

Balancing on the sword's edge: May an attorney acquire a mortgage over a client's home to secure a legal fee?

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OPSOMMING

Die registrasie van 'n verband deur 'n prokureur oor die eiendom van haar kliënt as sekuriteit vir regs-koste

Die meeste prokureurs is alewig in 'n stryd gewikkel om hulle fooie te verhaal van nie-betalende of onwillige kliënte. Dit blyk dat 'n toenemende aantal prokureurs noodgedwonge kontraktueel met kliënte beding om 'n verband te registreer oor hulle saaklike eiendom as sekuriteit vir regs-koste. Hierdie praktyk is belaaï met gevare vir kliënte en etiese vanggate vir prokureurs. Die professie vereis bepaalde etiese pligte en verantwoordelikhede teenoor kliënte en die hoogste moontlike graad van goeie trou word van prokureurs vereis. Teen hierdie agtergrond word die gevare verbonde aan die registrasie van 'n verband oor eiendom as sekuriteit vir die betaling van regs-koste ondersoek en die mate waartoe hierdie praktyk binne die etiese reëls van die onderskeie prokureursordes resorteer. Die benadering wat gevolg word in die Verenigde State van Amerika word ook ondersoek ter ondersteuning van die aanbeveling om hierdie praktyk uitdruklik te verbied as synde oneties en onbehoorlik.

“In matters of style, swim with the current: In matters of principle,
stand like a rock” – Thomas Jefferson

1 INTRODUCTION

Almost all attorneys in private practice, regardless of the size of their practice or area of concentration, at one time or another have the unenviable task of dealing with clients who are unwilling or unable to pay their legal fees. Of course, tough economic times, such as the current worldwide economic downturn, tend to exacerbate the bane of fee collection.

On the one hand, the practice of law is a business, and like other business people attorneys understandably want to ensure that they get paid for their work. In the case of clients who may be cash poor but balance sheet solvent, taking a mortgage, assignment or some other contractual security interest in the clients' real property may seem to offer a solution.

On the other hand, however, the practice of law is also a profession, giving rise to unique obligations and special duties owed by attorneys to their clients.

The fundamental characteristic of the relationship between attorney and client is the trust that the client places in the attorney.¹ Cognisant that she does not possess the knowledge or technical skill to act on her own, the client places herself in the hands of her attorney in the firm belief that her rights and property will be protected and that the attorney will act in her best interest. Randell and Bax² describe the relationship between an attorney and client as follows:

“The attorney must endeavour to be the ‘guide, philosopher and friend’ of his client. The client may not understand his position or know what are his rights. More probably he may not know what steps are necessary to safeguard his interests. It is the duty of the attorney to see that his client is properly protected.”

The nature of an attorney’s mandate will further determine the extent of an attorney’s authority to act on behalf of the client. It is of vital importance for the client to fully understand and comprehend the consequences of the authority granted to her attorney to register a mortgage over her real property to secure payment of legal fees. In *Bikitsha v Eastern Cape Development Board*³ it was held that “[f]or acts of great prejudice an attorney needs a special mandate . . . A general mandate does not authorise an attorney to act in a manner adverse to his client’s interests”.

There seems to be a growing trend among South African attorneys to take contractual security interests in clients’ real property to secure the payment of legal fees. This practice is fraught with danger for clients and ethical pitfalls for attorneys. The purpose of this article is to examine (i) the perils of taking a mortgage over a client’s real property to secure payment of legal fees, both from the perspective of the client and the attorney; (ii) if, and to what extent, this practice falls within the scope of proper ethical conduct generally, and pursuant to the rules and rulings of the law societies specifically; and (iii) how bar associations in the United States have addressed this practice, with particular focus on the position in New York. Lastly, we make recommendations with regard to specific guidance by the law societies to govern this practice.

2 THE PERILS

From the client’s perspective, the greatest danger is the potential for overreaching by the attorney, whether such overreaching is intentional or unintentional.⁴

1 Van Zyl *The theory of the judicial practice of South Africa* (1921) Vol 1 43 remarks that “[h]onesty’ in law, as in everything else, is always, and after all, ‘the best policy’. The law exacts from an attorney *uberrima fides* – that is, the highest possible degree of good faith. He must manifest in all business matters an inflexible regard for truth; there must be a rigorous accuracy in minutiae, a high sense of honour and incorruptible integrity; he must serve his client faithfully and diligently”. See also *Goodricke & Son v Auto-Protection Insurance Co Ltd (in liquidation)* 1967 2 SA 501 (W) 504G.

2 *The South African attorneys handbook* (1983) 111.

3 1988 3 SA 522 (E). See also Midgley “The nature and extent of a lawyer’s authority” 1994 *SALJ* 415–428; *Paramount Stores Ltd v Hendry (I)* 1957 2 SA 451 (W); *Mfaswe v Miller* (1901) 18 SC 172; *Alexander v Klitzke* 1918 EDL 87; *Estate Erasmus v Church* 1927 TPD 20; *Sussman v Testa* 1951 2 SA 226 (O); *De Vos v Calitz and De Villiers* 1916 CPD 465; *Forget v Knott* 1921 EDL 164; *Frasers Ltd v Nel* 1929 OPD 182; *Vena v Port Elizabeth Divisional Council* 1933 EDL 75; *Washaya v Washaya* 1990 4 SA 41 (ZHC); *Goosen v Van Zyl* 1980 1 SA 706 (O); *Dlamini v Minister of Law and Order* 1986 4 SA 342 (D); *Marais v City of Cape Town* 1997 3 SA 1097 (C).

4 In *Law Society of the Cape of Good Hope v Tobias* 1991 1 SA 430 (C) 435A–C it was stated that “[w]here an attorney and his fees are concerned, the word ‘overreach’ may be

A mortgage bond may contain highly technical language giving rise to significant legal obligations, readily ascertained by the attorney, but imperceptible to the unsophisticated client.⁵ The client who agrees to the mortgage for fear of being deprived of ongoing legal counsel is particularly vulnerable.

A mortgage bond over the client's home for an amount of fees that the attorney asserts is due an owing essentially converts an unestablished claim for a reasonable fee into the acknowledgement of an amount already due.⁶ Thus, the client may very well lose the ability to dispute the reasonableness of the attorney's fees.⁷

From the attorney's perspective, taking a mortgage bond over a client's real property creates an inherent conflict of interest, as the attorney acquires a security interest adverse to the client. It is beyond cavil that the mortgagee's interests differ from those of the mortgagor. It is not difficult to envision circumstances in which the mortgagor-client, at some point during the existence of the attorney-client relationship, may call into question the attorney's obligation to exercise independent professional judgment on the client's behalf.⁸

3 SOUTH AFRICA

3.1 General ethical principles

There is no rule in South Africa that explicitly prohibits the practice of taking a contractual security interest in a client's real property to secure a legal fee, and, unlike bar ethics committees in the United States, the law societies in South Africa have not directly addressed this practice. However, the fundamental principle in South Africa is that any contract between attorney and client is presumed to have been entered into under the attorney's influence and to be susceptible of attack by the client, unless the attorney is able to rebut the presumption.⁹ The attorney is in the best position to rebut the presumption by

taken as conveying the extraction by the attorney from his client, by the taking by the former of undue advantage in any form of the latter, of a fee which is unconscionable, excessive or extortionate, and in so overreaching his client that the attorney would be guilty of unprofessional conduct". See further Lewis *Legal ethics: A guide to professional conduct for South African attorneys* (1982) 12; *The Law Society Cape v Mgwigwi* 1964 3 SA 789 (E); *The Law Society of the Cape of Good Hope v Tobias* 1991 1 SA 430 (C); *Free State Agriculture and Ecotourism (Pty) Ltd v Mthembu & Mahomed* 2002 5 SA 343 (O) and *Pretoria Society of Advocates v Geach* 2011 6 SA 441 (GNP).

5 See Association of the Bar of the City of New York Committee on Professional and Judicial Ethics formal opinion 7 (1988).

6 See Claassen *Dictionary of legal words and phrases* Vol 3 (1997) M-65 in which the author states, with reference to *Lief v Dettman* 1964 3 SA 259 (A) that "[w]here a bond is intended to secure an existing debt it is inevitable that the amount of such debt secured by the bond should be indicated".

7 Jorgensen "Mortgages to secure fees" 1999 *Minnesota Lawyer* available at <http://bit.ly/YK5O20>.

8 See Association of the Bar of the City of New York Committee on Professional and Judicial Ethics formal opinion 7 (1988).

9 Lewis *Legal ethics* (1982) 261, citing *Lancashire Loans v Black* 1934 1 KB 380; *Magid v Armstrong* 1937 AD 260. To this fundamental rule, according to Lewis, there are two exceptions, namely (i) so-called "run-of-the-mill" contracts – those contracts that the client regularly enters into in the course of her ordinary business activities without the use or need for legal assistance; and (ii) the retainer agreement between attorney and client. A loan by the attorney to the client does not qualify as a so-called "run-of-the-mill" contract and falls under what Lewis terms "vulnerable transactions."

proving that the client had received independent legal advice in entering into the contract.¹⁰

Lewis points out that, although there is no absolute rule requiring independent legal advice, it is nevertheless desirable.¹¹ The author is critical of the latitude allowed by some of the English cases. For example, in *Cockburn v Edwards*,¹² the court held:

“A solicitor who lends money on mortgage to his client on any but strictly usual terms would be wise if he always required the intervention of another solicitor. If that is not done he must preserve evidence that the circumstances were explained to the client.”

As Lewis rightly notes, “evidence of the explanation” will not be sufficient unless the attorney can also show that (i) the client understood the explanation; and (ii) that the client agreed to the terms free from the attorney’s influence. Likewise, the decision in *Jones v Linton*¹³ offers “too easy an escape route” in its holding that “a security completed after full explanation will be upheld against the client although it contains unusual provisions”. The salient point is poignantly expressed by Lewis:¹⁴

“[T]he ethical considerations command the attorney to refrain from what in appearance justifies criticism even though on close examination his conduct may be vindicated. That the law may be less demanding than the ethical considerations will not, one may hope, encourage any conscientious practitioner to lower his standards.”

3 2 Rules and rulings of the law societies

As stated, the law societies have not specifically addressed the practice of attorneys taking security interests in their clients’ real property to secure their fees. However, in parsing the body of ethical mandates set forth in the rules and rulings of the law societies, it would seem that an attorney would be hard-pressed to justify the practice when faced with a complaint lodged by a client with the law society.

The rules of all four law societies demand, on pains of disciplinary action, that members maintain professional independence to enable them to give clients unbiased advice.¹⁵ As stated above, it can be argued that a mortgage bond over a client’s real property constitutes an inherent conflict of interest, as the interests of a mortgagor and mortgagee are adverse *per se*. A finding by the council of a law society of an improper conflicting self-interest would almost surely defeat any claim by the attorney that she preserved her relationship as an independent contractor with the client.¹⁶

10 See *Leite v Leandy & Partners* 1992 2 SA 309.

11 Lewis *Legal ethics* (1982) 263.

12 1881 18 ChD 449.

13 1881 44 LT 601.

14 Lewis *Legal ethics* 264.

15 Law Society of the Northern Provinces rule 72.1.1; Law Society of the Cape of Good Hope rule 14.3.8; Law Society of the Orange Free State rule 17(19); Natal Law Society rules 14(b)(xvii), 14(b)(xxv) and 14(b)(xxvi). It is proposed that these provincial rules shall be replaced by rule 40.8 of the Uniform Rules once adopted by the four law societies.

16 Commentary on the IBA International Principles on Conduct for the Legal Profession (2011) 12.

In addition to the general requirement of maintaining professional independence, members of the Law Society of the Cape of Good Hope (Cape Law Society) are also explicitly obligated to treat the interests of clients as paramount,¹⁷ and to “refrain from doing anything which places them *or could place them* in a position in which a client’s interests conflict with their own”.¹⁸ Thus, members of the Cape Law Society have to remain vigilant, not only against actual conflicts of interests, but also against any situation that *could potentially* present a conflict of interest in the future. Even if an attorney could argue that, under the particular circumstances of the case, taking a mortgage bond over a client’s real property did not create a conflict of interest when the mortgage was granted, the attorney would find it difficult indeed to argue that it was entirely unforeseeable that a conflict of interest could develop at some future point along the trajectory of the attorney-client relationship. The mere fact that the attorney sought a mortgage bond over the client’s property in the first place is evidence of the attorney’s concern that it was at least possible that the client may default in her obligation to pay the attorney’s fee. And, the option of seeking a default judgment and commence foreclosure proceedings against the client would unquestionably create a conflict of interest even if the mere act of taking a mortgage bond over the client’s real property did not.

The rules of the Natal Law Society (the Natal rules) incorporate by reference the rules of the International Code of Ethics¹⁹ of the International Bar Association (IBA), the rules of the Code of Ethics for Legal Practitioners and the IBA General Principles for the Legal Profession 2006, all of which demand that lawyers maintain their professional independence in the discharge of their duties.²⁰ Failure by a member to comply with any of these exogenous codes of ethics and general principles constitutes unprofessional, dishonourable, or unworthy conduct on the part of that member.²¹

In addition, the International Code of Ethics of the IBA mandates that lawyers abstain from any behaviour which *may tend to* discredit the profession,²² and never forget that they should put first, not their right to compensation for their services, but the interests of their clients.²³ It can be argued that, in taking a mortgage bond over a client’s real property – or, more blatantly, in foreclosing on a client’s property when the client fails to pay the fee – the attorney has prioritised her right to compensation over the best interests of the client. Moreover, as the *Schantz* case demonstrates,²⁴ the practice of taking a security interest in a client’s property to secure a fee has every potential to discredit the profession. It would therefore seem that this practice violates the International Code of Ethics of the IBA, and by extension the Natal rules.

17 Cape Law Society rule 14.3.2. The requirement to treat client’s interests as paramount is subject only to a member’s duty to the court, the interests of justice and observation of the law.

18 Cape Law Society rule 14.3.4 (emphasis added).

19 As adopted on 10 June 1995.

20 Eighth Schedule to the Natal rules (International Code of Ethics of the IBA) C-48 para 3; Thirteenth Schedule to the Natal rules (Code of Ethics for Legal Practitioners) C-65 para 2; Fourteenth Schedule to the Natal rules (IBA General Principles for the Legal Profession 2006) C-66 para 1.

21 Natal rules 14(b)(xvii), 14(b)(xxv) and 14(b) (xxvi), respectively.

22 C-48 para 2 (emphasis added).

23 C-48 para 17.

24 See 4 3 below.

On the one hand, the IBA General Principles of the Legal Profession 2006 (the IBA General Principles) explicitly state that lawyers are entitled to a reasonable fee for their work,²⁵ and they recognise the tension that exist between lawyers' service to their clients and lawyers' "legitimate expectation to maintain a reasonable standard of living".²⁶ On the other hand, however, the IBA General Principles also proclaim that lawyers are "specialised professionals who place the interests of their clients above their own",²⁷ they mandate that lawyers maintain independence to facilitate unbiased advice or representation²⁸ and that lawyers at all times maintain the highest standards of honesty, integrity and fairness,²⁹ and they expressly prohibit lawyers from assuming a position in which the clients' interests conflict with their own.³⁰ On balance, it is doubtful whether the practice of taking a mortgage bond over a client's real property would pass muster when measured against the ethical requirements of the IBA General Principles.

The Council of the Natal Law Society has echoed the rigorous ethical constraints of the International Code of Ethics of the IBA in rulings (the Natal rulings). Members should at all times maintain the honour and dignity of the profession, and should abstain from any behaviour "which *may tend to* discredit the profession of an attorney".³¹ Members should preserve their independence in the discharge of their professional duties³² and should put first, not their right to compensation for services, but the interests of their client and the exigencies of the administration of justice.³³ In addition, the Natal rulings clearly state that it is improper for an attorney to "take advantage of the inexperience, youth, want of education, ill health, lack of knowledge or unbusinesslike habits of a client".³⁴

As stated above, a disgruntled client who is staring foreclosure in the face by her own attorney, may very well be able to lodge a colourable complaint against the attorney with the council of the Natal Law Society, claiming that the attorney (i) engaged in conduct which tended to discredit the profession; (ii) failed to maintain her independence in the discharge of her duty; (iii) prioritised her right to be paid over the best interests of the client; and (iv) took advantage of the client by virtue of the client's inexperience, want of knowledge or unbusinesslike habits and the like.

25 C-66 par a10.

26 C-66 introductory paragraph.

27 See *Mouton v Mynwerkersunie* 1977 1 SA 119 (A); *Midgley Lawyers' professional liability* (1992) 120; *Randell and Bax* (1983) 107.

28 C-66 para 1.

29 C-66 para 2. In *Law Society, Transvaal v Matthews* 1989 4 SA 389 (T) 395 Kirk-Cohen J held that "[t]he integrity of an attorney should *inter alia* manifest itself in a situation where he must prefer the interests of his client above his own. It is required of an attorney that he observes scrupulously, and complies with, the provisions of the *Attorneys Act* and the *rules*".

30 C-66 para 3. According to the IBA General Principles, conflicts of interest are permissible if these conflicts are permitted by law or, if permitted in a particular jurisdiction, if the clients provide their consent. Innes CJ concluded in *Robinson v Randfontein Est GM Co Ltd* 1921 AD 168 177 that "[w]here one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to make a secret profit at the other's expense or place himself in a position where his interests conflict with his duty".

31 Natal ruling 1.(1) D-7 (emphasis added).

32 Natal ruling 1.(2) D-7.

33 Natal ruling 2.(5)(a) D-11.

34 Natal ruling 2.(2)(f) D-10.

The Natal rulings come closest to addressing directly the practice of taking a mortgage bond over a client's real property to secure a fee, albeit only a *species* of the practice. Natal ruling 2.(2)(b) mandates that a member "should not, contrary to the best interest of the client, acquire a financial interest in the subject matter of the dispute".³⁵ Therefore, members are expressly prohibited from taking mortgage bonds over clients' real property when that property is at issue in the dispute. This would presumably be the case in divorce matters where the marital residence is at issue and any number of transactional or litigation matters involving a client's real property.

4 UNITED STATES

4.1 Taking a security interest in a client's property to secure payment of fees is a business transaction

The predominant view among state and local bar ethics committees in the United States is that it is not inherently unethical for an attorney to acquire a mortgage bond over a client's home to secure a legal fee.³⁶ However, such an arrangement is not viewed merely as a permeation of the original fee agreement between attorney and client, or as an additional fee agreement. Most state and local bars treat a mortgage bond to secure legal fees as a business transaction between attorney and client that triggers additional and unique ethical and professional obligations to the client.³⁷

These additional safeguards afforded the client are deemed necessary because the attorney's "legal skill and training together with the relationship of trust that arises between client and lawyer, create the possibility of overreaching when a lawyer enters into a business transaction with a client".³⁸ The attorney usually possesses superior knowledge and skill regarding certain legal and business matters. As such, the attorney stands in a position of influence, which influence could be abused to gain an advantage over the client in business dealings. Clearly, an attorney who engages in a business transaction with a client is in a position to arrange the form of the transaction or give legal advice to protect the attorney's interests rather than advancing the client's interest.

In a formal opinion issued in 2002, the American Bar Association advised that "[a] lawyer who acquires a contractual security interest in a client's property to secure payment of fees earned or to be earned must comply with model rule 1.8(a)".³⁹

35 D-9.

36 See eg Massachusetts Bar Association opinion 81-7 (1988); Oklahoma Bar Association Opinion 297 (1980); State Bar of Michigan opinion 40 (1989); Maine Board of Overseers of the Bar opinion 144 (1994).

37 See eg Ohio Board of Commissioners on Grievances and Discipline opinion 8 (2004); Association of the Bar of the City of New York Committee on Professional and Judicial Ethics formal opinion 7 (1988), citing Wolfram *Modern legal ethics* (1986) 482.

38 Comment b to *Restatement (third) of the law governing lawyers* (2000) §126.

39 American Bar Association Standing Committee on Ethics and Professional Responsibility formal opinion 427 (2002).

Model rule 1.8(a) of the model rules of professional conduct states:

“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 a client unless:

- (1) the transaction and terms on which the lawyer acquires the interests are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
- (2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent counsel on the transaction; and
- (3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer’s role in the transaction, including whether the lawyer is representing the client in the transaction.”

4 2 Security interest in real property that is the subject-matter of litigation

Whether and under what circumstances an attorney may take a security interest in the client’s property where the property is the subject of litigation in which the attorney represents the client, is a matter over which courts and state and local bar opinions differ sharply.

The source of this legal uncertainty is former model rule 1.8(j) of the American Bar Association model rules of professional conduct. Former model rule 1.8(j) stated:

“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.”

One line of cases and bar ethics opinions under former model rule 1.8(j) concludes that a contractual security interest in the subject matter of litigation to secure an attorney’s fee either (i) is not a “proprietary” interest in the subject matter of the litigation, or (ii) satisfies the condition of a lien “granted by law”.⁴⁰

A diametrically opposed line of cases and opinions hold that taking a mortgage bond in a client’s property that is related to the litigation is a “proprietary” interest, and, because it has been granted by contract or upon the client’s consent, it is not “granted by law”.⁴¹

The American Bar Association has attempted to address the legal uncertainty on the state and local level by issuing model rule 1.8(i) to replace former model rule 1.8(j). Model rule 1.8(i) prohibits attorneys from acquiring a proprietary interest in the subject matter of litigation, although it permits attorneys to acquire a lien “authorised by law” to secure legal fees.⁴²

40 See eg *Twachtman v Hastings* 20 Conn L Rptr 145 1997 WL 433878 (Conn Super Ct 1997); *Iowa Committee on Prof Ethics and Conduct v McCullough* 468 NW2d 458 (Iowa 1991); *Burk v Burzynski* 672 P2d 419 (Wyo 1983); Connecticut Bar Association informal opinion 3 (1987); Georgia formal advisory opinion 7 (1986); Oklahoma Bar Association advisory opinion 297 (1980).

41 *Lee v Cassada Corp* 714 So2d 610 (Fla Dist Ct App 1998); *People v Franco* 698 P2d 230 (Colo 1985); Maine Board of Overseers of the Bar opinion 117 (1991); South Carolina Bar opinion 25 (1996); North Dakota Bar Association Ethics Committee opinion 08 (2000).

42 The text of model rule 1.8(i) is identical to that of former model rule 1.8(j), except that the phrase “granted by law” in former model rule 1.8(j) has been replaced by the phrase “authorised by law” in model rule 1.8(i).

By use of the word “authorised” in place of the word “granted” under former model rule 1.8(j), model rule 1.8(i) now explicitly permits any legally recognised lien upon property that is the subject of litigation to secure legal fees. Thus, liens “authorised by law” may include liens granted by statute, liens originating in common law, liens imposed by court order, and *liens acquired by contract with the client*.⁴³

However, model rule 1.8(i) suffers from both a procedural and a substantive defect. Procedurally, the model rules are aspirational and not compulsory, and as far as can be determined, no state or local bar association has adopted the model rule. Thus, in practice, the conflict between the states in which a security interest in the subject matter of the litigation constitutes a lien “granted by law” and those in which it does not, continues unabated.

Substantively, it begs the question what, if anything, model rule 1.8(i) actually contributes to the resolution of the ethical conundrum that arises when an attorney takes security interest in the client’s property that is the subject of litigation to secure the attorney’s fees. By expanding the scope of permissible liens from those “granted by law” to those “authorised by law” – to now include liens acquired by contract with the client – model rule 1.8(i) erodes crucial protections that former model rule 1.8(j) afforded the client.

Former model rule 1.8(j) prohibited, and most state and local bar rules continue to prohibit, an attorney from taking a security interest in a client’s property that is the subject of litigation to secure payment of a legal fee, save in two narrowly circumscribed circumstances: (1) if the lien is granted by law; and (2) as part of a reasonable contingent fee contract in a civil case. The rationale for this prohibition is the increased threat of the attorney’s security interest in the subject matter of the litigation interfering with the attorney’s professional judgment.

By expanding the scope of the narrow exceptions of former model rule 1.8(j) to include liens that the attorney acquires by contract with the client, model rule 1.8(i) essentially nullifies the distinction between a security interest in the client’s property that is not the subject of litigation, and a security interest in the subject of the litigation. Model rule 1.8(i) renders itself superfluous, as its effect is that any taking of a security interest in a client’s property by contract between attorney and client, whether the property is the subject of the litigation or not, is subject only to the protection of model rule 1.8(a), which governs business transactions between attorney and client.

By adopting model rule 1.8(i), the American Bar Association has explicitly countenanced the acquisition by attorneys of contractual security interests in clients’ property that is the subject of litigation. However, as stated, in practice, depending upon the attorney’s particular locale, an attorney is either prohibited outright from taking a security interest in the subject of the litigation, or such a security interest is only permissible in two narrowly enumerated circumstances.

4 3 Security interest in the marital residence in domestic relations matters

Taking a security interest in the marital residence to secure the attorney’s fees when representing a client in a domestic relations matter is a particularly thorny species of 4.2 as discussed above.

⁴³ Comment 16 to model rule 1.8(i) (our emphasis).

In the United States, taking a security interest in the marital residence during representation in domestic relations matters is viewed as ethical in some states, not ethical in others, and in yet others only ethical when the divorce has been concluded.⁴⁴ In New York this issue sparked action by the state legislature and touched off a flurry of litigation after one particular case garnered widespread media attention. *Schantz v O'Sullivan*⁴⁵ exemplifies the ethical pitfalls for attorneys and the damage to the image of the profession that can result when attorneys take security interests in clients' property, especially in the emotionally charged arena of divorce litigation.

In 1993 the New York legislature enacted a statutory provision specifically applicable to attorneys who represent clients in matrimonial matters. Entitled *Procedure for attorneys in domestic relations matters*, Part 1400.5 of the Judiciary Law provides as follows:

"1400.5 Security Interests

- (a) An attorney may obtain a confession of judgment or promissory note, take a lien on real property, or otherwise obtain a security interest to secure his or her fee only where:
 - (1) the retainer agreement provides that a security interest may be sought;
 - (2) notice of an application for a security interest has been given to the other spouse; and
 - (3) the court grants approval for the security interest after submission of an application for counsel fees.
- (b) Notwithstanding the provisions of subdivision (a) of this section, an attorney shall not foreclose on a mortgage placed on the marital residence while the spouse who consents to the mortgage remains the titleholder and the residence remains the spouse's primary residence."⁴⁶

This statutory provision did not exist at the time when Jean O'Sullivan consented to two mortgage bonds over the marital home in the total amount of \$48 913 in favour of Stewart Schantz, the attorney who represented Ms O'Sullivan in protracted divorce litigation from 1986 to 1994, to secure his fees.⁴⁷

A legal advertisement in the *Albany Times Union* on 10 July 2002 caught the attention of Ms O'Sullivan's children. The advertisement was placed by the

44 See eg State Bar of Georgia opinion 7 (1986) (a security interest in marital property to secure fees in a domestic relations case is ethical); Massachusetts Bar Association opinion 1 (1991) (in a divorce proceeding, a promissory note secured by a mortgage on a marital home is considered improper, but if the proceeding is complete, the attorney may take the assignment of a promissory note if certain conditions are met); Virginia State Bar Opinion 1653 (1995) (an attorney may not enter into an agreement assigning a share of a divorce client's profits from the sale of the marital residence to secure payment of the lawyer's fee, but when the decree is final such an agreement may be proper when certain conditions are met); Maine Board of Overseers of the Bar opinion 117 (1991) (after a divorce judgment is final, the taking of a mortgage on marital property may or may not be appropriate depending on the circumstances); South Carolina Bar opinion 25 (1996) (a lawyer may not take a security interest in property that is the subject matter of matrimonial litigation); Connecticut Bar Association opinion 3 (1987) (taking a mortgage on a client's marital home as security for legal fees is proper).

45 288 AD2d 536 (3d Dept 2001), subsequent appeal at *Schantz v O'Sullivan* 302 AD2d 739 (3d Dept 2003), subsequent appeal at, remanded by *Schantz v. O'Sullivan* 11 AD3d 22 (3d Dept 2004).

46 22 NYCRR § 1400.5

47 *Schantz v O'Sullivan* 288 AD2d 536 (3d Dept 2001).

court-appointed referee and announced that Ms O'Sullivan's home would be sold at foreclosure less than a month later.⁴⁸ Ms O'Sullivan's children took exception and hired an attorney. The press quickly took up the hue and cry and the story received wide publicity. It was first reported in the tabloid *New York Post*. The article described the plight of an elderly retiree in ill health living on a fixed income and facing homelessness because she could not come up with another \$47 000 for a divorce attorney who had already been paid tens of thousands of dollars.⁴⁹

New York lawmakers also jumped on the bandwagon. Senate Judiciary Chairman, James J Lack, proclaiming outrage after reading the article in *New York Post*, sponsored a bill that applied section 1400.5 retroactively and stayed the foreclosure of Ms O'Sullivan's home. He pointed out that

"we are not trying to legislate debts between attorneys and clients at all. What we are doing is codifying, as a matter of public policy, that foreclosures should not be taking place to pay for attorney's fees in matrimonial actions".⁵⁰

Senator Lack's bill enjoyed wide bipartisan support. It was passed unanimously by both houses of the state legislature and signed into law by the governor.⁵¹

The National Coalition for Family Justice, a non-profit organisation, also took up Ms O'Sullivan's cause, and issued a press release characterising Shantz as "greedy" and "unprincipled".⁵² An undeterred Shantz issued a press release of his own claiming that Ms O'Sullivan was a "deadbeat" who was attempting to "deny [him] a fee he more than earned by litigating and negotiating on her behalf for some eight years".⁵³ Shantz also challenged the constitutionality of the new law and, after two appeals, was ultimately successful in having it struck down by the New York Court of Appeals.⁵⁴

The *Schantz* saga is instructive for the insight it allows into the negative consequences that can follow when attorneys engage in taking contractual security interests in their clients' property. It is true that Schantz ultimately won the legal battle, and that not a single person – not even his former client – ever disputed that he was entitled to his fees. It is equally true, however, that this case was a public relations disaster for the legal profession. Ultimately, it matters little that Schantz prevailed on the law, or that he may have worked diligently over the course of many years on Ms O'Sullivan's behalf, earning every penny of his fee. What matters is the perception that this dispute left in the minds of John and Jane Public of the "greedy and unscrupulous lawyer who prayed upon the elderly and vulnerable".

5 CONCLUSION AND RECOMMENDATION

Although the rules and rulings of the law societies do not expressly prohibit the practice of taking a mortgage bond over a client's real property to secure a legal

48 Caher "Foreclosure stalled as law is challenged" 1 August 2002 *New York LJ* available at <http://www6.law.com/lawcom/displayid.cfm>.

49 Caher "Legislature acts to protect clients who mortgage homes to lawyers" 26 April 2002 *New York LJ* 1.

50 *Ibid.*

51 Caher fn 49.

52 *Ibid.*

53 *Ibid.*

54 Caher "NY lawyer wins right to foreclose on client's home" 30 July 2004 *New York LJ* available at <http://nylawyer.com/news/04/07073004a/html>.

fee (except pursuant to the Natal rulings in the case of a security interest in property that is the subject matter of the dispute), it is highly doubtful that this practice would pass muster when scrutinised by the ethics committees of the councils of the law societies. As a threshold matter, the practice almost surely violates the universal mandate that members must maintain professional independence to enable them to give clients unbiased advice. In addition, members of the Cape Law Society have to avoid, not only actual conflicts of interest, but also any situation that *could place them* in a position in which clients' interests conflict with their own. The Natal Law Society prohibits a member from engaging in any behaviour that *may tend to* discredit the profession. Both of these rules seem to impose a foreseeability test on members according to which members have to weigh the potential adverse consequences of a course of action before engaging in such course. Given that potential conflicts of interest and bad publicity cannot affirmatively be excluded and, in fact, could quite easily be imagined, these rules would seem to effectively proscribe the practice of taking a mortgage bond over a client's real property to secure a fee. In addition, the Natal rulings expressly prohibit members from acquiring a financial interest in the subject matter of the dispute.

We recommend that the law societies issue uniform guidance expressly prohibiting this practice, whether the real property over which the attorney takes a mortgage bond is the subject matter of the litigation or not. It simply cannot be said that the practice of securing legal fees with a mortgage bond over a client's home fosters the attorney-client relationship. The possibility of a dispute between attorney and client always lurks just beneath the surface – a dispute that may adversely affect the client's ability to maintain a roof overhead, no less.

However, should the law societies decide to countenance this practice, they should enumerate clear requirements for its application. In this regard the law societies may be guided by the more stringent requirements that have crystallised in United States practice. Taking a mortgage bond over a client's real property should be permissible – if at all – only if the following requirements are met:

- (a) the attorney shall obtain the client's written consent to the transaction in a document that is separate and apart from the transaction documents (eg mortgage bond note and agreement); and such separate consent document shall disclose:
 - (i) that the attorney is not representing the client in the transaction;
 - (ii) the nature of the attorney's conflicting interest; and
 - (iii) the reasonably foreseeable risks for the client from the attorney's conflict.
- (b) the client is advised, in writing, that he or she must seek independent legal advice in regards the transaction.⁵⁵

⁵⁵ In this instance we deviate from the general principle in the United States that the client should be advised of the desirability of seeking, and given a reasonable opportunity to seek, the advice of independent legal advice to the transaction. See eg 22 NYCRR Part 1200 (the New York rules of professional conduct) rule 1.8(a)(2). We believe independent legal advice should be a *sine qua non* for any transaction in which an attorney is granted a security interest in a client's real property to secure a fee.

- (c) the transaction is fair and reasonable to the client and the terms of the transaction are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client.
- (d) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction.

Any guidance by the law societies with regard to this practice should clarify that, in the event of a complaint lodged against a member, the burden of proof shall be on such member to show affirmatively that no deception was practiced; that there was no overreaching or undue influence used; that the client received independent legal advice; and that the transaction was fair, open, voluntary, with full disclosure and well understood by the client.

Given the very real and grave risks of overreaching and the attorney's interest in the subject matter of the litigation interfering with his professional judgment, the other law societies should follow the Natal rulings and outright prohibit the practice in the event that the real property to be mortgaged is the subject matter of the dispute.

Regardless of any rules or rulings issued by the law societies with regard to this practice, however, South African attorneys should heed the lesson from the *Schantz* saga and, in Lewis' words, "refrain from what in appearance justifies criticism, even though on close examination the conduct maybe vindicated". Even assuming, *arguendo*, that the practice of taking a contractual security interest in a client's property is technically not unethical under the rules and rulings of the law societies – a proposition that is highly doubtful in light of the above analysis – legality is hardly the issue. It is not the hundreds of these types of transactions that go smoothly, where the client eventually pays the full fee owed and the mortgage is extinguished, that are going to make the newspapers. It is the one case in which things go awry, where the attorney-client relationship breaks down, the client refuses or is unable to pay the fee and faces the loss of her home, and she lodges a complaint with the law society, whether justified or not, that will bring the unwelcome media spotlight to bear.

Sir Thomas Lund, CBE, cogently expressed the essence of the conduct of attorneys when he said:

"[R]eputation is the greatest asset a solicitor can have, and when you damage your reputation, you damage the reputation of the whole body of this very ancient and honourable profession of ours."⁵⁶

⁵⁶ Quoted in Introduction to the rulings of the council of the Natal Law Society D-5. This view is shared by Lewis *Legal ethics* (1982) 8 in his so-called golden rule: "A practitioner must avoid all conduct which, if known, could damage his reputation as an honourable lawyer and honourable citizen."