)(3) of that rule makes no mention of a lawyer charging interest on such costs.³ The omission is inconclusive.

Nevertheless, section 6147 of the California Business & Professions Code requires that - at least in most cases taken on a contingency fee basis - a lawyer's agreement with his or her client include "[a] statement as to how disbursements and costs incurred in connection with the prosecution or settlement of the claim will affect the contingency fee and the client's recovery." Cal. Bus. & Prof. Code Section 6147 (A)(2). Notably, a lawyer's failure to include such terms in the agreement with the client renders the agreement voidable at the option of the client and leaves the lawyer with the ability to collect only a reasonable fee. *Id.* In essence, the issue of whether a lawyer may charge interest on costs advanced is a simple matter of substantive law. Unless specifically provided for in a written agreement, then, a lawyer will be hard-pressed to make a lawful demand of interest on any costs advanced on behalf of his or her client.⁴ See Alderman v. Hamilton, 205 Cal. App. 3d 1033, 1038, 252 Cal. Rptr. 845, 848 (2d Dist. 1988) (noting voidability by client of fee agreement that did not include provisions concerning disbursements). This is consistent with the policy that lawyer-client fee agreements should be strictly construed against the lawyer. Alderman, 205 Cal. App. 3d at 1037, 252 Cal. Rptr. at 847-48.⁵

The Committee is of the opinion that Rule 3-300 of the Rules of Professional Conduct has no application in the resolution of this inquiry.⁶ Indeed, the discussion of Rule 3-300 specifically states that it is not intended to apply to the agreement by which the lawyer is retained by the client unless the agreement gives the attorney an adverse pecuniary interest. Recognizing that formal loans between lawyers and clients have in certain cases been held to implicate Rule 3-300 (or its predecessor, Rule 5-101), see, e.g., Hawk v. State Bar of California, 45 Cal. 3d 589, 247 Cal. Rptr. 599 (1988) (collecting cases), the Committee believes that the mere imposition of interest charges on costs advanced neither is a business transaction nor rises to the level of an adverse pecuniary interest within the meaning of that rule. Cf. Hunnicutt v. State Bar of California, 44 Cal. 3d 362, 243 Cal. Rptr. 699 (1988) (requiring compliance with predecessor rule to Rule 3-300 where lawyer solicited investment loan of settlement proceeds from client for real estate venture).

Because the collection of interest on costs advanced must be made part of the fee agreement, a lawyer may not as a matter of course, i.e., absent specific language in the agreement, unilaterally impose interest on a client once the representation is underway.⁷ In this respect, it is helpful to treat changes to the terms of the reimbursement of costs, such as the attempted imposition of interest thereon, in the same manner as changes to the lawyer's fee itself. See, e.g., Kroff v. Larson, 167 Cal. App. 3d 857, 213 Cal. Rptr. 526 (6th Dist. 1985) (noting concern about burden on client of paying fees or costs prior to occurrence of stated contingency and holding costs payable only upon recovery, where agreement so provided).⁸ In Severson & Werson v. Bolinger, 235 Cal. App. 3d 1569, 1 Cal. Rptr. 2d 531 (1st Dist. 1991), the Court of Appeal held that, where the fee agreement did not address changes in the attorneys' billing rates during the course of the representation but referred only to the firm's regular hourly rates, and where the client was never notified of any such rate changes, the attorneys could not collect fees higher than those initially disclosed to the client.

Implicit in a lawyer's acceptance of a case on a contingency basis, is his or her calculation of the time value of money. After all, pursuant to such an agreement, the lawyer may spend many hours working on such a case with only a possibility of later receiving a payment that is obviously worth more to the lawyer the sooner it is received. Costs advanced on behalf of a client are admittedly a slightly different creature, for they involve out-of-pocket outlays by the lawyer of funds that could have otherwise been earning interest or expended elsewhere.⁹ Absent a fee agreement with the client that specifically addresses the accrual of interest on such expenses, the Committee believes that a lawyer may not ethically (not to mention lawfully, under the Business & Professions Code) impose interest charges on those costs. See Ojeda v. Sharp Cabrillo Hosp., 8 Cal. App. 4th 1, 22, 10 Cal. Rptr. 2d 230, 244 (4th Dist. 1992) (noting that advance of costs in contingency cases effectively provides client with an interest-free loan which may never have to be repaid). Of course, when an interest charge is proper, the rate in any instance must not be illegal or unconscionable.¹⁰

This opinion is advisory only. The Committee acts on specific questions submitted ex parte, and its opinion is based only on such facts as are set forth in the questions submitted.

¹ Because the Committee addresses here only the issue of the lawyer's charging interest for the period from the time he or she pays the costs until the time they are recovered from the client, this opinion does not address the issue of any interest charges (or other expenses associated with delayed payment, such as late fees) incurred by the lawyer prior to the time he or she pays any third-party's bill for such costs. (The issue of liability for interest or late fees associated with a lawyer's dilatory payment of a third-party's bill would be a separate matter to be settled between lawyer and client.)

² In responding to this general inquiry, the Committee makes certain important assumptions about the situations in which this question will arise. In the first place, the Committee expects that this issue will surface primarily in the litigation context and almost exclusively in cases involving contingency fee agreements, where reimbursement for costs advanced is not typically made until the conclusion of the case (if there is a recovery). In non-litigation contexts, or in others in which a client is billed regularly during the course of the representation, the issue is less salient, though the same analysis would apply to a lawyer seeking to charge a client interest on costs advanced for the period from the time they are paid by the lawyer until the time the client is regularly billed.

³ The Committee does not distinguish the case in which the lawyer pays the client's costs out of his or her own pocket from that in which the lawyer secures funding from an outside source and incurs interest charges on those funds.

⁴ Failure to comply with a statute is not necessarily a per se violation of any ethical rule. In re Harney, 3 Cal. State Bar. C. Rptr. 266 (April 4, 1995) (ruling that failure to comply with either Cal. Bus. & Prof. Code Section 6147 or Section 6148 [concerning non-contingency fee representations] should not be considered generally disciplinable under Cal. Bus. & Prof. Code Section 6068(a)). Nevertheless, the attempted collection of interest not provided for in the fee agreement may well cause a lawyer to run afoul of California Rule of Professional Conduct 4-200(A), which prohibits a lawyer from charging or collecting an illegal or unconscionable fee.

⁵ An attorney may not be permitted to circumvent the statute through the use of late fees or service charges that operate as the practical equivalent of interest on costs advanced. See Informal Opinion 1970-1 of the Legal Ethics Committee of the Bar Association of San Francisco.

⁶ California Rule of Professional Conduct 3-300 states:

A member shall not enter into a business transaction with a client, or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

(A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and

(B) The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(C) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.

⁷ Such a practice, even if the lawyer could obtain the client's consent, would raise the issue of a lack of consideration under standard principles of contract law insofar as it would call for additional payments on a pre-existing duty.

⁸ For the same reasons cited in Kroff, a lawyer on a contingency fee is not entitled to reimbursement from his or her client for interest on costs advanced until after the contingency has occurred. Kroff 167 Cal. App. 3d at 861, 213 Cal. Rptr. at 528.

⁹In the (unlikely) event that resolution of the client's case involves the opposing party paying interest on the client's costs, such interest should fairly be payable to the lawyer to the extent he or she had advanced those costs.

¹⁰ The Committee does not opine on what would be a fair and reasonable rate of interest to be imposed upon the client. However, it should be noted that the imposition of an excessive interest rate could be a violation of California Rule of Professional Conduct 4-200, which, as noted above, bars illegal or unconscionable fees.

For a discussion of unconscionability within the meaning of (former) California Rule of Professional Conduct 2-107(A), which is virtually identical to the present rule 4-200(A), see State Bar Formal Opinion 1980-53 and LACBA Formal Opinion 370.