Utah State Bar

Ethics Advisory Opinion Committee

Opinion Number 13-05

Issued September 10, 2013

ISSUE

1. To what extent may an attorney participate in an "on-site" fee/retainer funding program to obtain and finance attorney retainer or litigation funds?

OPINION

2. A lawyer may not participate in an "on-site" fee/retainer funding program, under the circumstances set forth herein, as such would violate the provisions of Rules of Professional Conduct 1.7(a) (Conflict of Interest: Current Clients), Rule 1.8(a) (Acquire a pecuniary interest adverse to the client). The lawyer may, however, obtain a waiver of the conflict by complying with the terms of Rules 1.7(b) and 1.8(a), including making full disclosure and obtaining "informed consent" confirmed in writing. Adequate measures must also be taken to safeguard the lawyer's independent judgment under Rule 5.4(c) (A third party may not direct or regulate the lawyer's professional judgment.)

BACKGROUND

3. A financing company, "Instant Legal Fee Funding" (the "finance company"), offers a same as cash funding program for law firm retainers and fees. The finance company provides the physical equipment necessary to carry out the mechanics of the arrangement on site at the lawyer's office. To initiate the process at the lawyer's office, the client swipes an item of personal financial identification through the finance company's identifying device. The finance company also provides the law firm with an imaging machine that scans the client's personal check in order to facilitate the finance company's collection of periodic loan repayments directly from the client's banking account.

4. The finance company then may qualify the client for a loan of up to $5000. The finance company charges a transaction fee ranging from 9.95% interest to 28.95% depending on risk factors it considers, including the repayment period. If the client qualifies, the law firm provides the client with the finance company's contractual agreement to repay the finance company. The finance company has no recourse against the lawyer if the client does not pay the money.

ANALYSIS

5. Rule 1.7(a)(2) requires an attorney to refrain from representation if "There is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to …a third person or by a personal interest of the lawyer." Comment 10 to that section provides:

The lawyer's own interests should not be permitted to have an adverse effect on representation of a client…In addition, a lawyer may not allow related business interests to affect representation, for example, referring clients to an enterprise in which the lawyer has an undisclosed

interest.

6. Because of the necessarily close relationship which must exist between the finance company and the lawyer, it is apparent that a conflict exists under 1.7(a) which may create a "significant risk" that the lawyer's representation of the client would be "materially limited." Additionally, Rule 1.8(a) prohibits a business transaction or other pecuniary interests adverse to a client.[1] For the reasons set forth herein, the arrangement contemplated is sufficiently adverse to the client so that a conflict appears to exist under 1.8(a) as well.

7. Under both rules, the material question concerns the involvement of the attorney in both the attorney obtaining the retainer by this method and the finance company's ability to collect the retainer fee back from the client. We presume from the stated facts that the attorney has no direct interest in the finance company. That, however, does not resolve all issues. The question that must be answered is whether the financial arrangement, albeit indirect, between the lawyer and the finance company, may adversely affect the representation of the client. Although, the finance company has no recourse against the lawyer if a client defaults on a loan, it is only natural that the lawyer will want to keep the finance company happy in order to assure perpetuation of the relationship between the lawyer and finance company. The lawyer will be under pressure to assure that the finance company is repaid. The lawyer may very well feel obliged in litigation to make certain the client achieves a recovery, even if it requires settlement at a lesser amount than would otherwise be accomplished, in order to avoid the risk that the finance company would go unpaid. Thus, the lawyer obviously has a financial and personal interest adverse to the client in continuing the advancement of fees program solely for the benefit of the lawyer in future cases. This places both Rules 1.7(b) and 1.8(a) in issue.

8. The lawyer receives a financial benefit in the advancement of fees by the finance company. She gets her retainer paid in cash with no recourse, which may very well influence the lawyer to "market" this source of funding to the exclusion of others. The interest of the lawyer in perpetuating this benefit could cloud the lawyer's judgment as to the merits of the case, for example by influencing the lawyer to advise the client that the case had greater merit than were actually the case.[2] Further, the lawyer must give disinterested and truthful advice as to the merits of funding through this program as opposed to other funding options. The lawyer's advice as to the merits of proceeding with the finance company would require the disclosure of the material aspects of the financing contract, which necessarily involves a fairly intimate relationship between the lawyer and the finance company, irrespective of whether the lawyer has an equity interest, financial or otherwise, in the company. Additionally, although the request does not so state, there must, of necessity, be some contractual agreement between the finance company and the lawyer. The conclusion is difficult to escape that the lawyer's desire to stay on the good side of the finance company may cause the lawyer to be less candid than otherwise regarding many of these facets both as to the merits of the client's case and the basics of the funding program.

9. Because of the obvious interest of the lawyer in maintaining and continuing the arrangement with the finance company, and the close inter-relationship between the means of providing funding through the finance company and the role of the lawyer and the lawyer's office in the selection of the finance company and the method and means of the client's procurement of the loan through the finance company's "on site" equipment and the finance company's contract provided funding contract provided to the client through the lawyer, it is the opinion of the Committee that there is a conflict under Rules 1.7(a) and 1.8(a).

10. Such conflicts may be resolved under either Rule 1.7(b) or Rule 1.8(a) by obtaining informed consent from the client confirmed in writing. Rule 1.0 (f) defines 'informed consent" as denoting "the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonable alternatives to the proposed cause of action."[3]

11. At a minimum, "informed consent" would require disclosure of any and all interests the lawyer might have in the financing arrangement, including the interest in continuing the relationship with the finance company by making certain clients repay the agreement. The lawyer would have to disclose the terms of the agreement and any rights the finance company would obtain in enforcing the agreement. The lawyer would have to explore alternatives to the financing arrangements. The lawyer would have to explain that while she would not take direction from the finance company, repayment of the loan might complicate the settlement of the dispute as a dispute may arise between the lawyer and the client as to whether to settle the case for less than he might be entitled if repayment to the finance company were not a factor. This may make obtaining a client's waiver of the conflicts of interest posed by the financing arrangement problematic. That is not to say however, that such a waiver with informed consent manifested in writing could not be obtained.

12. Of course, the lawyer may not permit the lending company to have any direction or regulation of the lawyer's professional judgment in rendering candid advice to the client in the underlying litigation.[4]

CONCLUSION

13. Such a financing arrangement is sufficiently close to the lawyer's own personal and financial interests as to be a conflict under Rules of Professional Conduct 1.7(a) and 1.8(e). Given these conflicts, such a financing arrangement will be proper only if the attorney obtains informed consent, confirmed in writing by the client.

[1] Rule 1.8(f) would preclude the lawyer from accepting compensation for representing the client from another entity unless the client gives informed consent to the representation and the lawyer's relationship with the funding company does not interfere with the lawyer's independent judgment.

[2] The lawyer is always obligated to follow Rule 3.1 (Meritorious Claims and Contentions.) She may not bring or defend a claim unless there is a basis in law or fact. The temptation to bring a frivolous case or present a frivolous defense in order to obtain a prepaid retainer is per se a violation of the rules.

[3] Additionally, the lawyer must comply with Rule 1.7(b)(1) which requires a reasonable belief that the lawyer will be able to provide competent and diligent representation to the client given the existence of the funding company.

[4] The lawyer must comply with Rules of Professional Conduct 5.4 (c). The lawyer must guard against allowing the finance company to exercise any direction or regulation of the lawyer's legal services.

4811-5447-0934, v. 1

Utah State Bar Ethics Advisory Opinion Committee: Opinion No. 97-11

(Approved December 5, 1997)

Issue: May an attorney finance the expected costs of a case by borrowing money from a non-lawyer pursuant to a non-recourse promissory note, where the note is secured by the attorney's interest in his contingent fee in the case?

Conclusion: An attorney's grant of a security interest in a contingent fee from a particular case to secure a loan constitutes the sharing of fees with a non-lawyer in violation of Utah Rules of Professional Conduct 5.4(a).

Facts: "Attorney" has consulted with a private individual who is not an attorney ("Lender"). Lender proposes to loan to Attorney an agreed-on amount to be used for costs and expenses in pursuing a matter on behalf of Attorney's client ("Client"). Attorney and Client have a contingent-fee agreement under which Attorney is responsible for costs, and under which Attorney is entitled to a percentage of the recovery. A promissory note would be executed under which an interest rate would be calculated on the basis of the risk of loss of the case and the fact that Attorney's portion of the recovery would be the only source of repayment of the funds. Funds would be disbursed by Attorney in periodic draws as expenses were incurred.

The loan agreement would also state that Attorney would pay Lender the first proceeds of his share of any recovery until the amount of the note, plus interest, was paid. However, the loan would be "nonrecourse" to Attorney; that is, in the event the loan is not repaid, the Attorney could not be held personally liable by Lender for repayment. As security for the loan, Attorney would assign to Lender his interest in the contingent-fee agreement with Client. A security agreement and financing statement would be signed and proper filings with the appropriate authorities would be made to perfect Lender's security interest. Client would specifically consent to the loan in writing. Lender would agree that he has no right to direct or influence the litigation, that his sole contact with Attorney would be for Attorney to report on the progress of the case, and that Lender could audit expenses paid from loan proceeds for genuineness.

Analysis: Except in certain circumstances, none of which apply to the matter before us, Rule 5.4(a) prohibits a lawyer or law firm from sharing legal fees with a nonlawyer.**1**The Comment to Rule 5.4 states that the rule "expresses traditional limitations on sharing fees," and that "[t]hese limitations are to protect the lawyer's professional independence of judgment."

Lender contends that the proposed arrangement does not involve "fees," because it is merely the repayment of "costs." We disagree. First, the proposed source of repayment is from Attorney's share of the award under the contingent-fee agreement with Client. Attorney agreed to accept responsibility to pay costs and took the risk that he would not recover them out of his share of the award. For our purposes, all of his receipts are "fees." Even if we were to view the first funds coming to Attorney as reimbursement of costs, however, it is clear that, due to the interest factor on the loan, some amounts from the pure "fee" portion of the recovery could have to be paid to Lender to pay the note in full.

Lender also contends that, because Attorney has merely agreed to repay the loan with interest, as opposed to granting a percentage in legal fees received, the proposed loan is merely like any other non-recourse loan. Again, we disagree.**2**We are not troubled by the fact that Attorney needs to borrow funds to run his practice. Many attorneys and firms borrow money and grant security interests in their accounts receivable generally as collateral for the loan. Likewise, it is axiomatic that most attorneys' primary, if not sole, source of revenue is from fees generated from matters undertaken on behalf of clients. Taken to its logical extreme, a Rule 5.4 prohibition on lawyers' meeting their loan repayment obligations from fees received would mean not only the lawyers could not borrow money to run their practices, but that they could not pay for any goods or services on credit.**3**

However, once a security interest in the recovery of contingent fees from a particular case is granted, Rule 5.4 is implicated.4Upon that grant, Lender has an interest in the attorney's contingent-fee award, which Lender has the right to attach upon a default in payment on the loan. That particularized interest in the contingent fees of a case could compromise the lawyer's judgment in a number of ways. For example, the lawyer's judgment may be impaired in drawing up the proposed budget for expenses. He may be influenced in recommending that a client accept a settlement offer because of the impact it may have on the repayment of the debt with Lender. The fact that Lender may agree not to be involved in decisions involving the case or that Client may agree in writing and in advance does not save the proposed arrangement, as Rule 5.4(a) makes no exception for such cases.**5**

Accordingly, we find that an attorney may not finance the costs of a contingent-fee case in which a non-recourse promissory note is

secured by the attorney's interest in the contingent fee.

Footnotes

1.(a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

> (1) An agreement by a lawyer with the lawyer's firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;
>
> (2) A lawyer who undertakes to complete unfinished legal business of a deceased lawyer may pay to the estate of the deceased lawyer that proportion of the total compensation which fairly represents the services rendered by the deceased lawyer; and
>
> (3) A lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement.

Utah Rules of Professional Conduct 5.4(a).

2.*See In re Van Cura*, 504 N.W.2d 610 (Wis. 1993) (unethical fee splitting found when law firm agreed to finance its product-liability litigation with nonlawyer consulting firm in return for which consulting firm would receive half the fees received from such cases).

3.*See* ABA Formal Op. 320 (1968), which held a financing plan did not constitute a per se violation of Rule 5.4 where a lawyer charged a client a fixed fee, took a promissory note for the fee, and then sold the note to a bank at a discounted price. The note was endorsed to the bank "without recourse," and the attorney had the right to repurchase the note prior to the bank's instituting any legal action on it. The plan, however, specifically excluded contingent fees.

4.*See* Utah State Bar Ethics Advisory Op. No. 139, 1994 WL 579849 ("[P]rovided no other rule of professional conduct is violated, compensation of non-lawyer employees may be based upon a percentage of gross or net income so long as it is not tied to the fees from a particular case.")

5. If neither Lender nor Client is an attorney, the Rules of Professional Conduct would not apply to them, and a loan transaction between Lender and Client, where Client signs the promissory note and secures the note by granting a security interest in his share of the recovery, would not violate the Rules. We caution, however, that attorneys should be aware of Rule 8.4(a), which provides that a lawyer may not "violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another."