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Conflict of interest from preparing note used by client:

Hetos Invs., Ltd. v Kurtin, 2003

Roger Bernhardt

Law firm is not barred, as matter of law, from representing its client in lawsuit asserting that promissory note that firm prepared on client's behalf was usurious in violation of California law.

Hetos Invs., Ltd. v Kurtin (2003) 110 CA4th 36, 1 CR3d 472

After a real estate transaction went awry, the parties entered into a settlement agreement. One party (Kurtin) agreed to advance settlement monies to another party (Hetos), but did not want to incur legal fees in connection with the documentation of the loan. Hetos asked his law firm to prepare a promissory note documenting the terms to which he and Kurtin had already agreed. The law firm did so and sent the document directly to Hetos. Hetos and Kurtin themselves then negotiated an addendum to the promissory note; Hetos did not request assistance from his counsel. The deal further soured and Hetos sued the other parties to the settlement agreement, including a cause of action for usury based on the promissory note. The law firm that prepared the promissory note was also the one that filed the complaint on behalf of Hetos, the borrower. Kurtin moved to disqualify that law firm, alleging the violation of ethical rules and the appearance of impropriety. The trial court denied the motion.

The court of appeal affirmed, holding that Kurtin did not demonstrate that the law firm had violated Cal Rules of Prof Cond 3–210, which provides that an attorney cannot advise the violation of any law. The court rejected Kurtin's argument that, because the firm admitted to having documented the loan that it later claimed was in violation of the usury laws, the firm had violated Rule 3–210 as a matter of law. The court pointed out that if the usury laws had been violated, the violation would be on Kurtin's part for seeking to collect interest at a usurious rate. Because Kurtin was not represented by the firm in connection with the loan documentation, however, it had not advised him to break the law. There is authority for the proposition that the firm had violated Rule 3–210 by failing to advise its client, Hetos, against paying an excessive interest rate. Moreover, there is no authority for the proposition that it is illegal to agree to pay an interest rate that exceeds what the law permits the payee to demand.

The court also explained that, even if a law firm's actions may give rise to an appearance of impropriety, that does not mean the firm must be disqualified, because "appearance of impropriety" is not the test for disqualification of counsel in California. The court also refused to hold that, in the event a law firm prepares a legal document and later discovers that a provision in that document may violate the law, the law firm must be disqualified as a matter of law from representing its client in a lawsuit that challenges the validity of the offending provision. To so hold (110 CA4th at 52)

would be to enunciate an overbroad rule with potentially undesirable consequences. It would mean that any time a firm negotiated a transaction and later discovered a mistake in one of the documents it had prepared, it would be unable to clean up the matter on its client's behalf. The firm would be precluded from making its best arguments as to how the documents should be

interpreted and applied in light of the mistake. This should not be the case. A firm should not be prohibited, as a matter of law, from trying to protect its client's interests once those mistakes are known.

THE EDITOR'S TAKE: One interesting tactical question for an attorney negotiating a contract for a client is how to respond to a demand for the inclusion of a provision from the other side that she knows or believes is unenforceable. On the one hand, she could refuse to accept it precisely because it is unenforceable; on the other hand, if its unenforceability will not jeopardize the basic contract and its inclusion will not be deemed to constitute a waiver of whatever prohibition exists, why not assent to the demand, get some trade-off in return, and only later announce your client's intention not to comply with it? Just as the proponent of an invalid clause may want it only for its in terrorem effect, might not the recipient agree to it only because of its prospective invalidity? (I'm not talking about drafting a provision that makes the entire contract unenforceable, which the rules of ethics prohibit, only about drafting one on some truly collateral matter.)

Hetos Invs., Ltd. v Kurtin (2003) 110 CA4th 36, 1 CR3d 472, points out that there can be a side effect worth watching out for in that kind of strategic bargaining. If there is litigation later on, the same attorney who assented to and drafted the provision but now wants to challenge it in court may have trouble continuing to represent her client. That the drafting law firm was not disqualified tends to supply a favorable answer to that question, but the question was made rather easy in this case because the firm played only a very attenuated role and it is unlikely that the drafter will ever be put on the witness stand. What if it had done more, as is often the case?

The lesson to learn from this is that, if you believe your opponent's demand won't be honored in court, don't draft it for him. And don't say "approved," except possibly as to form. —*Roger Bernhardt*