

**THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 11-0001**

ISSUE: Who is entitled to the refund of remaining advance fees at the end of a case where fees were paid by a non-client?

DIGEST: Where a third-party pays the attorneys' fees for a client and there are funds remaining after the representation is concluded, the attorney must return the balance to the payor, rather than to the client, unless the agreement with the client and the payor specifies otherwise.

AUTHORITIES

INTERPRETED: Rules 3-310(F), 3-700(D)(2), and 4-100 of the Rules of Professional Conduct of the State Bar of California .^{1/}

Code of Civil Procedure section 285.1.

Labor Code section 2802.

STATEMENT OF FACTS

Attorney is retained by Spouse to handle Spouse's dissolution of marriage. Spouse's Parent agrees to pay the attorneys' fees. There is no dispute that Attorney made all proper disclosures under rule 3-310(F) of the California Rules of Professional Conduct, including "disclosure" under rule 3-310(A)(1), and Spouse consented in writing to the financial arrangement after such disclosures. Upon termination of the representation, Attorney files a Notice of Withdrawal pursuant to Code of Civil Procedure section 285.1.^{2/} Spouse insists unused sums in the trust account be disbursed to her, while Spouse's Parent asks for the money to be returned to her.^{3/}

DISCUSSION

There are several common circumstances in which a third party may pay the attorneys' fees for a party to litigation or a transaction. For example, parents may pay the attorney for fees incurred on behalf of their adult child in a domestic relations or criminal matter. Employers often pay the fees for an employee being sued, pursuant to Labor Code section 2802.^{4/} Sometimes the attorney is representing both the employee and the employer. In commercial

^{1/} Unless otherwise indicated, all rule references are to the Rules of Professional Conduct of the State Bar of California.

^{2/} Section 285.1 reads: "An attorney of record for any party in any civil action or proceeding for dissolution of marriage, . . . may withdraw at any time subsequent to the time when any judgment in such action or proceeding, other than an interlocutory judgment, becomes final, and prior to service upon him of pleadings or motion papers in any proceeding then pending in said cause, by filing a notice of withdrawal."

^{3/} These facts assume that fees have been appropriately earned and paid and the only issue is with regard to surplus funds.

^{4/} Labor Code section 2802 requires an employer to "indemnify his or her employee for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties, or of his or her obedience to the directions of the employer...." This requires an employer to defend or indemnify an employee who is sued by third persons for conduct in the course and scope of his employment. *Douglas v. Los Angeles Herald-Examiner* (1975) 50 Cal.App.3d 449 [123 Cal.Rptr. 683].

lending transactions, the borrower sometimes pays the fees of the lender's attorney.^{5/} In any such case, rule 3-310(F)^{6/} makes clear that the third-party must not be allowed to interfere with the client-lawyer relationship, or have access to confidential information. Rule 3-310(F) does not answer the question of what happens to surplus funds when the case ends.

Three state bar ethics committees have opined on this question. The Maryland State Bar Committee on Ethics said in Opinion 2001-6: "absent agreement to the contrary, once the retainer check was made payable to you and deposited in your escrow account as a retainer for your handling the representation, that you were accountable to your client for those funds and not to the client's mother." They went on to say: "the only person who could demand the return of any funds would be the client." The North Carolina State Bar, in 2005 Formal Ethics Opinion 12, analyzed it this way: "The lawyer understands that the legal fees were paid by a third-party for the purpose of Client's representation. See ABA Model Rule 1.8(f).^{7/} The unearned funds held in trust belong to the third-party, not the client. In the event the payor wants the funds returned, Lawyer is obliged to do so." South Carolina Formal Opinion 02-07 provides the fullest analysis of the issue. It states: "The present case may be reduced to the question of which individual is 'entitled to receive' the funds at issue – client or his brother, the third-party payor. The comments to ABA Model Rule 1.15 acknowledge that a third-party may have just claims against property in a lawyer's custody.... In addition, a lawyer must balance this duty to third parties with the duty of loyalty owed to his client." After analyzing ABA Model Rule 1.15 and its comments, the South Carolina Ethics Advisory Committee concluded: "The lawyer should retain the disputed fees in trust until the parties reach an agreement resolving the dispute or an appropriate court determines the rights of the parties."

In California, rule 4-100(B)(4) requires an attorney to "[p]romptly pay or deliver, as requested by the client, any funds . . . in the possession of the member which the client is entitled to receive." [Emphasis added.] This raises the question of whether the client is entitled to receive the money.

This Committee, in Cal. State Bar Formal Opn. No. 2008-175, held that rule 4-100(B)(4), although it refers to the duty to deliver funds to the client, also includes the duty to deliver funds to a third-party who is entitled to receive them. Rule 3-700(D)(2) requires an attorney, at the end of the matter, to "[p]romptly refund any part of a fee paid in advance that has not been earned." [Emphasis added.] The rules do not define "refund." The dictionary defines it as "to return (money) in restitution, repayment, or balancing of accounts."^{8/} [Emphasis added.] The concept of a refund implies that the money is returned to its source, in this case the third-party payor. We conclude that, absent a fee agreement spelling out the disposition of the surplus funds, the money should be returned to the payor.

^{5/} This opinion only addresses the situation where the paying party is not a party to the action. Also it does not address payment by an insurer, payment by a parent for a minor child, or third-party financing of matters, where the third party is loaning money to the attorney or client, rather than paying the funds.

^{6/} Rule 3-310(F) states: A member shall not accept compensation for representing a client from one other than the client unless:

- (1) There is no interference with the member's independence of professional judgment or with the client-lawyer relationship; and
- (2) Information relating to representation of the client is protected as required by Business and Professions Code section 6068, subdivision (e); and
- (3) The member obtains the client's informed written consent, provided that no disclosure or consent is required if:
 - (a) such nondisclosure is otherwise authorized by law; or
 - (b) the member is rendering legal services on behalf of any public agency which provides legal services to other public agencies or the public.

^{7/} The ABA Model Rules are not binding in California but may be used for guidance by lawyers where there is no direct California authority and the ABA Model Rules do no conflict with California policy.

^{8/} See <http://www.merriam-webster.com/dictionary/refund>.

Under our hypothetical, the client asked that the balance in the trust account be paid to her. The California Supreme Court discussed a similar issue in *Johnstone v. State Bar* (1966) 64 Cal.2d 153, 155-156 [49 Cal.Rptr. 97]. The court looked at what an attorney does when receiving funds in a settlement that are subject to a third-party lien. The court held that the attorney receiving funds holds the funds as a fiduciary for that third-party. (“When an attorney receives money on behalf of a third-party who is not his client, he nevertheless is a fiduciary as to such third-party. Thus the funds in his possession are impressed with a trust, and his conversion of such funds is a breach of the trust.” (*Johnstone*, at pp. 155-156.)) See also *In the Matter of Riley* (Review Dept. 1994) 3 Cal. State Bar Ct. Rptr. 91.) While both *Johnstone* and *Riley* dealt with medical liens, the issue here is similar—funds held by the lawyer belonging to a third-party. Giving the funds to the third-party complies with this fiduciary duty, but violates the express direction of the client.^{9/} The lawyer is faced with a quandary. If he delivers the funds to the client, he can be held liable for a conversion. (*Johnstone*, at pp. 155-156.) If he gives the funds to the payor, he is violating the direct instructions of his client. Under the facts of our hypothetical, we conclude that the third-party payor is entitled to the funds, and therefore, the attorney has a fiduciary duty to advise the payor of the availability of the funds and to turn them over to her.^{10/} Cal. State Bar Formal Opn. No. 2008-175 (“An attorney cannot follow a client’s direction not to pay a lienholder from settlement proceeds because to do so would be a breach of the attorney’s fiduciary duty to the lienholder.”). Since the funds in the account belong to the payor, the attorney cannot give the money to the client.

The lawyer in this situation may have to face two additional issues: (1) what happens if the client requests that the lawyer retain the money for further services after the completion of the agreed work or the payor requests the refund before the work is completed, and (2) what happens if the payor questions the refund amount? The first question depends on the terms of the attorney-client engagement. If the engagement agreement and the rule 3-310(F) agreement with the third-party are not clear, it is a question of contract interpretation to determine the appropriate action of the lawyer. That is a legal question beyond the scope of the committee’s work.^{11/}

The second question relates to accounting for the spent funds to the payor. It is very likely that the information necessary to account for the earned fees will consist of or include confidential information. Rule 3-310(F) makes clear that the payor must not have access to information which is confidential under Business and Professions Code section 6068(e). The hours spent and the general nature of services performed, without detail, are probably not confidential information, so that much can be disclosed to Parent.^{12/} Without consent from the client, there is no way for the attorney to provide any greater detail that might reveal confidential information.

^{9/} Cf. *Virtanen v O’Connell* (2006) 140 Cal.App.4th 688 [44 Cal.Rptr.3d 702], where lawyer held property as escrow holder and had duties both to his client and to the opposing party.

^{10/} To the extent the facts are such that the payor’s entitlement to the refund is less clear than under our hypothetical facts, the lawyer may interplead the funds with the court in order to allow the court to make the determination. In any event, it would not violate the lawyer’s ethical duties to interplead the funds under any factual scenario in which he had a good faith basis for questioning the payor’s right to the surplus funds. Cal. State Bar Formal Opn. 2008-175.

^{11/} All of the problems addressed in this opinion can be prevented by the use of a carefully drafted retainer agreement or engagement letter. They also can be addressed in the Rule 3-310(F) agreement with the paying party.

^{12/} *Clarke v. American Commerce Bank* (9th Cir. 1992) 974 F.2d 127, interpreting federal common law, held that as long as there was no disclosure in the billing statement of specific research or litigation strategy, the information was not privileged. See also Los Angeles County Bar Assn. Formal Opn. No. 456 (“[Information in a lawyer’s bills to a client about time spent, expenses and fees incurred and specific work performed in connection with the lawyer’s representation of that client may be within the scope of section 6068(e). However, absent special circumstances, information in the bills indentifying the client or referring generally to the nature of the work and fee arrangement is not within the scope of section 6068(e).”).

CONCLUSION

When an attorney receives payment for fees from a third party payor, any refund of excess fees at the conclusion of the case should be paid to the payor, unless the parties have contracted a different result.

This opinion is issued by the Standing Committee on Professional Responsibility and Conduct of the State Bar of California. It is advisory only. It is not binding upon the courts, the State Bar of California, its Board of Governors, any persons, or tribunals charged with regulatory responsibilities, or any member of the State Bar.

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