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HANDBOOK OF TEXAS LAWYER AND JUDICIAL ETHICS:
Attorney Tort Standards
Attorney Ethics Standards

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ment of consultants. On more than one occasion, one of the authors has encountered lawyers who hire their own relatives, or companies that those relatives own, as consultants, paying them exorbitant fees for work of dubious quantity or quality. That author has even seen lawyers hire entities as consultants that they themselves own in whole or in part, all without advising clients of those circumstances. Again, the key thing to remember is that the lawyer, as fiduciary for his clients, has an obligation to take reasonable measures to ensure that the fees charged by consultants for the services that they offer are negotiated at arms length and are in keeping with customary charges, given the consultant's experience and qualifications, and that the lawyer does not profit from them himself. In addition, as part of the lawyer's fiduciary obligations, the lawyer must make a full disclosure of any financial relationship that the lawyer has with any entity providing consulting services to the lawyer's clients.

- Finally, it should go without saying that expenses incurred should actually relate to the matter to which they are charged, and should not be charged in full to more than one matter. These lessons have not been learned by some lawyers, who have seen their expense reimbursement requests dramatically reduced by enterprising judges, who find that they had either billed expenses to one matter that were incurred in connection with another, or else had billed multiple clients for the same item and, in some cases, even been reimbursed for it previously.[35]

b. A Particular Problem: A Fee Based On A "Stake In The Venture"

One type of fee, that merits further discussion is one in which a lawyer accepts an ownership interest in an entity as all or a portion of the fee for representing the entity—typically in its formative stages, but perhaps thereafter as well.[36] Such an arrangement, while increasingly common in connection with services offered to start-up enterprises, is unusually fraught with conflicts of interest. By way of illustration, to what extent, if at all, can a lawyer structure the fledgling enterprise so as to protect the lawyer's ownership interest, even though restrictions developed for that purpose might not otherwise be in the best interests of the new entity? What if the value of the ownership interest acquired by the lawyer is (or becomes) of considerably greater value than that of the services provided if paid for on a cash (hourly) basis? What impact, if any, does the fact that the lawyer and client will enter into an ongoing business relationship have on the as-

[35]This precept does not prohibit apportioning an expense item benefiting multiple clients among them in some fair and reasonable way, only charging them, in the aggregate, more than 100% of the expense item involved.

[36]*See* ABA Formal Op. 00-418 (2000).

sessment of whether the ownership-for-services transaction is proper?

A recent ethics opinion of the American Bar Association addresses many of these questions.[37] In that opinion, the ABA concluded that a legal fee consisting in whole or in part of an ownership interest in the client or some other entity was not *per se* improper, but that special safeguards had to be followed. Chief among these is the requirement that the propriety of the fee be evaluated not just under the disciplinary rule governing attorney's fees[38] but also under the separate rule governing business transactions between lawyer and client.[39] Under the latter standard, Texas Rule 1.08(a), which is similar to the comparable provision of the Model Rules discussed in ABA Formal Opinion 00-418 (2000), imposes four requirements on a lawyer entering into a business transaction with a client, each of which has a counterpart in the Texas Rules.

- The transaction must be fair and reasonable.[40]
- The terms of the transaction must be fully disclosed to the client in a manner that can be reasonably understood by the client.[41]
- The client must be given a reasonable opportunity to seek the advice of independent counsel in deciding whether to enter into the transaction.[42]
- The client must consent to the transaction in writing.[43]

Moreover, the burden is on the lawyer—not the client—to show that these requirements have been satisfied.[44]

The principal ethical danger that such a fee presents to a lawyer is that, if the entity prospers, the lawyer's fee may appear to be or become exceptionally large in comparison to the ordinary value of the legal services provided.[45] The prevailing view is that in all but the most extraordinary circumstances, the propriety of the lawyer's fee should be judged by the circumstances known to the parties at the time the agreement was entered into, rather than those prevailing at some later point in time.[46] However, in extreme cases the temptation to view the lawyer's fee as excessive might become difficult to resist.

The most effective way to forestall a successful challenge to the

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[37]*See* ABA Formal Op. 00-418 (2000). *Accord*, Ass'n of the Bar of the City of New York, Comm. on Prof'l and Jud'l Ethics, Formal Op. 2000-3 (2000).

[38]*See* ABA MR 1.5 (requiring that attorney's fees be "reasonable" and setting out factors affecting the determination of "reasonableness"); Tex. Rule 1.04 (requiring that fees not be "unconscionable," with a fee being "unconscionable" if "a competent lawyer could not form a reasonable belief that the fee is reasonable").

[39]*See* ABA MR 1.8(a); Tex. Rule 1.08(a).

[40]*See* Tex. Rule 1.08(a)(1).

[41]*See* Tex. Rule 1.08(a)(1).

[42]*See* Tex. Rule 1.08(a)(2).

[43]*See* Tex. Rule 1.08(a)(3).

[44]*See* ABA Formal Op. 00-418 (2000), at n. 10 and accompanying text.

[45]ABA Formal Op. 00-418 (2000), at n. 12 and accompanying text.

[46]ABA Formal Op. 00-418 (2000), at n. 9 and accompanying text. *Accord* Tex. Rule 1.04, cmt. 7.

agreed-upon fee, besides scrupulous compliance (preferably in writing) with the requirements of Texas Rule 1.08(a) noted above, is to spell out the services to be provided by the lawyer carefully, attempt to place a cash value on the lawyer's services, and limit the ownership interest taken in the entity accordingly.[47] If for some reason it is not possible to take all of these steps (for example, because there is no ready market for the entity's shares of stock), the lawyer should document the value of the lawyer's services if paid for in cash as well as the lawyer's willingness to be compensated on that basis were the client able to do so, and candidly acknowledge the possibility that the value of the shares of stock being taken in lieu of a cash fee could in time substantially exceed the ordinary value of the lawyer's services, should the entity prosper.[48]

In a limited class of cases, a lawyer's acquisition of stock may be tantamount to acquiring "a proprietary interest in the cause of action or subject matter of litigation" within the meaning of Texas Rule 1.08(h).[49] This could occur, for example, where the only substantial asset of an entity is a patent to which it holds title, the validity of which is being contested, and the lawyer is representing the entity in litigation to resolve that contest in return for a fee consisting of an ownership interest in the entity or in the patent itself. Out of concern over avoiding champerty and maintenance, such activity is generally prohibited except, *inter alia*, where the lawyer's interest consists of "a contingent fee that is permissible under [Texas] Rule 1.04."[50] Although an ownership interest in an entity or in intellectual property is not a traditional contingent fee, ABA Formal Opinion 00-418 (2000) takes the position that there is no reason why it should be placed on a different footing.[51] This seems to be a sensible view. Consequently, such fees should not be prohibited for failure to comply with Texas Rule 1.08(h),[52] although any such arrangement must satisfy Texas Rules 1.04 and 1.08(a).

c. Another Problem: Delay in Setting Fee

Yet another problem—and one that you hopefully will avoid—is determining what fee is appropriate where a lawyer and client have not come to an agreement on that topic before the lawyer has completed work on the matter involved. That issue was raised by the

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[47]ABA Formal Op. 00-418 (2000), at n. 15 and accompanying text.

[48]ABA Formal Op. 00-418 (2000), at nn. 6, 16 & 21 to 22 and accompanying text.

[49]Tex. Rule 1.08(h).

[50]Tex. Rule 1.08(h)(2).

[51]*See* ABA Formal Op. 00-418 (2000), at nn. 25 to 27 and accompanying text.

[52]*But see* PEC Op. 610 (Aug. 2011) (it would violate Texas Rule 1.08(h) for a lawyer to take a security interest in a client's recovery in order to secure payment of the lawyer's contingent fee).