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Who is entitled to fee-based sanctions awards in contingent fee cases – lawyer or client?

By SUZANNE BURKE SPENCER

Spencer

It is not uncommon in the course of civil litigation, particularly in discovery disputes, for one party to be ordered to pay another party monetary sanctions that are calculated based on the attorney's fees and costs incurred in connection with a motion or proceeding. *See, e.g.,* Cal. Civ. Proc. Code 128.7 (frivolous pleadings), § 425.16(c) (anti-SLAPP motions), 396b(b) (venue transfer motions) and §§ 2030.300(d), 2031.320(b), 2033.290(d) (discovery motions). In hourly fee litigation cases, where the client is obligated to pay the attorney based on the hours worked, ownership of a fees-based sanction award is relatively straightforward. The sanctions award would belong to the client, if the client had already paid for the fees awarded, and to the attorney, if the hours had been incurred but not yet paid by the client. See L.A. County 'n Prof. Resp. and Ethics Comm., Opin. No. 515 (August 15, 2005).

In a contingent fee case, however, where the attorney is not paid a fee unless and until the client ultimately prevails in the case, the ownership of fees-based sanctions awards is far less clear. May the attorney keep the sanctions as compensation in addition to his or her contingent fee? Must the attorney treat the sanctions award as a recovery in the case, such that she may keep only her contingent fee percentage of the sanctions awarded? May the attorney ethically preempt this issue by including language in the fee agreement that specifies ownership of such awards? If so, what ethical limitations exist? How should an attorney handle a dispute with her client over ownership of the funds? This article explores the answers to these questions.

In the absence of an agreement, are fees-based sanctions awards part of the client's recovery or do they belong to the lawyer?

In contingent fee cases, an attorney does not earn a fee and a client does not incur an obligation to pay unless and until the contingency occurs. Thus, a contingent fee client does not technically "incur" additional fees as the result of an opposing party's conduct in the litigation. Nonetheless, courts have held in a variety of contexts that statutes permitting a party to recover the reasonable attorneys' fees incurred in making or opposing a motion apply in contingent fee representation. *See, e.g., Ketchum v. Moses,* 24 Cal.4th 1122 (2001) (contingency fee lawyer awarded fees under SLAPP statute); *In re Marriage of Adams,* 52 Cal.App.4th 911 (1997) (affirming award of sanctions for frivolous and delaying tactics to contingency fee lawyers); *see also Do v. Superior Court,* 109 Cal.App.4th 1210 (2003) (permitting fee award as discovery sanction where counsel represented client pro bono). This is because "[m]odern jurisprudence does not require a litigant seeking an attorney fee award to have actually incurred the fees." *Moran v. Oso Valley Greenbelt Ass'n*, 117 Cal.App.4th 1029, 1036 (2004). However, the right to seek an award is not the same as the right to retain the award. *Id.*

A contingent fee attorney, then, may contend that the fee award belongs to the attorney because it results from the attorney's industry and effort and is not reimbursement for any amount incurred by the client. The client, on the other hand, may reasonably contend that such awards belong to the client because sanctions are generally awarded to the prevailing *party* (*i.e.* the *client*), not to the attorney, who is not a party to the case. Moreover, contingent fees are generally calculated as a percentage of the client's "recovery." It is not unreasonable to interpret the term "recovery" to encompass all sums received by the client as a result of the litigation, which would include sanctions awarded to the client.

Thus, it is unclear whether an amount awarded as a discovery or other sanction should be treated as recovery subject to the contingent fee split belongs exclusively to the client or belongs exclusively to the lawyer. See, e.g., Rylaarsdam, et al., Cal. Prac. Guide: Civ. Proc. Before Trial, ¶ 1:360-360.1 (The Rutter

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1. In order to recover attorney's fees under a statute permitting a party to recover the reasonable attorneys' fees "incurred" in making or opposing a motion, the client must have actually incurred or paid a fee.

○ True ○ False

2. In an hourly fee matter, a fee-based sanctions award would belong to the lawyer, unless the client had already paid the attorney for those fees, in which case the fees awarded would properly be refunded to the client.

○ True ○ False

3. If a contingent fee agreement does not otherwise specify how an amount

awarded as a discovery or other sanction should be treated, it will be regarded as belonging to the client.

○ True ○ False

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Although the issue is undecided as to fee-based sanctions awards, some courts have addressed the ownership of certain statutory prevailing party fee awards with varying results. These cases address fee awards to the prevailing party in cases seeking to enforce statutes in the public interest. *See, e.g., Evans v. Jeff D.,* 475 U.S. 717, 731 (1986) (42 U.S.C. § 1988 fees in civil rights cases belong to client); *Flannery v. Prentice,* 26 Cal.4th 572, 590 (2001) (statutory fees in FEHA discrimination case belong to attorney in absence of contrary agreement); *Henry M. Lee Law Corp. v. Superior Court,* 204 Cal.App.4th 1375, 1388 (2012) (Labor Code wage and hour statutory fees belong to *attorney* absent contrary contract).

Although attorneys may be tempted to extend the reasoning of cases like *Flannery* and *Lee*, finding prevailing party statutory fee awards belong to the attorney in the absence of a contrary agreement, the application of those cases to fee-based sanctions awards is likely limited. Among other things, unlike the attorney fee statutes enacted to encourage attorneys to take meritorious anti-discrimination cases and to prosecute similar statutory protections for the public, discovery-type sanctions statutes are designed to "prevent abuse of the discovery process and correct the problem presented [citations]." *Do v. Superior Court,* 109 Cal.App.4th 1210, 1213 (2003); *Mileikowsky v. Tenet Healthsystem*, 128 Cal.App.4th 262, 279-80 (2005) (fee-shifting provisions of the Discovery Act are intended to simply "produce compliance with the discovery rules"). That purpose is achieved regardless of whether the sanctions award belongs to the lawyer or client. As long as the opposing party is required to pay the sanction to someone, the purpose is achieved. Thus, the public policy considerations upon which the *Flannery* and *Lee* decisions were based are not present in the context of fees-based sanctions award statutes.

Reliance on these cases to justify retention of sanctions awards over a client's objection, then, may cause the attorney to breach ethical duties, including the duty to turn over promptly to a client all client funds in the attorney's possession. See Cal. Rule of Prof. Conduct 4-100(B)(4) (a lawyer must "[p]romptly pay or deliver, as requested by the client, any funds, securities, or other properties in the possession of the member which the client is entitled to receive"). Moreover, the client must be promptly notified when the lawyer receives client funds. Rule of Prof. Conduct 4-100(B)(1). The payment of such funds by the opposing party is also likely a significant development which the lawyer is ethically bound to communicate to the client. Rule of Prof. Conduct 3-500; Bus. & Prof. Code § 6068(m). An attorney receiving sanctions funds must comply with these rules and attempt, if possible, to reach an agreement with the client as to how the funds should be distributed. Any such agreement reached after the attorney-client relationship has been created must be fair and reasonable and fully disclosed in writing to the client, the client must be advised in writing of the right to seek the advice of independent counsel and be given a reasonable opportunity to do so and the client must thereafter consent in writing to the terms of the agreement. Rule of Prof. Conduct 3-300.

Ethical limitations on contractual provisions concerning ownership of fee-based sanctions awards

It appears that lawyers may deal with this situation in advance by including in their contingency fee representation agreements a provision that specifies how sanctions awards will be allocated between the lawyer and the client. However, it is important to understand the ethical rules that apply.

First, any such provision should clearly and unambiguously provide how attorney's fee awards will be treated and how such awards will affect the total fee owed under the contract. Fee agreements must be "fair, reasonable and fully explained to the client" and will be "strictly construed against the attorney." *Alderman v. Hamilton*, 205 Cal.App.3d 1033 (1988). A contingent fee agreement may specify that sanctions awards will belong exclusively to counsel to compensate for the additional effort resulting from the opposing party's sanctionable conduct. For example, the agreement could provide "in the event that the court orders another party or person to pay an award of sanctions that is based on the reasonable attorney's fees incurred, Attorney shall retain the entire award as compensation for the additional services required in the matters which led to the sanctions award. The sanctions awarded and retained by Attorney shall be in addition to any contingent fee otherwise earned under this agreement." Alternatively, the agreement may state that such sanction awards shall be applied against the client's contingent fee obligation. *See Denton v. Smith*, 101 Cal.App.2d 841, 844 (1951). Or the agreement may specify that such awards belong exclusively to the client or, alternatively, will be split with the client as a recovery subject to the attorney's contingent fee percentage.

Second, if the fee agreement provides for an outright assignment by the client to the attorney of any right to seek or recover fee-based sanctions awards, an argument may be made that compliance with Rule 3-300 (governing business transactions with a client) is required. *See Matter of Yagman*, 3 Cal. State Bar Ct. Rptr. 788 (Rev. Dep't 1997) (assignment to attorney of client's right to attorney's fees in civil rights case would not be improper "at least, when it is made in accordance with rule 3–300"). A provision that such awards will be split with the client as part of the recovery, however, would not appear to violate to Rule 2-200 (prohibiting splitting fees with non-lawyers) because the policies behind that rule are not implicated in the arm's-length negotiation of such a fee arrangement. *See* L.A. County Bar Ass'n Prof. Resp. and Ethics Comm., Opinion No. 523 (June 15, 2009).

Finally, as with any other fee provision, the provision will be subject to the attorney's ethical obligations not to collect or even attempt to collect an unconscionable fee. Cal. Rule of Prof. Conduct 4-200. Even if a fee does not rise to the level of unconscionability it may nevertheless be unenforceable as an unreasonable fee. *See Bird, Marella, Boxer & Wolpert v. Superior Court,* 106 Cal.App.4th 419, 430-31 (2003) (No fee agreement 'is valid and enforceable without regard to considerations of good conscience, fair dealing, and . . . the eventual effect on the cost to the client.'" (quoting *Altschul v. Sayble,* 83 Cal.App.3d 153, 162 (1978)); *Cazares v. Saenz,* 208 Cal.App.3d 279, 287 (1989); *see also* ABA Model Rule 1.5(a).

In other words, while there may be nothing *per se* improper about a provision providing that the attorney will receive both a contingent fee and any additional amounts awarded as sanctions, the contract terms cannot be rigidly applied. If, in application, the provision would result in an unethical or unreasonable fee, the attorney may be required to adjust the fee. "Unconscionability of a fee shall be determined on the basis of all the facts and circumstances existing at the time the agreement is entered into *except where the parties contemplate that the fee will be affected by later events*." Rule of Prof. Conduct 4-200(B). Where the contract contemplates the occurrence of later events – such as a recovery in the case or the award of sanctions – the conscionability of the fee is determined when the later event occurs. Thus, the conscionability of a contingent fee will be determined when the contingency occurs and the fee is taken. *See Matter of Yagman,* 3 Cal. State Bar Ct. Rptr. 788, 800 (Rev. Dep't 1997).

Whether a fee is unconscionable or unreasonable depends on many factors, including "[t]he amount of fee in proportion to the value of the services performed," the relative sophistication of the attorney and client, the novelty of issues and skill necessary to perform the legal services, the amount involved and results achieved, whether the fee is fixed or contingent, the time and effort expended, the

client's informed consent to the fee and other factors. Rule 4-200(B).

Thus, even if the fee agreement permits the attorney to retain as a fee all sanctions awards, if the total of the sanctions actually retained plus the full contingent fee is unreasonable or unconscionable in the context of the case, the attorney would be required to reduce the total fee. In *Matter of Yagman,* 3 Cal. State Bar Ct. Rptr. 788 (Rev. Dep't 1997), for example, a contingent fee contract provided that the attorney would be paid any statutory attorney fee award and 45 percent of the client's gross recovery. Although not unconscionable on its face, in application the fee provision yielded payment of $810 to each of the four clients and over $400,000 to the attorney in fees and costs. The fee was found unconscionable. *Id.*; *see also Tarver v. State Bar*, 37 Cal.3d 122, 134 (1984) (attorney fee found unconscionable where the alleged contract fee exceeded by $35,000 the amount awarded as a reasonable fee by the court). *Matter of Yagman* and *Tarver* involved a statutory prevailing party fee award subject to the court's determination of reasonableness, but the rule prohibiting unconscionable or unreasonable fees would apply equally to any fee arrangement.

Resolving disputes with clients over ownership of sanctions

Where the fee agreement does not expressly and unambiguously address who is entitled to receive amounts awarded to the client under sanctions statutes, disputes may arise between the client and attorney, each asserting entitlement to the award. Rule 4-100(B)(4) requires the attorney to promptly disburse to the client upon request any funds the client is "entitled to receive." Where the attorney disputes the client's entitlement to the funds, the attorney is required to deposit the sanctions funds into the client trust account and release to the client any portion not disputed. *See* Rule of Prof. Conduct 4-100(A)(2); *Friedman v. State Bar,* 50 Cal.3d 235, 240–241 (1990). The attorney must then take prompt, substantive steps to resolve the dispute. *See Matter of Kroff,* 3 Cal. State Bar Ct. Rptr. 838, 853–854 (Rev. Dept. 1998) ("the attorney violates rule 4–100(B)(4) if he or she does not promptly take appropriate, substantive steps to resolve the dispute in order to disburse the funds.").

In considering the attorney's entitlement to the funds, the attorney should be mindful that a genuine dispute over who is entitled to ownership of the funds is likely the result of an ambiguity in the fee agreement, which ambiguity will be interpreted against the attorney and in favor of the client. *Boardman v. Christin,* 65 Cal.App. 413, 418-419 (1924); *Hollingsworth v. Lewis,* 93 Cal.App. 526 (1928).

Finally and significantly, if the dispute over ownership of the funds arises while the case is still ongoing such that the attorney's personal interests conflict with his client's, the attorney may be required to withdraw from the representation.

Conclusion

In the absence of an agreement to the contrary, the ownership of fees-based sanctions awards in contingent fee arrangements is an open issue in California. To avoid a dispute or potential ethical violations, contingency fee agreements should clearly and unambiguously provide who such awards will belong to and how the awards will affect the total fee owed by the client under the contract. While a contract providing that an attorney may collect both a contingent fee and any amounts awarded as sanctions may not be per se improper, if in application the agreement yields an unconscionable or unreasonable fee, the lawyer may not collect it and must adjust the total fee to ensure that it is fair and reasonable to the client.

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