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ASSERTION OF ATTORNEY'S CHARGING LIEN/ SECURITY INTEREST IN PROPERTY

Adopted January 19, 2002.

Amended May 19, 2002.

Scope

This opinion discusses the situations when it is permissible to assert a charging lien, the limitations on asserting such liens, and the ethical requirements for taking a security interest in client property.¹

Syllabus

A lawyer may ethically assert a charging lien for payment of legal services the lawyer has rendered, against property or funds the lawyer has assisted or is assisting the client to obtain. Colo. RPC 1.8(j) and C.R.S. § 12-5-119 (2001). A lawyer may take a security interest in client property for payment of fees so long as the lawyer complies with Colo. RPC 1.8(a).

Discussion

Charging Liens

Colo. RPC 1.8(j) prohibits a lawyer from acquiring a proprietary interest in a cause of action or the subject matter of litigation except that the lawyer may have a lien permitted by law in order to secure the lawyer's fees or expenses. In Colorado, the right to a charging lien arises by statute only, C.R.S. § 12-5-119 (2001), since no common law right to a lien exists. *People v. Brown*, 840 P.2d 1085 (Colo. 1992). The right to a lien accrues when the lawyer begins the representation, *In re Marriage of Berkand*, 762 P.2d 779 (Colo. App. 1988). A lawyer may ethically assert a charging lien for payment of legal services the lawyer has rendered, provided the lawyer complies with the statute.

Colo. RPC 1.8(j) provides:

A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

- (1) acquire a lien granted by law to secure the lawyer's fee or expenses; and
- (2) contract with a client for a reasonable contingent fee in a civil case.

The lien statute, C.R.S. § 12-5-119 (2001), provides in pertinent part:

All attorneys and counselors-at-law shall have a lien on any money, property, choses in action, or claims and demands in their hands, on any judgment they may have obtained or assisted in obtaining, in whole or in part, and on any and all claims and demands in suit for any fees or balance of fees due or to become due from any client. In the case of demands in suit and in the case of judgments obtained in whole or in part by any attorney, such attorney may file, with the clerk of the court wherein such cause is pending, notice of his client as lienor, setting forth specifically the agreement of compensation between such attorney and his client, which notice, duly entered of record, shall be noticed to all persons and to all parties, including the judgment creditor. . . . Such lien may be enforced by the proper civil action.

The purpose of the charging lien statute is to enable a lawyer to preserve the lawyer's right to payment and to place others on notice that the attorney is asserting an interest in property or in a judgment that is subject to the lien. Since this right arises from statute, strict compliance is required. *Telluride Real Estate Co. v. Penthouse Affiliates LLC*, 996 P.2d 151, 154 (Colo. App. 1999) (statute in derogation of common law strictly construed).

The lien is notice to third parties that the lawyer has a claim in some or all of the property that is the subject of the litigation. Once the lien is reduced to judgment, the attorney is then entitled to enforce it. *In re Marriage of Weydert*, 703 P.2d 1336 (Colo. App. 1985); *In re The Marriage of Smith*, 687 P.2d 519 (Colo. App. 1994). Until the lien is reduced to judgment, funds held by a lawyer remain the property of the client. *See People v. Gray*, 2001 Colo. Discipl. Lexis 49 (June 6, 2001). When a lawyer enforces the lien can become important to determine whether the conduct is ethical. If, for example, the lawyer attempts to enforce the lien during the pendency of the litigation, it may be necessary that the lawyer withdraw from the representation pursuant to Colo. RPC 1.16.

In the situation where a lawyer holds funds subject to a claim of a charging lien by another lawyer, it is unethical to disburse the funds without making appropriate provision for the charging lien. *People v. Egbune*, 28 Colo. Law. 129 (Colo. PDJ 1999) (lawyer suspended for disbursing funds subject to a charging lien and then failing to disclose information about the settlement to the lawyer claiming the lien). *See also* Colo. RPC 1.15, which requires an attorney to hold property separate from the attorney's property if a third party claims an interest in such property.

Although lawyers are permitted to assert a charging lien pursuant to Colo. RPC 1.8(j), that right is limited by ethical considerations. An unfounded claim of a lien or an improper assertion violates the professional responsibility rules. *See People v. Razatos*, 636 P.2d 666 (Colo. 1981), *appeal dismissed*, 455 U.S. 930, 102 S.Ct. 1415, 71 L.Ed. 2d. 639 (1982) (lawyer cannot assert charging lien against proceeds from a sale that was not the basis of the cause of action); *People v. Smith*, 830 P.2d 1003 (Colo. 1992); and *People v. Mills*, 861 P.2d 708 (Colo. 1993) (decided under DR-102(A)(5)) (lawyer cannot ethically assert a charging lien for services unrelated to the case in which the attorney is representing the client); *see also* Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility, Ethical Considerations in Attorney Liens, Formal Opinion 94-35 (Charging liens are permitted but there are ethical limitations such as not asserting a lien for more than the judgment or property obtained). Colorado courts in non disciplinary cases have held that child support is generally exempt from imposition of an attorney's lien as a matter of public policy, *see Marriage of Etcheverry and Pratt*, 921 P.2d 82 (Colo. App. 1996), which construes C.R.S. § 13-54-102.5(1).

Lawyers who do not assist in obtaining proceeds or property for a client may not assert a charging lien. For example, a charging lien would be inappropriate if asserted by a special advocate, guardian *ad litem* or a criminal defense attorney and the matter that is the subject of the representation does not involve obtaining property or proceeds for the client. Accordingly, lawyers in these situations may not ethically assert a charging lien.

Assuming an agreement for compensation between the attorney and the client exists and an action is pending, the Ethics Committee believes that it is unnecessary to comply with Colo. RPC 1.8(a) when filing a lien because the mere filing of a lien in the litigation is neither a business transaction with a client nor acquiring a security interest in the subject matter. Two other jurisdictions that have addressed this issue also concluded that Rule 1.8(a) does not apply. *See* Utah State Bar Ethics Advisory Opinion Committee Opinion No. 01-01 approved January 26, 2001 (Utah Ethics Committee concluded that Utah's Rule 1.8(a) is not applicable to the statutory lien situation); *Shapiro, Lifschitz & Schram, P.C. v. Hazard*, 24 F. Supp. 2d. 66 (D.C. 1998) (the court concludes that Rule 1.8 does not apply to the creation of an attorney's lien); *but see* Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility, Ethical Considerations in Attorney Liens, Formal Opinion 94-35 (lawyers must advise the client to obtain independent counsel and give the client the opportunity to obtain counsel before enforcing the lien).

An attorney's lien provides persons notice that the attorney claims an interest in the property; it is not commencement of a civil action pursuant to the charging lien statute. *People v. Gray*, *supra*; *In re the Marriage of Mitchell*, 2002 Colo. App. Lexis 162 (Colo.App., Feb. 14, 2002); 31 Colo.Law 153 (April 2002). Accordingly, a charging lien for fees pertaining to services rendered in that particular matter may be enforced in that matter or in a separate lawsuit; *see Gee v. Crabtree*, 192 Colo. 550, 560 P.2d 835 (1997). The attorney asserting the lien has the burden to show that the lawyer comes within the purview of the statute; *In re Mitchell*.

However, mere assertion of the lien in most situations will be insufficient to give the attorney the right to record the notice of lien against real property. The lawyer must first comply with the statutory requirements. In *People v. Smith, supra* (Colo. 1992), an attorney who represented a client in a dissolution of marriage action that he neglected, filed a notice of lien. He recorded it in the real estate records against the marital property after his services were terminated. He refused to remove the recorded lien. The court held that the charging lien statute did not authorize such recording because the attorney was not entitled to the lien in the first place. Smith violated the prior Code of Professional Responsibility, disciplinary rules, DR-102(A)(5), DR-102(A)(6), and DR5-103(A)(1), which are now Colo. RPC 8.4(d), 8.4(h), and 1.8(j).

Dolan v. Flett, 582 P.2d 694 (Colo.App. 1978), upheld an attorney's right of redemption after the attorney obtained a judgment for the client that nullified a note and deed of trust on the client's real property, and the client consented to the amount of the attorney's lien without the attorney first obtaining a judgment. *Dolan v. Flett* was decided before *People v. Smith*, a disciplinary case. Given the unresolved issues and factual distinctions between a civil case (*Dolan v. Flett, supra*) and the disciplinary case (*People v. Smith, supra*), which contains prohibitive language, attorneys should exercise care to follow the requirements of the charging lien statute prior to recording a lien.

The amount of an attorney's lien should comply with the requirements for fees as established by Colo. RPC 1.5.

Taking a Security Interest In Property Owned By The Client

Colo. RPC 1.8(a) allows lawyers to take a security interest in client property for payment of fees if the conditions set forth in the rule are met: the terms of the transaction must be fair and disclosed in writing; the client must be informed that independent counsel may be advisable; and the lawyer must obtain written consent from the client.

There are three common situations in which lawyers require security for payment of fees. The first involves the situation where a client is in need of legal services and owns property, including real property, that could be used as security for payment of legal services. The second scenario involves a client providing security for payment of the retainer. The third scenario involves a client who has failed to pay fully the outstanding bills for the legal services rendered as the matter progresses and the lawyer wishes to secure the payment of the past due legal fees by a promissory note and a deed of trust or some other security instrument.

Colo. RPC 1.8(a) provides:

A lawyer shall not enter into a business transaction with a client or *knowingly acquire* an ownership, *possessory, security or other pecuniary interest adverse* to the client unless:

- (1) The transaction terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client;
- (2) The client is informed that the use of independent counsel may be advisable and is given a reasonable opportunity to seek the advice of such independent counsel and the transaction; and
- (3) The client consents in writing thereto.

(Emphasis added).

A lawyer may require security for payment of past or future fees or for a retainer.² However, because of differing interests, conflicts between the lawyer and client can exist. Although the client is certainly interested in having the legal services rendered, the client may not understand the ramifications of providing a security interest in property the client owns or in which the client has an interest. It is the lawyer's responsibility to be certain the client has been made aware of the protections of Colo. RPC 1.8(a). Courts in other states have also required that the lawyer explain the transaction to the client and that the terms of such transaction are fair. See *Read v. State Bar*, 53 Cal.3d 394, 410, 807 P.2d 1047, 1052 (Cal. 1991), modified at 53 Cal.3d 1009a; and *Hawk v. State Bar*, 45 Cal.3d 589, 754 P.2d 1096, 247 Cal.

Rpt. 599 (1988); *see also* The Restatement of the Law Governing Lawyers, 3rd, § 43(4). Therefore, before a lawyer enters into such an arrangement, the lawyer must comply with Colo. RPC 1.8(a).

Other ethics committees have concluded that an attorney may accept a security interest for payment of fees upon compliance with Rule 1.8(a).³ *See* Connecticut Bar Association Committee on Professional Ethics, Informal Opinion 97-4, March 4, 1997 (Rule 1.8(a) is applicable to a lawyer's acquisition of a security interest taken in client property for security of a payment for fees); Los Angeles County Bar Association Professional Responsibility in Ethics Committee, Opinion No. 492 (January 26, 1998) (lawyer is required to comply with Rule 3-300 of the California Rules of Professional Conduct when accepting a security interest in real property to ensure the payment of the lawyer's fees, whether the client owns or has an interest in the property).

If a lawyer takes a security interest in property for more than the fees actually earned, *e.g.* for a retainer, the lawyer must take steps to release that portion of the security that is in excess of the earned fees. For example, when a lawyer takes a security interest against the client's real property for \$100,000 because she believes the fees for the commercial litigation matter will be that amount, the lawyer must file a partial satisfaction or otherwise credit the amounts not earned when the case is concluded or the representation is terminated, so the property is not encumbered for more than the fees actually earned.

Rule 1.7(b)

Even if the lawyer complies with Colo. RPC 1.8(a) when taking a security interest, or Colo. RPC 1.8(j) when filing a charging lien, the lawyer must also comply with the provisions of Colo. RPC 1.7. The lawyer must ensure that his or her own interest in getting paid does not have an adverse effect on the representation of the client. Colo. RPC 1.7(b). This is especially true if the attorney attempts to enforce the lien or foreclose on the security interest while the attorney is representing the client. If the lawyer's responsibilities to that client are materially limited by the lawyer's own interest, because the lawyer wants to ensure that he or she is paid, then the lawyer may have to withdraw pursuant to Colo. RPC 1.16. Lawyers have been disciplined for violating Colo. RPC 1.7(b) when a lawyer has taken property in lieu of fees. *See People v. Mason*, 938 P.2d 133 (Colo. 1997) (Obtaining a transfer of property from a client in lieu of a previously earned legal fee and then representing the client in a suit by the holder of the security interest in the transferred property violates Colo. RPC 1.8(j) and Colo. RPC 1.7(b)).

NOTES

1. This Opinion does not address attorneys' liens on property held in the name of multiple owners, some of whom are not the clients of the lawyer.

2. Normally, when a lawyer is taking a security interest, the lawyer is not taking title to or actual possession of the client's property. In those circumstances where the lawyer actually takes possession of the security, *e.g.*, stocks and bonds, then the attorney must comply with Colo. RPC 1.15 by safeguarding the property.

3. This section of the Opinion applies to security interests only; it does not apply to charging liens as permitted by C.R.S. § 12-5-119 (2001).