THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 20-0005
CONVERSION CLAUSES IN CONTINGENT FEE AGREEMENTS

ISSUES: Under what circumstances, if any, are "conversion clauses" in contingent fee agreements ethically permissible?

DIGEST: A conversion clause is a term in any contingent fee agreement, in either a litigation or transactional matter, that provides that, upon termination of the relationship or refusal to settle on terms recommended by an attorney before the happening of the contingent event, the attorney's fee may convert to an hourly rate or some other calculation other than the original contingent fee. Conversion clauses in contingent fee agreements are ethically prohibited primarily because their use improperly interferes with important client rights, including the client's right to discharge the attorney or the client's right to determine whether to settle. Conversion clauses violate an attorney's ethical duties and may constitute an agreement to charge an unconscionable fee.

AUTHORITIES INTERPRETED: Rules 1.2, 1.5, and 1.16 of the Rules of Professional Conduct of the State Bar of California.[1]

INTRODUCTION AND SCOPE

This opinion addresses the ethical permissibility of conversion clauses in contingent fee agreements. For purposes of this opinion, a conversion clause is a contractual provision that, if triggered, converts the fee due to an attorney from that contingent fee to an alternate fee arrangement that purports to entitle the attorney to a fee greater than the reasonable value of the attorney's services up to the time of discharge not calculated against the recovery actually obtained or against the services of successor counsel in relation to the recovery actually obtained.[2]

It is the view of the committee that such conversion clauses are ethically prohibited for two reasons. First, they impermissibly interfere with the client's right to discharge the attorney and second, they can impermissibly interfere with the client's right to determine whether to settle. In doing so, they can result in the charging of an amount more than the discharged attorney's right to a "reasonable fee," which is

[1] Unless otherwise indicated, all references to "rules" in this opinion will be to the Rules of Professional Conduct of the State Bar of California.

[2] This opinion is not intended to address the ethical validity or enforceability of hybrid fee agreements, which are distinct from conversation clauses and usually involve the payment of attorneys' fees in some combination of an hourly rate, flat rate, or contingency fee. For some analysis of ethical issues related to hybrid fee agreements, see Bar Association of San Francisco Formal Ethics Opn. No. 1999-1 (opining that if the client enters into the fee agreement in an arm's length transaction and agrees to the fee with informed consent, such arrangements would be permissible under rule 1.5 provided that the fee charged is not unconscionable).

not permitted by California case law and thus would constitute an agreement to charge an unconscionable fee.

DISCUSSION

A. The Client's Right to Discharge Counsel.

Both the rules and California decisional law confirm a client's absolute right to discharge his or her attorney. (Rule 1.16(a)(4); *Fracasse v. Brent* (1972) 6 Cal.3d 784 [100 Cal.Rptr. 385]; *Kroff v. Larson* (1985) 167 Cal.App.3d 857, 860 [213 Cal.Rptr. 526] [client has the absolute right at any time to discharge an attorney, with or without cause].) Conversion clauses purport to entitle an attorney in a contingent fee representation, if terminated, to an amount more than the quantum meruit value of the attorney's services up to the time of discharge (an amount that cannot be determined unless and until the contingency in fact occurs) are impermissible because they would interfere with the client's right to discharge counsel. (See *Fracasse v. Brent, supra,* 6 Cal.3d at p. 792 [improper to burden the client in contingency cases with an absolute obligation to pay the attorney regardless of outcome]; see also, Colorado State Bar Ethics Opinion 100 (1997); 64 Mercer L. Rev. 363 (2013); *Compton v. Killtelson* (2007) 171 P.3d 172 [contingent fee agreement retroactively converted to hourly fee upon discharge of attorney was unconscionable and a violation of Model Rule 1.2]; *U.S. Postal Service v. Haselrig Corp* (D. Md. 2004) 349 F.Supp.2d 955 [agreement that attempted to unlawfully penalize the client for discharge of the attorney by requiring payment of 40% contingency or flat $35,000 was unreasonable at inception].)

Some argue that conversion clauses are necessary to "protect" contingent fee attorneys from perceived bad faith termination by clients. However, established law already protects a contingent fee attorney in these circumstances under the principles of *quantum meruit*,[3] which allows a terminated contingent attorney to receive a fee commensurate with the reasonable value[4] of the services provided up to the time of discharge. As the California Supreme Court in *Fracasse* noted (in a different but related context): ". . . we find no injustice in a rule awarding a discharged attorney the reasonable value of the services he has rendered up to the time of discharge," a rule which the court noted, "preserve[s] the client's right to discharge his attorney without undue restriction, and yet acknowledge[s] the attorney's right to fair compensation for work performed." (*Fracasse v. Brent, supra,* 6 Cal.3d. at p. 791.) Conversion clauses

[3] "Quantum meruit" refers to the principle that the law implies a promise to pay for services performed under circumstances disclosing that they were not gratuitously rendered. The doctrine of *quantum meruit*, where appropriate, allows attorneys to recover the reasonable value of their services even in the absence of a valid or enforceable contract. (See *Sheppard, Mullin, Richter & Hampton, LLP v J-M Manufacturing Co., Inc*. (2018) 6 Cal.5th 59, 88 [237 Cal.Rptr.3d 424].) Although beyond the scope of this opinion, California has a well-developed body of law concerning when a discharged lawyer's conduct entitles or disentitles the lawyer to a reasonable fee (i.e., a *quantum meruit* recovery) such as where a contingent fee attorney withdraws from the case without justifiable cause (see *Rus Miliband & Smith v. Conkle & Olesten* (2003) 113 Cal.App.4th 656 [6 Cal.Rptr.3d 612]*; Hensel v. Cohen* (1984) 155 Cal.App.3d 563 [202 Cal.Rptr. 85]; *Fracasse v. Brent, supra,* 6. Cal.3d. at p. 791) or engages in certain ethical violations such as an egregious conflict of interest (see *Cal Pak Delivery, Inc. v. United Parcel Service Inc*. (1997) 52 Cal.App.4th 1 [60 Cal.Rptr.2d 207]).

[4] For further analysis of the factors involved in the determination of a reasonable fee, see State Bar of California Arbitration Advisory 1998-03 (rev. 2016).

purporting to entitle a discharged attorney to a fee more than quantum meruit operate as improper penalties rather than ethically permissible attorney protections.

In addition, because the reasonable value of the discharged attorney's services in a contingent fee matter cannot be calculated until the case terminates and the amount of recovery, if any, is known, and there is a risk that a contractually agreed formula may ultimately result in a fee greater than the reasonable value of the services provided up to the date of termination of the relationship or in a fee where no recovery ultimately is obtained. The risk creates a further impermissible disincentive to the exercise of the client's right to discharge counsel.

For these reasons, it is the view of the committee that any conversion clause that purports to entitle a discharged contingent-fee attorney to more than *quantum meruit* is ethically prohibited. Further, it is the view of the committee that a conversion clause that seeks to entitle a contingent-fee attorney to *any* fee in circumstances under which that contingent-fee attorney would otherwise be legally disentitled to recover a fee in *quantum meruit* is ethically prohibited. (See fn. 3, *supra*).

B. The Client's Right to Decide Whether or Not to Settle

An attorney is ethically required to abide by a client's decision concerning the objectives of the representation. The rules expressly extend this precept to the decision to accept or reject a settlement offer. "[A] lawyer shall abide by a client's decision whether to settle a matter." (Rule 1.2(a).) Nonetheless, some conversion clauses may be designed to "protect" an attorney against what the attorney perceives as a client's unreasonable or even bad faith decisions regarding whether to accept or reject settlement proposals contrary to the attorney's recommendation.

Such conversion clauses may purport to entitle the attorney to payment of the attorney's contingent fee percentage calculated against any settlement offer that the attorney recommends the client accept, but which the client rejects. Alternatively, some clauses entitle an attorney to the attorney's hourly rates if the client accepts a settlement offer (or walk-away agreement) that the attorney believes is insufficient.

While ethics committees of other states have approached such settlement-related conversion clauses from a variety of perspectives, all (save for one possible exception posed in a hypothetical comment from a Colorado opinion) have found conversion clauses to be ethically impermissible. (See, e.g., 64 Mercer L. Rev. 363 (2013); Wisconsin State Bar Professional Ethics Committee Formal Opinion No. E-82-5 (1982) (a contingent fee agreement that permits charging hourly fees if attorney deems a settlement offer inadequate is overreaching and unethical); Philadelphia Bar Association Ethics Opinion No. 2001-1 (majority opinion would permit conversion where there is clear advanced agreement on the goals of representation and agreement as to alternate methods of compensation if the client's goals change; the minority opinion would permit conversion clauses for sophisticated clients, not unsophisticated clients); Nebraska Ethics Advisory Opinion No. 95-1 (a provision triggered by a client not following attorney's settlement advice, which allows the attorney to choose between the contingent percentage or full hourly fee, restricts the client's authority to settle a matter).)

It is the view of the committee that the requirement imposed by rule 1.2(a), that "a lawyer shall abide by a client's decision whether to settle a matter," is clear and nonwaivable and its elimination by contract is not permitted under rule 1.2(b). (See, e.g., *Amjadi v. Brown* (2021) 68 Cal.App.5th 383 [283 Cal.Rptr.3d 448] [holding that a provision in a fee agreement purporting to grant the attorney the right to accept a settlement offer on behalf of the client in the attorney's "sole discretion" violates the rules

and is void];[5] *In the Matter of Guzman* (Review Dept. 2014) 5 Cal. State Bar Ct. Rptr. 308, 314–315 [the State Bar Court held that "[a]ttempts by an attorney to restrict a client's right to control his or her case are invalid and evidence of overreaching"].) Conversion clauses keyed to the acceptance or rejection of settlement offers thus are ethically prohibited.

CONCLUSION

It is the view of the committee that conversion clauses are ethically prohibited because they impermissibly interfere with a client's right to (1) terminate an attorney or (2) decide whether to settle, in doing so, because they can result in an agreement to charge an unconscionable fee, either facially or as applied.

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 Trustees, any persons, or tribunals charged with regulatory responsibilities, or any member of the State Bar.

[5] *Amjadi* also held that attempts by lawyers to wrest control from clients as to settlement decisions not only violate rule 1.2 but also create a conflict of interest between the lawyer and client under rule 1.7(b) whenever the client and attorney disagree about settlement.