DELAWARE STATE BAR ASSOCIATION
COMMITTEE ON PROFESSIONAL ETHICS

Opinion 2009-2
March 25, 2009

This opinion is merely advisory and is not binding on the inquiring attorney or the Court or any other tribunal

Background Facts

The inquirer, a Delaware attorney (hereinafter "Attorney"), seeks guidance on the following issue:

> Would it be ethically permissible to include a provision in a client engagement letter or retainer agreement which would say something to the effect that "in the event of default in payment, Client will pay reasonable attorney's fees and costs incurred in collecting said amount which may be due?"

Conclusion

It is the Committee's opinion that inclusion of language and conditions in a client engagement or retainer letter providing for the Attorney's ability to recover actual costs and reasonable outside counsel attorney's fees, if a collection action is instituted against the client, is ethically permissible under the Delaware Lawyers' Rules of Professional Conduct, specifically Rule 1.5, assuming the engagement or retainer letter contains in writing:

a. A clear statement that, should the client default on payments to Attorney, that Attorney has the ability to seek payment of the owed amounts, and, in addition, seek costs and outside counsel attorney's fees for the recovery efforts;

b. A clear statement that the right to recover costs and outside counsel fees is reciprocal or mutual in nature, in that the client, in the event a fee dispute arises, also has the ability to seek the same costs and reasonable attorneys' fees in defending the action by Attorney;

c. A clear statement that the costs would be limited to actual costs incurred by the Attorney or client in bringing or defending against the action; and

d. A clear statement that the client may seek the advice of an independent attorney prior to the execution of the engagement or retainer letter, and that the engagement or retainer letter does not in any way prevent the client from seeking or retaining other counsel at any time, including a situation where a fee dispute arises.

Discussion

Rule 1.5(a) and (b) of the Delaware Lawyers' Rules of Professional Conduct (Fees) states, in relevant part:

> (a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses . . .
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> (b) The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.

Here, Attorney inquires as to the propriety of including language in an engagement or retainer letter which would permit the recovery of actual costs and outside counsel attorney's fees should the client default in payment of fees or amounts owed to Attorney accrued by way of Attorney's representation of the client. The Committee's opinion is limited to an analysis of inclusion of language in an engagement or retainer letter which provides for the recovery of costs and outside counsel attorney's fees in collection efforts. Attorney is reminded that other duties owed to the client must be considered not only at the time of the engagement, but during representation of the client and when a client may be in a default situation that may implicate Attorney's collection efforts.[1]

It cannot be overlooked that there always exists the possibility that any relationship with a client may become adverse at some point, especially with regard to the payment of fees earned by the Attorney. In fact, the Preamble to the Delaware Lawyer's Rules of Professional Conduct recognizes that "[v]irtually all difficult ethical problems arise from conflict between a lawyer's responsibilities to clients, to the legal system and to the lawyer's own interest in remaining an ethical person while earning a satisfactory living." DLRPC Preamble ¶ 9. However, the Preamble further cautions that "[s]uch issues must be resolved through the exercise of sensitive professional judgment and moral judgment guided by the basic principles underlying the Rules."

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[1] This opinion assumes that Attorney will exercise diligence in the representation of the client and should mitigate any negative consequences to the client, as required by the Delaware Lawyers' Rules of Professional Conduct, specifically Rule 1.2 (Scope of representation), Rule 1.3 (Diligence), and Rule 1.16 (Declining or terminating representation) and DLRPC 1.9 (regarding duties owed to former clients) before instituting any recovery action for amounts owed to Attorney with respect to the prior representation of the client. The Committee believes that additional disclosure obligations may have to be considered and undertaken at the time of engagement depending on the sophistication of the client. For instance, a sophisticated corporate client that presumably has other counsel may not require any additional information or explanation aside from the provision of the engagement letter containing the subject language. In comparison, an individual with little or no business acumen may require additional explanation and assurances as to the application of the engagement letter's terms and conditions.

Id. The Committee is of the opinion that the correct balance of moral and professional judgment may be achieved in such a way to fulfill not only the ethical obligations to the client, but also to fulfill Attorney's ability to be fairly compensated for services and collection efforts that may be needed in certain circumstances.

As noted by the inquiring Attorney, the Delaware courts have not directly addressed the issue of whether an engagement or retainer letter could contain provisions for recovery of costs and outside counsel fees in collection efforts. Moreover, the Committee's opinion is not intended to offer any formal conclusion on how a court should address this issue should it be formally presented in a valid legal action. However, court decisions in this jurisdiction and in others do offer the Committee guidance which is worth noting when exploring the issue of recovery of costs and outside counsel fees during collection efforts.[2]

In *Melson v. Michlin*, 223 A.2d 338 (Del. 1966), the Delaware Supreme Court analyzed the standards and criteria governing a business relationship between a client and attorney where the attorney acquired a property interest that was not adverse to the client at the outset, but which subsequently became adverse. In *Melson,* the Court held that:

> In all relations with his client, an attorney is bound to the highest degree of fidelity and good faith. Strict adherence to this rule of conduct is required by time-honored, deeply rooted concepts of public policy.... The burden of proof is always upon the attorney, as a fiduciary, to establish clearly the absence of any taint in the transaction; otherwise it is voidable.
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> But an attorney and his client are not under an absolute legal disability to contract with each other; nor are all business transactions between them necessarily voidable because of the relationship. By reason of the very nature of the attorney-client relationship, however, a business transaction between attorney and client will be subject to the closest judicial scrutiny, if attacked,

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[2] The inquiring Attorney has directed the Committee's attention to two other ethics opinions that touch on the identical issue presented herein. In both, the committees were of the opinion that it would not be improper for an attorney to place in the initial fee agreement a clause for the recovery of reasonable attorney's fees if collection proceedings are initiated. *See* Opinion 310 of the District Of Columbia's Bar Legal Ethic's Committee at http://www.dcbar.org/for_lawyers/ethics/legal_ethics/opinions/opinion310.cfm; VA LE Op. No. 1667. The DC Bar Legal Ethics Committee also addressed another issue, not part of the present inquiry here, but relevant nonetheless. In Opinion 310 they expressed the opinion that it was permissible to collect interest on the unpaid debt of the client, as long as it is specifically provided for in the existing fee arrangement. Research of the Committee shows that a majority of ethics boards have concluded that the charging of interest owed on past due amounts is permitted, so long as it was specifically provided for in the engagement agreement. *See e.g.* CT Eth. Op. 99-26, 1999 WL 958143 (Conn. Bar. Assoc.); OR Eth. Op. 2005-97, 2005 WL 5679688 (Or. St. Bar. Assn.); MN Eth. Op. 16, 1993 WL 190146 (Minn. Prof. Resp. Bd.); OH Adv. Op. 91-12; 1991 WL 717482 (Ohio Bd. Com. Griev. Disp.); FL Eth. Op. 86-2, 1986 WL 84406 (Fla. St. Bar. Assn.); CA Eth. Op. 198053, 1980 WL 19390 (Cal. St. Bar. Comm. Prof. Resp.); NY Eth. Op. 873, 2005 WL 607111 (N.Y. St. Bar. Assn. Comm. Prof. Eth.); MI Eth. Op. RI-40, 1989 WL 428585 (Mich. Prof. Jud. Eth.); TN Eth. Op. 82-F-28, 1982 WL 196516)(Tenn. Bd. Prof. Resp.); PA Eth. Op. 91-27, 1991 WL 787543 (Pa. Bar. Assn. Comm. Leg. Eth. Prof. Resp.).

> and will be upheld only if the attorney is able to sustain the burden of proving that (1) the transaction, at its inception, was not disadvantageous to the client; (2) the transaction was entered into in utmost good faith and with complete fairness; (3) there was full disclosure to the client of the nature and effect of the transaction and of his interests and rights therein; and (4) was no undue influence exerted by the attorney.

Melson, 223 A.2d at 249 (citations omitted).

Although not precisely on point, the Committee believes *Melson* offers general guidance as to factors that should be addressed by attorneys in crafting engagement or retainer letters containing the language of the sort proposed by the inquiring Attorney. Attorney should also be guided by the general principles enunciated in the Preamble to the Delaware Lawyer's Rules of Professional Conduct, including, but not limited to, that as member of the legal profession and "as advisor, a lawyer provides the client with an informed understanding of the client's legal rights and obligations and explains their practical implications." As such, the Committee concludes that: the engagement letter should not be disadvantageous to the client; it must be entered into in good faith and with complete fairness; there must be full and complete disclosure to the client of the effect of the provisions in the engagement or retainer letter; and there must not be undue influence exerted by the attorney.

An attorney is not without recourse should a client default on fees, because Delaware law does provide an attorney the right to bring an action against the client for unpaid fees or to seek a lien for recovery of compensation for his services. *See e.g., Blank Rome v. Vendel,* 2003 WL 21801179, No. C.A. 19355 (Del. Ch. Aug. 5, 2003)(affirming arbitration award for unpaid fees); *Royal Ins. Co. v. Simion,* 174 A. 444, 446 (Del. Ch. 1934)(recognizing attorneys claims for a charging lien or retaining lien). However, under the American Rule and Delaware law, litigants are normally responsible for paying their own litigation costs. *Chrysler Corp. V. Dann,* 223 A.2d 384, 386 (Del. 1966)("a litigant must, himself, defray the costs of being represented by counsel). Thus, an attorney seeking to collect unpaid fees, must inevitably bear the costs of the collection action unless there is a fee shifting provision in the engagement or retainer letter. Fee shifting is permissible in Delaware if it is expressly permitted by contract or statute. *Cason v. Nationwide Ins. Co.*, 455 A.2d 361, 370 (Del. Super. 1982)(Delaware courts "may not order the payment of attorney's fees as part of costs to be paid by the losing party unless the payment of such fees is authorized by some provision of statute or contract."); *see also* Del. Code § 3912 (governing counsel fees and recovering in actions on written instruments, which provides that counsel fees shall not be entered a part of a judgment unless the instrument relied upon expressly provides for payment and allowance thereof.)[3]

The Committee sees no legal impediment to a fee shifting provision in an engagement or retainer letter. Further, the Committee is of the opinion that there is no professional ethical impediment to a valid fee shifting provision in the client agreement. Rule 1.5 contains no

[3] The Committee's analysis does not attempt to decide the legal application of 10 Del. C. § 3912 to an engagement or retention letter, which is a question of law for the Courts.

prohibitions against such, other than that Attorney "shall not make an agreement for, charge, or collect an unreasonable fee, or an unreasonable amount for expenses." The Committee is of the opinion that as long as an engagement or retainer letter contains a clear and plain explanation that should the client default on payments to Attorney, the Attorney has the ability to seek payment of the owed amounts, and in addition, seek costs and outside counsel attorney's fees for the recovery efforts.

However, the Committee also believes that such right must be mutual or reciprocal. In other words, the client must have the reciprocal right to costs and attorneys' fees should an action be pursued by Attorney and the client successfully defends the action. As pointed out by inquiring Attorney, courts in other jurisdictions have addressed the issue and concluded that the reciprocal nature of an agreement is a highly relevant factor as to its fairness. *See Ween v. Dow,* 35 A.D.3d 58, 63 (N.Y. App. Div. 2006)(retainer letter's provision for attorneys' fees in collection action "without a reciprocal allowance for attorneys' fees should the client prevail, [is] fundamentally unfair and unreasonable."); *In re Ernst,* 382 B.R. 194 (S.D.N.Y. 2008)(non-reciprocal "collection costs" provision in law firm's retainer agreement was per se unconscionable); *Farmers Ins. Exchange v. Law Offices of Conrado Joe Sayas Jr. Esq.*, 250 F.3d 1234 (9th Cir. 2001)(affirming recovery of attorneys' fees in collection action under express terms of retainer agreement with reciprocal provisions); *cf. Lustig v. Horn*, 732 N.E.2d 613 (Ill. App. Ct. 2000)(finding non-reciprocal provision for attorneys' fees in retainer unenforceable). Here, the Committee is of the opinion that fairness dictates that a clear and plain explanation must be made to the client that the right to recover costs and outside counsel fees is reciprocal or mutual in nature.

It is also well settled that in Delaware attorney's fees and expenses (i.e. "costs" as framed by inquiring Attorney) are limited to reasonable attorneys' fees and expenses. Rule 1.5 *supra*; *Mahani v. EDIX Media Group Inc.*, 935 A.2d 242, 246 n. 11 (Del. 2007)(citing Rule 1.5). In fee shifting cases the reasonableness of fees and expenses are questions of law for the Court to determine. *Mahani*, 935 A.2d at 245. Therefore the Committee expresses no opinion to what is a reasonable or unreasonable fee under the circumstances, but only that the engagement or retainer letter fully explain that this will be a reasonable fee so as to satisfy Attorney's ethical obligations under the Delaware Lawyer's Rules of Professional Conduct. The Committee is of the opinion that that "costs" should be limited to the actual costs of the Attorney in the collection action, and the engagement or retainer letter should expressly say so.

Finally, the Committee is of the opinion that it may be advisable for the engagement or retainer letter to contain cautionary language that the client may seek the advice of an independent attorney prior to the execution of the engagement or retainer letter, and that the engagement or retainer letter does not in any way prevent the client from seeking or retaining other counsel at any time, should a fee dispute in fact arise. Attorney should remember the ethical obligations under Rule 1.16, regarding withdrawal of Attorney as counsel. Attorney, upon withdrawal, should give reasonable notice to the client of the withdrawal and allow for reasonable time for employment of another attorney to protect the former client's interests, should the client desire to seek new counsel.

DELAWARE STATE BAR ASSOCIATION
COMMITTEE ON PROFESSIONAL ETHICS

Opinion 2009-2 (Concurrence)

The bylaws of the Committee state:

"The purpose of the Committee on Professional Ethics (the "Committee") shall be to **advise** members of the Delaware State Bar Association (the "Association") in respect to professional conduct of lawyers and ethics of the profession; to express its **opinion** concerning professional conduct" (emphasis added).

In our view, this purpose is fulfilled when the Committee considers all potentially relevant provisions of the Delaware Lawyers' Rules of Professional Conduct ("DLRPC") and other sources of law that impact upon the proposed conduct of an inquiring attorney, and to assist that attorney in avoiding conduct that may be considered in violation of the DLRPC. Viewed in this framework, we think the opinion of the Committee adequately addresses the inquiry. However, the undersigned members of the Committee are of the opinion that the Committee should have addressed the DLRPC Comment concerning the Delaware State Bar Association's Fee Dispute Resolution Program as discussed below.

The inquiry of the attorney, as stated in the opinion is as follows:

> Would it be ethically permissible to include a provision in a client engagement letter or retainer agreement which would say something to the effect that "in the event of default in payment, Client will pay reasonable attorneys' fees and costs incurred in collecting said amount which may be due?"

(hereinafter, the "Inquiry"). The conclusion of the Committee is that: "[The] inclusion of language and conditions in a client engagement or retainer letter providing for the Attorney's ability to recover actual costs and reasonable outside counsel attorney's fees, if a collection action is instituted against the client, is ethically permissible under the Delaware Lawyers' Rules of Professional Conduct, specifically Rule 1.5, assuming the engagement or retainer letter contains in writing: [details of subsequent opinion text omitted].

In reaching this conclusion, the Committee analyzes the impact of Rule 1.5(a) and (b) of the Delaware Lawyers' Rules of Professional Conduct upon the proposed conduct. The Committee further discusses certain other portions of the DLRPC that concern the Inquiry, including: (1) the Preamble to the Delaware Lawyer's Rules of Professional Conduct; (2) Rule 1.2 (Scope of Representation), Rule 1.3 (Diligence), and Rule 1.16 (Declining or Terminating Representation) and DLRPC 1.9 (regarding duties owed to former clients).

As one example of the above, the Committee assumes that the "Attorney will exercise diligence in the representation of the client and should mitigate any negative consequences to the client, as required by the Delaware Lawyers' Rules of Professional Conduct."

Elsewhere, the Committee states that it:

> believes that additional disclosure obligations may have to be considered and undertaken at the time of engagement depending on the sophistication of the client. For instance, a sophisticated corporate client that presumably has other counsel may not require any additional information or explanation aside from the provision of the engagement letter containing the subject language. In comparison, an individual with little or no business acumen may require additional explanation and assurances as to the application of the engagement letter's terms and conditions.

In the opnion of the undersigned members of the Committee, all of these additional observations of the Committee in its opinion are appropriately included. They provide proper guidance to the Attorney, a member of our Bar, in that Attorney's attempt to contour his or her prospective conduct in accordance with not only Rule 1.5, but other relevant Rules, and in accordance with the purpose of those Rules as a whole.

However, it should be noted that there is a comment to Rule 1.5 of the Delaware Lawyers' Rules of Professional Conduct that the Committee fails to discuss or even mention, and in the opnion of the undersigned members of the Committee, the Attorney should be explicitly informed.

Comment 14 to Rule 1.5 of the Delaware Lawyers' Rules of Professional Conduct states in relevant part:

> [14] *Disputes over fees.* If a procedure has been established for resolution of fee disputes, such as an arbitration or mediation procedure established by the bar, the lawyer must comply with the procedure when it is mandatory, and, even when it is voluntary, the lawyer should conscientiously consider submitting to it.

The Attorney should be further informed that there *is* a voluntary fee dispute procedure established by the Delaware Bar Association that is available free of charge to the client and the inquiring attorney.[1] Therefore, by the explicit terms of the above Comment, in the event the client fails to pay fees the Attorney believes are owed to the Attorney, the Attorney should "conscientiously consider" submitting to the voluntary fee dispute procedure established by the Delaware Bar Association."

With this addition, and on this basis, we concur in opinion.

Adam Singer

Albert Greto

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[1] More information about the Fee Dispute Conciliation and Mediation Committee is available at http://courts.state.de.us/odc/addinfo.htm#fee