

IN THE SUPREME COURT OF TEXAS

No. 99-0981

RON LEVINE AND SERENA LEVINE, PETITIONERS

v.

BAYNE, SNELL & KRAUSE, LTD., RESPONDENT

ON PETITION FOR REVIEW FROM THE
COURT OF APPEALS FOR THE FOURTH DISTRICT OF TEXAS

Argued on April 12, 2000

JUSTICE ENOCH delivered the opinion of the Court, in which CHIEF JUSTICE PHILLIPS, JUSTICE BAKER, JUSTICE HANKINSON, and JUSTICE O'NEILL join.

JUSTICE OWEN filed a concurring opinion.

JUSTICE HECHT filed a dissenting opinion, in which JUSTICE ABBOTT joined.

Ron and Serena Levine agreed to pay their lawyers one-third of "any amount received by settlement or recovery" from their lawsuit against Donald and Pat Smith. The Levines obtained an award against the Smiths, but the award was offset by the Smiths' successful counterclaim. The Levines and their attorneys now argue over how to calculate the one-third contingent fee -- Should the fee be calculated on the full amount awarded to the Levines, or should it be calculated on the amount awarded to the Levines after the offset is subtracted? The trial court and court of appeals concluded that the attorneys were entitled to one-third of the full amount awarded. Because we disagree, we reverse the court of appeals' judgment and render judgment that the Levines owe nothing further to their attorneys.

The Levines hired Bayne, Snell & Krause, Ltd. to sue the Smiths for their failure to disclose foundation defects in the home they sold to the Levines. Because of the alleged foundation defects, the Levines stopped making mortgage payments to the Smiths, who had financed the house purchase. The Smiths therefore counterclaimed for breach of the mortgage agreement.

After a jury verdict, the trial judge awarded the Levines \$243,644 in damages for the foundation defects, along with interest and attorney's fees. But the court also found that the Smiths were entitled to the balance due on the mortgage, accrued interest and attorney's fees, all of which totaled \$161,851.38. The trial court thus offset the Levines' \$243,644 award with the Smiths' \$161,851.38 recovery, resulting in an \$81,792.62 judgment for the Levines. The offset extinguished the Levines' mortgage obligation, giving them clear title to their home.

After the court of appeals affirmed the trial court's judgment, the Smiths paid the Levines \$104,110.31, which included \$81,792.62 plus interest that had accrued during the appeal. Bayne/Snell then sent the Levines a statement claiming \$155,866.13 in fees: one-third of the Levines' award *before* the offset, prejudgment interest, and costs; plus court-awarded attorney's fees, and post-judgment interest and expenses.

The Levines disagreed with Bayne/Snell's fee calculation because the calculation did not reflect the trial court's offset for the Smith's successful counterclaim. In any event, though still contesting the fees, the Levines endorsed the Smiths' check for \$104,110.31 over to Bayne/Snell to pay the attorney's fees. And because the Levines refused to pay the remainder, Bayne/Snell sued.

The Levines, in their briefing, do not specify the amount they believed they owed Bayne/Snell. But they apparently estimate that the one-third fee should have been calculated on the

approximately \$36,000 difference between the Levines' total damages and prejudgment interest and the Smiths' total damages and prejudgment interest; added to court-awarded attorney fees, post-judgment interest, and expenses. Regardless, although the \$104,110.31 the Levines paid Bayne/Snell is greater than the amount the Levines would pay under the net recovery method, they have not asked for money back from the firm.

The Levines' contract with Bayne/Snell provided in part:

Client agrees to pay attorney as attorney's fees for such representation 33-1/3% (1/3) of *any amount received* by settlement or recovery and to receive such payments, Client assigns to attorney a 33-1/3% (1/3) undivided interest in his cause of action.

Any attorneys fees awarded by any court shall go to my attorneys in addition to the above percentages of recovery.¹

The contingent attorney's fee contract in this case does not define "any amount received."

Section 35 of the Restatement (Third) of the Law Governing Lawyers and its comment answer the question the parties pose. That section states that "when a lawyer has contracted for a contingent fee, the lawyer is entitled to receive the specified fee only when and *to the extent the client receives payment*."² And comment d explains: that "[i]n the absence of [a] prior agreement to the contrary, the amount of the client's recovery is computed net of any offset, such as a recovery by an opposing party on a counterclaim."³

¹ (Emphasis added.)

² RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 35 (1998) (emphasis added).

³ *See id.* cmt. d.

Some courts, in cases similar to this one, have opted to apply the fee to the client's full award, reasoning that such a calculation better reflects the comprehensive value of the attorney's services and the economic value received by the client. For instance, in *Manzo v. Dullea*, the court approved a fee applied to a full award under an insurance policy, although a portion of the award had been deducted and retained by the insurer in satisfaction of mortgages that had been assigned to the insurer. The court reasoned "[t]hat part of the judgment was used to pay for a debt for which [the client] was personally liable and which, but for the successful efforts of the attorney in collecting the insurance by suit, would have been left a debt secured by the mortgages" ⁴ In *Consolidated Underwriters of South Carolina Insurance Co. v. Bradshaw*, the court held that an attorney fee was calculable on the full award, even though part of the judgment was paid to the client's mortgagee, because it "was in fact a recovery . . . since it extinguished [the client's] debt." ⁵ And in *Saulsbury v. American Vulcanized Fibre Co.*, the court concluded that an attorney, employed to act for a client for a percentage of the amount recovered, was entitled to a percentage of the amount that the client would have been required to pay, but from which the client was released by the court's decree. ⁶

Here, the Levines unquestionably benefitted, financially, beyond recovering a money judgment for \$81,792.62. The judgment extinguished their mortgage obligation, allowing them to

⁴ 96 F.2d 135, 137 (2nd Cir. 1938).

⁵ 136 F. Supp. 395, 403 (W.D. Ark. 1955).

⁶ 91 A. 536, 542 (Del. Super. Ct. 1914)

receive clear title to their home. But sound reasons convince us that we should apply section 35 of the Restatement and interpret "any amount received" to mean net recovery.

Such an interpretation rests on the premise that "lawyers are more able than most clients to detect and clarify omissions in client-lawyer contracts" because "lawyers almost always write such contracts" and are more familiar with the intricacies of legal representation and with the law and drafting of fee agreements and other contracts.⁷ For example, the Indiana Supreme Court has stated, "[l]awyers almost always possess the more sophisticated understanding of fee arrangements. It is therefore appropriate to place the balance of the burden of fair dealing and the allotment of risk in the hands of the lawyer in regard to fee arrangements with clients."⁸ Similarly, the California Supreme Court has added that attorneys are "presumably familiar with legal terms and proceedings and accustomed to the use of language appropriate to the framing of contracts"⁹ Motivated by some of these concerns, courts in other jurisdictions have already applied this rule in construing contracts in lawyer-client fee disputes.¹⁰ Because the lawyer is better able than the client to predict and provide for fee arrangements based on recoveries diverging from the traditional payment actually received, the burden should fall on the lawyer to express in a contract with the client whether the contingent fee will be calculated on non-cash benefits as well as money damages.

⁷ RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 18 cmt. h (1998).

⁸ *In re Myers*, 663 N.E.2d 771, 774-75 (Ind. 1996).

⁹ *Bennett v. Potter*, 183 P. 156, 158 (Cal. 1919).

¹⁰ See *Hamilton v. Ford Motor Co.*, 636 F.2d 745, 748 (D.C. Cir. 1980) (holding that this principle applies with even greater force in the attorney-client context because the client has had no legal training); *Kirwin v. McIntosh*, 110 P.2d 735, 737 (Kan. 1941); *In re Irwin*, 91 P.2d 518, 523 (Or. 1939) (construing retainer agreement against lawyer based on the lawyer's superior knowledge of the work covered by the agreement).

To place this burden upon attorneys is justified not only by the attorney's sophistication, but also by the relationship of trust between attorney and client. As the Minnesota Supreme Court has concluded, to impose the obligation of clarifying attorney-client contracts upon the attorney "is entirely reasonable, both because of [the attorney's] greater knowledge and experience with respect to fee arrangements and because of the trust [the] client has placed in [the attorney]."¹¹

Courts that follow Section 18(2)'s approach in calculating an attorney's fee on the client's net recovery also do so because contingency fee contracts allocate the risk of non-recovery to the attorney. A Kentucky court of appeals, applying the fee to the net recovery, reasoned that when attorneys accept employment to bring suit, they do so "with at least the implied knowledge that the contemplated suit is liable to be defeated by any of the defenses allowed by law, including a plea of set-off."¹² And a New York appellate court applied the fee to the net recovery, concluding that the lawyer "assumed the risk that the recovery in moneys would be diminished by the allowance of the . . . counterclaim."¹³

Our holding is not novel; rather, it simply emphasizes one facet of a lawyer's duty to the client, *i.e.*, to inform a client of the basis or rate of the fee at the outset of the matter.¹⁴ Importantly, requiring the attorney to better stipulate whether the attorney and client contemplate a fee calculated on the total value or net monetary recovery benefits the client, the lawyer, and the legal system by

¹¹ *Cardenas v. Ramsey County*, 322 N.W.2d 191, 194 (Minn. 1982). *See also Kirwin*, 110 P.2d at 736-37 (also citing the fiduciary relationship between lawyer and client as a reason to construe contracts against a lawyer).

¹² *Wooldridge v. Bradbury*, 215 S.W. 406, 408 (Ky. 1919).

¹³ *Mackey v. Passaic*, 40 N.Y. S.2d 613, 614 (N.Y. App. Div. 1943).

¹⁴ *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 38 (1998).

encouraging better communication and thereby reducing later disputes about what was communicated. This holding even avoids disputes arising from situations in which the client fails to reveal important information to the lawyer or ignores the lawyer's recommendations. The lawyer can simply provide for these situations ahead of time, making it clear in the agreement that the client cannot reduce his bill by deceiving the lawyer.

Because in this case the contingent fee contract did not provide otherwise, "any amount received" refers only to the net amount of the client's recovery. We, therefore, conclude that no further fee is due from the Levines to their attorneys. Accordingly, we reverse the judgment of the court of appeals and render judgment for the Levines.

Craig T. Enoch
Justice

Opinion delivered: February 1, 2001