

RESOLUTION 10-02-04

DIGEST

Attorneys Fees: Attorneys Liens

Adds Civil Code section 3090 et. seq. creating attorneys' liens statutes.

RESOLUTIONS COMMITTEE RECOMMENDATION

DISAPPROVE

History:

No similar resolutions found.

Reasons:

This resolution adds Civil Code section 3090 et. seq. creating attorneys' liens statutes. This resolution should be disapproved because the lien is incompatible with an attorney's fiduciary duties to clients.

The proposed statutes would permit an attorney to encumber the papers, personal property and money of the client for services rendered and permit an attorney to retain the client's property until the lien is satisfied. Under California Rules of Professional Conduct Rule 3-700(D)(1) an attorney who has been terminated is obliged to "promptly release to the client, at the request of the client, all the client papers and property." This duty applies regardless of whether the client has paid for the property or not. Also, under the ABA Model Rules, DR 2-110 (A)(2), an attorney is not permitted to withdraw from representation until she has taken reasonable steps to avoid foreseeable prejudice to the rights of the client, including delivery of all papers and property to the client. Hence, the lien statutes may hinder clients from discharging attorneys and obtaining new counsel. Effective representation of clients will be harmed should new counsel not have ready access to deposition transcripts, discovery and litigation files. This resolution is similar to A.B. No. 2336, which has been referred to the Judiciary Committee as of March 18, 2004.

TEXT OF RESOLUTION

RESOLVED that the Conference of Delegates of California Bar Associations recommends that legislation be sponsored to add Civil Code Title 14, chapter 9, section 3090 et seq. to read as follows:

1 §3090

2 An attorney has a lien for compensation whether specially agreed upon or implied,
3 upon all papers, personal property and money of the client in the possession of the attorney
4 for services rendered to the client. The attorney may retain the papers, personal property
5 and money until the lien created by this Chapter, and the claim based thereon, is satisfied,
6 and the attorney may apply the money retained to the satisfaction of the lien and claim.

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8 §3091

9 (a) The owner of papers or personal property subject to a lien created by Section
10 3090, or any other interested person, may file with the recording officer of the county in
11 which the attorney has the principal office of the attorney a bond executed by a corporation
12 authorized to issue surety bonds in the State of California to the effect that the owner of the
13 papers and personal property against which the lien is claimed shall pay the amount of the
14 claim and all costs which are awarded against the papers and personal property on account
15 of the lien. The bond shall be in an amount not less than 150 percent of the amount
16 claimed under the lien, and must be filed prior to the commencement of a foreclosure
17 proceeding by the attorney.

18 (b)(1) In lieu of the surety bond provided for in subsection (a) of this section, a
19 person may deposit with the treasurer of the county in which the attorney has the principal
20 office of the attorney an irrevocable letter of credit issued by an insured institution, as
21 defined in Financial Code Section 10010, or a sum of money or its equivalent equal in
22 value to 150 percent of the amount claimed under the lien.

23 (2) When a person deposits money or an irrevocable letter of credit with the
24 treasurer of a county under this subsection, the person shall file with the recording officer
25 of the same county an affidavit stating that the deposit was made.

26 (c) When a bond is filed under subsection (a) of this section or money or an
27 irrevocable letter of credit deposited and an affidavit filed under subsection (b) of this
28 section, the recording officer shall issue to the owner or other person a certificate stating
29 that the bond, irrevocable letter of credit or money is substituted for the chattel and that the
30 lien on the chattel is discharged.

31 (d) When a bond is filed under subsection (a) of this section, or money or an
32 irrevocable letter of credit is deposited under subsection (b) of this section, the owner or
33 other person filing the bond or depositing the money shall promptly send a copy of the
34 certificate received from the recording officer under subsection (c) of this section to the
35 attorney by registered or certified mail.

36 (e) If the attorney establishes the validity of the lien claim by a suit to enforce it,
37 the attorney is entitled to judgment or decree against the sureties upon the bond, against
38 the irrevocable letter of credit issuer or against the deposited money.

39 §3012

40 If an attorney considers the bond filed with a recording officer or the irrevocable
41 letter of credit deposited with the treasurer of a county inadequate to protect the claim of
42 the attorney for lien for some reason other than the amount of the bond or irrevocable letter
43 of credit, the attorney shall, within 10 days of receipt of the notice of filing, petition the
44 court in which the suit to foreclose the lien may be brought for a determination of the
45 adequacy of the bond or irrevocable letter of credit. The attorney shall state in detail the
46 reasons for the inadequacy. If the court determines that the bond is inadequate for one or
47 more of the reasons stated by the attorney, the court shall order such action as shall make
48 the bond or irrevocable letter of credit adequate to protect the claim for lien.

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50 §3013

51 An attorney has a lien upon actions, suits and proceedings after the commencement
52 thereof, and judgments, decrees, orders and awards entered therein in the client's favor and
53 the proceeds thereof to the extent of fees and compensation specially agreed upon with the
54 client, or if there is no agreement, for the reasonable value of the services of the attorney.

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§3014

(a) When an attorney claims a lien under Section 3013, if the judgment or decree is for a sum of money only, the attorney must file a notice of claim of lien with the clerk of the court that issues the judgment or decree within three years after the judgment or decree is given. The clerk shall enter the notice in the records of the action or suit and shall also make a note of the filing of the notice in the judgment docket of the court.

(b) When an attorney files a notice of claim of lien under subsection (a) of this section, the attorney shall send forthwith a copy of the notice to the client by registered or certified mail sent to the client at the last-known address of the client.

(c) A lien under Section 3013 on a judgment or decree for a sum of money only remains a lien on that judgment or decree for as long as the judgment or decree remains valid under Civil Code Section 2911 or 2913.

(d) For purposes of this section, a "judgment or decree for a sum of money only" does not include a decree or order for the payment of money for the support of any person under relevant provisions of the California Family Code.

§3015

(a) When an attorney claims a lien under Section 3013, if the judgment or decree is for the possession, award or transfer of personal property, the attorney must file a notice of claim of lien not later than one year after entry of the final judgment or decree and disposition of any appeal thereof. The notice shall be filed with the recording officer of the county in which the judgment or decree is rendered, with the recording officer of the county, if known, in which the personal property is located and with the recording officer of the county, if known, in which the attorney's client resides. The recording officer of a county shall record the notices filed under this section in a book called "index of liens upon chattels."

(b) Except as provided in subsection (c) of this section, a lien under Section 3013 on a judgment or decree for the possession, award or transfer of personal property must be foreclosed not later than one year after the notice of claim of lien is filed under subsection (a) of this section.

(c) An attorney and the client of the attorney may, by an agreement in writing, extend the period of time within which a lien created by Section 3013 must be foreclosed to two years after the notice of claim of lien is filed. An agreement to extend a foreclosure period under this subsection shall contain the time and place of the filing of the notice of claim of lien by the attorney and shall be filed with the recording officer with whom the notice of claim of lien was filed.

§3016

(a) When an attorney claims a lien under Section 3013, if the judgment or decree is for the possession, award or conveyance of real property, the attorney must file a notice of claim of lien not later than six months after entry of the final judgment or decree and disposition of any appeal thereof. The notice shall be filed with the recording officer of the county in which the real property, or any part of it, is situated. The recording officer of a county shall record the notices filed under this section in a book that shall be indexed in the same manner as the record of deeds and mortgages.

101 (b) Except as provided in subsection (c) of this section, a lien under Section 3013
102 upon a judgment or decree for the possession, award or conveyance of real property must
103 be foreclosed not later than one year after the notice of claim of lien is filed under
104 subsection (a) of this section.

105 (c) An attorney and the client of the attorney may, by agreement, in writing, extend
106 the period of time within which a lien created by Section 3013 must be foreclosed to two
107 years after the notice of claim of lien is filed. An agreement to extend a foreclosure period
108 under this subsection shall contain the time and place of the filing of the notice of claim of
109 lien by the attorney and shall be filed with the recording officer with whom the notice of
110 claim of lien was filed.

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112 §3017

113 If the notice of claim of lien is not filed within the time required, the lien created by
114 Section 3013 shall cease to exist.

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116 §3018

117 The notice of claim of lien required under Sections 3014 and 3015 shall be a
118 statement in writing verified by the oath of the attorney and must contain:

119 (a) A statement of the attorney's demand, including the amount of the fee or
120 compensation of the attorney;

121 (b) The citation to the book, volume and page of the judgment docket wherein is
122 entered the judgment or decree upon which the attorney claims a lien and a description of
123 the real or personal property which is to be awarded, transferred or conveyed to the client
124 under the judgment or decree;

125 (c) A statement that the amount claimed is a true and bona fide existing debt as of
126 the date of the filing of the notice of claim of lien; and

127 (d) The date on which payment was due to the attorney for professional services to
128 the client.

129
130 §3010

131 (a) Except as provided in subsections (c) and (d) of this section, the lien created by
132 Section 3013 is not affected by a settlement between the parties to the action, suit or
133 proceeding before or after judgment, decree, order or award.

134 (b) Except as provided in subsections (c) and (d) of this section, a party to the
135 action, suit or proceeding, or any other person, does not have the right to satisfy the lien
136 created by Section 3013 or any judgment, decree, order or award entered in the action, suit
137 or proceeding until the lien, and claim of the attorney for fees based thereon, is satisfied in
138 full.

139 (c) A judgment debtor may pay the full amount of a judgment or decree into court
140 and the clerk of the court shall thereupon fully satisfy the judgment or decree on the record
141 and the judgment debtor shall be thereby released from any further claims thereunder.

142 (d) If more than one attorney appears of record for a litigant, the satisfaction of the
143 lien created by Section 3013 by any one of the attorneys is conclusive evidence that the
144 lien is fully satisfied.

145
146 §3011

147 Attorneys have the same right and power over actions, suits, proceedings,
148 judgments, decrees, orders and awards to enforce their liens as their clients have for the
149 amount due thereon to them.

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151 §3012

152 In suits to foreclose a lien created by Section 3013, the court shall allow a
153 reasonable amount as attorney fees at trial and on appeal to the prevailing party.

154
155 §3013

156 (a) Except for tax liens, prior encumbrances and prior liens of record on the real or
157 personal property subject to the lien created by Section 3013, the lien created by Section
158 3013 is superior to all other liens.

159 (b) When the lien of an attorney created under Section 3013 attaches to a judgment
160 or decree allowing or enforcing a client's lien, the attorney's lien has the same priority as
161 the client's lien with regard to personal or real property subject to the client's lien.

(Proposed new language underlined; language to be deleted stricken.)

PROPONENT: Beverly Hills Bar Association

STATEMENT OF REASONS

Existing Law: There is currently no law authorizing the creation of an attorney's lien relative to the rendering of legal services.

This Resolution: Would create an Attorney Lien set of statutes, modeled after the Oregon Revised Statutes.

The Problem: The problem created by California not having an attorney lien statute is one of federal and state income taxation. Currently, a successful plaintiff in a personal injury civil action who receives both compensatory damages and punitive damages is placed in an unfair position vis a vis the Internal Revenue Code. Under the Internal Revenue Code ("IRC") the full amount of the award is required to be taken into income in computing the plaintiff's income tax liability. When the plaintiff pays his or her legal bill (presumably a contingent fee on a percentage basis) the amount so paid is generally not deductible under IRC §162 or 212. However, the amount paid is gross income to the attorney who performed the services. Thus, a plaintiff receiving a punitive damage award of \$600,000 may pay the attorney \$200,000 for legal services. From a tax perspective, the entire \$600,000 is included in the plaintiff's gross income and there is no deduction for the \$200,000 paid to the attorney. At the same time, the \$200,000 is also gross income to the recipient attorney. This means that a total of \$800,000 is subject to tax when only \$600,000 was actually paid.

The recent case of *Sigitas Banaitis v. Commissioner of Internal Revenue* (9th Cir. 2003) 340 F.3d 1074, held that when attorney's fees are paid directly to the law firm that successfully represented the plaintiff, the unique features of Oregon attorney's lien law resulted in the portion paid to the attorneys not being included in the plaintiff's income. Thus, in the example given

above, the plaintiff received \$400,000 and the attorney \$200,000, and were thereafter taxed accordingly.

The proposed change is intended to create a similar attorney's lien in California in order to achieve both federal and California tax equity for California plaintiffs.

IMPACT STATEMENT

This resolution does not affect any other law, statute or rule.

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COUNTERARGUMENTS

CONTRA COSTA COUNTY BAR ASSOCIATION

This resolution creates more problems for the practitioner than it solves. First, the attorney lien created by this resolution could likely qualify as an "adverse interest," as defined by California Rules of Professional Conduct – Rule 3-300, if it were created as part of a modification of an existing fee arrangement (e.g., an oral fee agreement for existing client that is later memorialized in a writing, or an hourly fee arrangement that is modified to a contingency fee agreement.) If so, this would require written disclosure and an adequate opportunity for the client to receive independent legal advice as to the liens possible consequences. Second, the lien on "all papers, personal property and money of the client in the possession of the attorney" created by this resolution would only reinforce the public's already negative view of lawyers as being primarily motivated by their own pecuniary interests, rather than the interest of their clients. Third, if the resolution's primary goal is to "achieve both federal and California tax equity for California plaintiffs" perhaps proposing amendments to the California Revenue & Taxation Code and the Internal Revenue Code would be more appropriate.

ORANGE COUNTY BAR ASSOCIATION

This resolution proposes to enact, in California, an Oregon attorney's lien statute (O.R.S. §87.430 et seq) which in effect grants the attorney an ownership interest in the client's cause of action and any related recovery. In fact, the proposed lien statute seems to have broader application, i.e.: "an attorney has a lien for compensation, whether specifically agreed upon or implied, upon all papers, personal property and money of the client, in the possession of the attorney for services rendered to the client. The attorney may retain the papers, personal property and money until the lien created by this section, and the claim based thereon, is satisfied, and the attorney may apply the money retained to the satisfaction of the lien and claim." (O.R.S. §87.430)

The stated purpose of the proposed attorney lien statute is to provide a basis for the deductibility of attorney's fees by a personal injury plaintiff who has received a damage award. The resolution is prompted by a recent decision of the Court of Appeals for the Ninth Circuit -

Segitas Banaitis v. Commissioner of Internal Revenue (9th Circuit 2003) 340 F 3d 1074. In the Banaitis case, the IRS and the Tax Court, both held the contingent fee received by plaintiff's attorneys was not deductible, for income tax purposes, for the award received by plaintiff Banaitis. Thus, for example, if a plaintiff recovers \$1,000,000 and a 40% contingency fee is paid to the attorneys, the plaintiff, nevertheless, is taxed on the full \$1,000,000 recovery. In addition, of course, the attorneys must report the contingent fee as income.

However, the Ninth Circuit Court of Appeals in *Banaitis* reversed the tax court as to the deductibility of the attorney's fees from the award received by plaintiff. The Ninth Circuit allowed the deduction, holding that "unique features" of the Oregon attorney lien statute conferred more than a lien in favor of the attorneys, but, in effect, a property/ownership interest in any judgment or settlement which, for example, would give the attorneys a right of action, similar to that of their clients, to enforce a judgment to collect the amount of fees due the attorneys. The Court distinguished the attorney lien provisions of other jurisdictions, including California, whose laws do not vest attorneys with such extensive rights.

The proposed statutory scheme may be moot for its stated purpose and seems over-broad, if not violative of the California Rules of Professional Conduct.

The tax objective of the proposed resolution may become moot as the Supreme Court has granted certiorari to the IRS in the *Banaitis* case (3/29/04). The principal basis for the grant of certiorari is that a conflict exists among the various courts of appeal, some of which have held that sums paid as attorney's fees pursuant to contingent fee agreements are included the client's gross income regardless of the nature of the attorney's rights under state law. E.g., *Young v Commissoner* (4th Cir. 2001) 240 F 3d 369, 378.

In California, an attorney's fee agreement may provide for the creation of a lien on any recovery obtained by the attorney for the client. However, any such arrangements must be fair and reasonable and, after advice to secure independent counsel (CA Rules Prof. Conduct, Rule 3-300). Enforcement of the lien ultimately must be by an independent action to establish the existence of the lien, the amount due the attorney and the right to enforce the lien. *Carroll v Interstate Brands Corp* (2002) 99 Cal App. 4th 1168,1173.

In California, a lien on the files of a client has been held to be void as contrary to public policy *Academy of Calif. Optometrists v Sup. Ct.* (1975) 51 Cal App. 3rd 999, 1006. Similarly, the lien on all papers and personal property of the client in possession of the attorney, as provided in the Oregon statute, seems to be contrary to the letter and spirit of California Rules of Professional Conduct, Rules 3-700 and 4-100 which require release to the client, upon request, of papers and property of the client.

SANTA CLARA COUNTY BAR ASSOCIATION

The income tax problem this resolution addresses is serious, but the proposed solution is worse. Strong public policy in California, expressed in Rules of Professional Conduct, Rule 4-100, requires attorneys to return to their clients, upon request, all funds and property to which the clients are entitled. This policy is grounded in part in the necessity that clients trust their attorneys. If attorneys are allowed to hold client documents and funds hostage for the payment of disputed fees, or to exercise self-help by applying client funds to the payment of fees, such

trust, and the effective administration of justice, will be seriously undermined. Attorneys cannot effectively advance their clients' interests if the clients are reluctant to provide them with important documents such as wills, insurance policies, and potential documentary evidence.

Attorney self-help with respect to client funds gives attorneys an unfair advantage over clients in cases of bona fide disputes over fees. Some clients cannot afford to post a bond to obtain the release of their funds.

SAN DIEGO COUNTY BAR ASSOCIATION

A problem does seem to exist as it relates to the Minimum Alternative tax in that a tax payer may, under certain circumstances be taxed on the full amount of a verdict he or she recovers without being able to claim as a deduction the contingency fee paid to the attorney. However, creating an entire body of law granting extensive lien rights to lawyers seems to be more cure than is necessary and may prove onerous to clients who are subject to disputed or bad faith lien claims. It may also conflict with many of the fee dispute mechanisms already in place in California. In short, there must be a better way to solve this problem.