

# AMERICAN BAR ASSOCIATION

STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY

**Formal Opinion 484**

**November 27, 2018**

## **A Lawyer's Obligations When Clients Use Companies or Brokers to Finance the Lawyer's Fee**

*Lawyers may refer clients to fee financing companies or brokers in which the lawyers have no ownership or other financial interests provided they comply with Model Rules 1.2(c), 1.4(b), 1.5(a) and (b), 1.6, 1.7(a)(2), and 1.9(a). If a lawyer were to acquire an ownership or other financial interest in a finance company or brokerage and thereafter refer clients to that entity to finance the lawyer's fees, the lawyer would be entering into a business transaction with a client, or obtaining a security or pecuniary interest adverse to the client, or both. In that instance, the lawyer would also be required to comply with Model Rule 1.8(a).<sup>1</sup>*

### **I. Introduction**

Some clients may be unable to afford lawyers' fees absent some form of accommodation or assistance. For example, a criminal defense or family law client may be unable to afford a lawyer's flat fee at the outset of a representation.<sup>2</sup> The client may be able to afford the lawyer's fee, however, if the client can finance the fee through a loan from a third-party. Or, a client may simply wish to finance a lawyer's fee rather than pay a lump sum. In some instances, the client may be able to obtain a loan from a bank or other traditional financial institution, but in other cases that option will not be available. In the latter situation, the client may want to finance the lawyer's fee through a finance company. This raises the following questions: (a) whether the lawyer may refer the client to a finance company that will likely loan the client money to pay the lawyer's fees,

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<sup>1</sup> This opinion is based on the ABA Model Rules of Professional Conduct as amended by the ABA House of Delegates through August 2018. The laws, court rules, regulations, rules of professional conduct and opinions promulgated in individual jurisdictions are controlling.

<sup>2</sup> A client in such a situation may wish to pay the lawyer's fee by credit card if possible; numerous jurisdictions permit lawyers to accept credit cards to pay fees with certain conditions. *See, e.g.*, ABA Comm'n on Ethics & Prof'l Responsibility, Formal Op. 00-419 (2000) (rejecting the reasoning in prior opinions regarding the use of credit cards to pay for non-professional services and merchandise, "the Committee accepted, per se, the propriety of using credit cards to pay legal fees"); Ill. State Bar Ass'n Advisory Op. 14-01 (2014), 2014 WL 2434670, at \*2; N.Y. State Bar Ass'n, Comm on Prof'l Ethics Op. 1112 (2017), 2017 WL 527372 at \*1; Or. State Bar Ass'n, Bd. of Gov'rs Op. 2005-172 (2005), 2005 WL 5679599, at \*1.

or (b) whether the lawyer may refer the client to a broker who will assist the client in obtaining fee financing. Lawyers have reported several fee financing scenarios.

First, a lawyer may know of a finance company in which the lawyer has no ownership or other financial interest. An interested client applies for a loan for the lawyer's full fee with the finance company, which determines whether to make a loan, the amount of any loan, the interest rate on the loan, and the amount of any financing fee (which reportedly ranges between 5–15%). If the finance company approves the loan, it deposits the full loan amount in the lawyer's bank account, less the financing fee. The lawyer receives nothing from the finance company for the client's participation other than the fee payment; the loan to the client is non-recourse as to the lawyer. The lawyer's fee agreement with the client explains the arrangement. Absent other circumstances permitting or requiring the lawyer to terminate the attorney-client relationship, the lawyer will continue to represent the client even if the client defaults on the loan.<sup>3</sup>

Second, the lawyer agrees to pay an initial fee to the finance company in exchange for the right to submit loan applications from clients. The lawyer has no financial or other interest in the finance company, and the finance company makes all decisions about whether to loan funds to the client, in what amount, and on what terms. The client is solely responsible for repaying any loan; the loan is non-recourse as to the lawyer. The finance company pays the loan proceeds directly to the lawyer, minus a 10% finance fee.<sup>4</sup>

Third, the lawyer knows of a finance company in which the lawyer has no ownership or other interest. The lawyer negotiates a fee with a client consistent with the lawyer's customary

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<sup>3</sup> Fla. State Bar Ass'n, Comm. on Prof'l Ethics Op. 16-2 (2016), 2016 WL 8648795, at \*1 [hereinafter Fla. Ethics Op. 16-2] (describing such an arrangement).

<sup>4</sup> Ill. State Bar Ass'n Advisory Op. 92-9, at 1 (1993) (outlining this arrangement).

practice. “In appropriate circumstances,” the lawyer may inform a client of the possibility of financing the fee through the finance company.<sup>5</sup> If the client is interested in financing the fee, the lawyer provides the client with additional information about the financing plan. The client then completes the company’s printed credit application in the lawyer’s office and the lawyer sends the application to the company. If the company approves the credit application, it will establish a credit facility for the payment of the lawyer’s fees up to the credit limit established by the company. The lawyer periodically submits vouchers to the finance company for services rendered to the client. The client must approve the vouchers. If the client approves a voucher, the finance company pays the lawyer the amount of the voucher minus a 10% service charge (up to the client’s unused credit limit). The client must repay the amount of each voucher plus interest at a rate comparable to the interest rates banks charge for credit cards. The finance company also requires the client to deposit funds in a reserve account to reduce the finance company’s risk of default.

Fourth, the lawyer knows of a finance company in which the lawyer has no ownership or other interest. The lawyer gives clients a link to the finance company’s website or posts the link on the lawyer’s website, either of which directs clients to the finance company’s loan application forms. If a client completes the application, the finance company decides whether to lend the client money and on what terms. The finance company disburses the loan funds directly to the client, but the finance company provides the lawyer with a “portal” through which he or she can learn whether the client applied for a loan, and when and in what amount loan funds were disbursed to the client. To participate in these programs, the lawyer pays a fee to the finance company of

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<sup>5</sup> Or. State Bar Ass’n, Bd. of Gov’rs Op. 2005-133, 2005 WL 5679557, at \*1 [hereinafter Or. Ethics Op. 2005-133].

several hundred dollars either as a one-time registration fee or as a monthly subscription fee.<sup>6</sup> Again, any loan to a client is non-recourse with respect to the lawyer.

Fifth, a finance company offers a “same as cash” funding program for a lawyer’s fees or retainer in which the company provides the physical equipment necessary to carry out the mechanics of the arrangement on-site in the lawyer’s office. To initiate the process at the lawyer’s office, the client swipes an item of personal financial identification through an identifying device provided to the lawyer by the finance company. The finance company also provides the lawyer with an imaging machine that scans the client’s personal check to facilitate the finance company’s collection of periodic loan repayments directly from the client’s checking account. The finance company then may qualify the client for a loan at a wide range of interest rates depending on the finance company’s determination of the risk of non-payment and the length of the repayment period. If the client qualifies, the lawyer provides the client with the loan documents and the finance company pays the lawyer directly. The finance company has no recourse against the lawyer if the client defaults.<sup>7</sup>

Sixth, but similarly, a lawyer may associate with a financial brokerage company that helps clients obtain legal fee financing. The broker is not a lender; it locates banks willing to finance the client’s legal fees. The broker charges the lawyer an initial setup fee and a monthly fee to create and maintain a webpage that facilitates the brokerage function. The lawyer also pays a “merchant fee” on the amount of the financed legal fee. More particularly, the broker provides interested clients with loan applications to submit to banks. Approved clients receive offers from competing

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<sup>6</sup> N.Y. State Bar Ass’n, Comm. on Prof’l Ethics Op. 1104 (2016), 2016 WL 7338634, at \*1 [hereinafter N.Y. Ethics Op. 1104] (explaining this arrangement, and identifying factors the lawyer should consider).

<sup>7</sup> Utah State Bar, Ethics Advisory Opinion Comm. Op. 13-05 (2013), 2013 WL 7393113, at \*1 (explaining this arrangement and addressing the conflicts and other issues the lawyer should consider).

banks, and are free to pick the offer that works best for them, or to decline all offers. If the client accepts an offer, the lending bank pays the loan amount to the client. The client then pays the lawyer's fee in accordance with their fee agreement.<sup>8</sup> Once again the loan is non-recourse insofar as the lawyer is concerned.

As explained below, fee financing arrangements of the types described here are ethically permissible provided that the lawyer complies with Model Rules of Professional Conduct 1.2(c), 1.4(b), 1.5(a) and (b), 1.6, 1.7(a)(2), and 1.9(a).<sup>9</sup>

## II. Analysis

First, a lawyer who is willing to allow a client to finance the lawyer's fee must under Model Rule 1.4(b) explain the arrangement to the client to the extent reasonably necessary to permit the client to make informed decisions about the representation. Depending on the facts, this may include explaining (1) the lawyer's relationship with the finance company or broker, including any fees paid by the lawyer to the company or broker, the payments received by the lawyer, and whether the company or broker is also a client of the lawyer; (2) how the lawyer's fee will be paid by the finance company or bank where the finance company or bank disburses funds directly to the lawyer, or how the client is expected to pay the lawyer's fee where the finance company or bank disburses the loan funds to the client; (3) that the finance company will inform the lawyer when it makes a loan to the client and disburses funds to the client, as in the third scenario outlined above; (4) the costs and benefits of the transaction to the client; (5) the terms of the arrangement

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<sup>8</sup> 2018 N.C. State Bar Formal Op. 4 (2018), 2018 WL 2215870, at \*1 [hereinafter N.C. Ethics Op. 4] (describing this arrangement and identifying factors the lawyer should consider).

<sup>9</sup> MODEL RULES OF PROF'L CONDUCT (2018) [hereinafter MODEL RULES]. The Committee expresses no opinion on whether such arrangements may violate consumer protection or usury laws. Should they do so, a lawyer who facilitates the arrangements may risk violating Model Rules 1.2(d), 4.1(a), 8.4(b), and 8.4(d).

between the finance company or broker and the client as known or understood by the lawyer; (6) alternative payment options for the client; (7) any payment terms that the lawyer intends to impose if the finance company disburses the loan proceeds to the client rather than to the lawyer; (8) whether the lawyer will charge a higher fee than he or she would charge otherwise because of the financing arrangement, as perhaps to recoup any financing or other fee the lawyer must pay to the finance company or broker;<sup>10</sup> (9) the lawyer's obligation to maintain the confidentiality of client information with respect to the finance company, broker, or bank; (10) that paying the lawyer through fee financing may affect the rights and remedies the client might have to obtain the repayment or return of those funds or the forgiveness or reduction of the client's debt in a dispute arising out of the lawyer's performance; and (11) any other factor that the lawyer knows or reasonably should know to be material to the financing of the representation.

A lawyer may not want to advise a client about the costs and benefits of financing the lawyer's fee or the terms of any such agreement or transaction. For example, the lawyer may view those conversations as more suitably held between the client and representatives of the finance company or broker, or between the client and the client's family or other advisors. If so, and given the possibility that a client might believe that the lawyer is exercising professional judgment in recommending the finance company or broker, or that the lawyer has evaluated the loan terms and believes them to be suitable for the client, the lawyer must limit the scope of the representation in accordance with Model Rule 1.2(c).<sup>11</sup>

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<sup>10</sup> A lawyer always has a duty to communicate to the client "the basis or rate of the fee and expenses for which the client will be responsible" unless the lawyer "will charge a regularly represented client on the same basis or rate." MODEL RULES R. 1.5(b) (2018).

<sup>11</sup> See MODEL RULES R. 1.2(c) (2018) ("A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent."); see also N.Y. Ethics Op. 1104, *supra* note 6, at \*3 (endorsing the lawyer's limitation of the representation under Rule 1.2(c) where a potential client might

The lawyer may wish to advise the client that the finance company, broker, or bank will not direct or regulate the lawyer's professional judgment in representing the client in accordance with Model Rule 5.4(c).<sup>12</sup> Admittedly, Model Rule 5.4(c) does not apply to any of the scenarios under consideration because the finance company, broker, or bank is not paying the lawyer—the client is paying the lawyer with borrowed funds.<sup>13</sup> Furthermore, unlike litigation funding or financing, a legal fee lender in the scenarios described above has no direct financial interest in the outcome of the matter, and therefore no incentive to attempt to influence the lawyer's advice, strategy, or tactics. Accordingly, the lawyer generally has no obligation to inform the client of the professional independence that Model Rule 5.4(c) assures in appropriate cases. Even so, because the loaned funds are tied to the representation and because an unsophisticated client may view the finance company, broker, or lending bank as “paying” the lawyer, a lawyer may see value in assuring the client of the lawyer's obligation to exercise independent professional judgment in representing the client regardless of the source of the funds used to pay the lawyer.

Second, any fee that the lawyer charges the client must be reasonable.<sup>14</sup> If the lawyer increases the fee for the representation above what the lawyer normally charges for a similar matter to account for any finance fee or subscription the lawyer must pay to the finance company or

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believe that the lawyer is exercising professional judgment in recommending financing, recommending a particular financier, or has evaluated the loan terms).

<sup>12</sup> See MODEL RULES R. 5.4(c) (2018) (“A lawyer shall not permit a person who recommends, employs, or pays the lawyer to direct or regulate the lawyer's professional judgment in rendering such legal services.”).

<sup>13</sup> Model Rule 1.8(f) does not apply because the client is paying the lawyer with the client's own funds; this is not a situation where someone other than the client is paying the lawyer to represent the client. The fact that the client has borrowed the funds used to pay the lawyer does not change the fact that the funds belong to the client. *See id.* (stating that a lawyer “shall not accept compensation for representing a client from one other than the client” unless three conditions are met). *But see* N.Y. Ethics Op. 1104, *supra* note 6 (noting that “For all practical purposes, the lawyer is accepting fees ‘from one other than the client’ (the lender). . . . [A]lthough the funds are not paid directly to the lawyer, the lender informs the lawyer when the funds are disbursed, presumably to help ensure that the lawyer gets paid. When the lender gives the lawyer information about a disbursement, that information is something ‘of value’ that triggers Rule 1.8(f).”)

<sup>14</sup> MODEL RULES R. 1.5(a) (2018) (stating that a lawyer “shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses”).

broker, the fee charged to the client must still be reasonable.<sup>15</sup> Furthermore, the lawyer must inform the client that the lawyer will be charging the client a higher fee to account for the finance or subscription fee that the lawyer must pay to the finance company or broker.<sup>16</sup>

Third, if a lawyer accepts loan proceeds to pay a flat fee, the lawyer must deposit those funds in the lawyer's trust account or operating account and treat them as unearned or earned just as the jurisdiction provides for the payment of flat fees generally.<sup>17</sup> If either the client or the lawyer terminates the representation before the lawyer fully earns the flat fee, the lawyer must refund the unearned funds to the client. The failure to do so would result in the lawyer collecting an unreasonable fee in violation of Model Rule 1.5(a).

Fourth, while a lawyer may refer a client to a finance company or broker, the lawyer may not reveal information regarding the client's representation to the company, broker, or lending bank except as permitted under Rules 1.6(a) or (b).

Fifth, in referring a client to a finance company or broker, a lawyer must be alert to the possibility of a material limitation conflict of interest under Model Rule 1.7(a)(2).<sup>18</sup> Arguably the greatest risk is that the lawyer will recommend the finance company or broker to the client even though fee financing is not in the client's interests because the client's arrangement of financing

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<sup>15</sup> In some jurisdictions, a lawyer may be prohibited from charging a higher fee because the fee is being financed. *See, e.g.*, FLA. RULES OF PROF'L CONDUCT 4-1.5(h) (2015) ("A lawyer or law firm may accept payment under a credit plan. No higher fee shall be charged and no additional charge shall be imposed by reason of a lawyer's or law firm's participation in a credit plan.").

<sup>16</sup> MODEL RULES R. 1.4(b) (2018).

<sup>17</sup> Some jurisdictions permit lawyers to treat flat fees as earned upon receipt and therefore not entrusted. In those jurisdictions, lawyers who elect to treat flat fees as earned upon receipt must deposit them in their operating accounts to avoid commingling allegations. Other jurisdictions hold that because flat fees are merely advance fee payments, they must be held in trust until earned through the lawyer's performance of the agreed services.

<sup>18</sup> *See* MODEL RULES R. 1.7(a)(2) (2018) (stating that a concurrent conflict of interest exists if "there is a significant risk that the representation of one or more clients will be limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer").



best assures payment or timely payment of the lawyer's fee. A conflict of interest might also exist if the finance company or broker is also a client of the lawyer. A lawyer may avoid a conflict in the first instance by not recommending fee financing to the client. As the North Carolina State Bar has explained, "[a] lawyer does not put his own financial interests ahead of those of his client by providing payment options to a client who requires financial assistance in paying the lawyer's fees. However, given the lawyer's self interest in being paid in full for his services, the lawyer may not recommend one payment option over another."<sup>19</sup> In either instance, the client may give informed consent to the representation notwithstanding any material limitation conflict provided that the Model Rule 1.7(b) requirements are satisfied.<sup>20</sup>

Sixth, if the lawyer previously represented the finance company, broker, or lender in connection with loans to clients of other lawyers and is representing his or her current client in obtaining fee financing from the finance company, broker, or lender, the lawyer must consider whether the current client's interests are materially adverse to the former client's interests. If they are, the lawyer must obtain the former client's informed consent to the representation at hand and confirm it in writing.<sup>21</sup>

As noted earlier, some finance companies charge a lawyer a financing or subscription fee. For example, if a finance company loans a client \$10,000 to pay a lawyer's flat fee, the company may deduct a 5% financing fee from the loan proceeds paid to the lawyer, such that the lawyer receives \$9,500 for his or her services rather than the full \$10,000. Such terms do not constitute

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<sup>19</sup> N.C. Ethics Op. 4, *supra* note 8, at \*1.

<sup>20</sup> *See, e.g.*, Or. Ethics Op. 2005-133, *supra* note 5, at \*3 (noting the risk that the lawyer might encourage a client to enter into a financing plan to assure the payment of fees or to avoid the expense of collecting fees even if the plan was not necessarily in the client's best interests, but stating that the client could give informed consent to the representation notwithstanding the Rule 1.7(a)(2) material limitation conflict).

<sup>21</sup> MODEL RULES R. 1.9(a) (2018).

fee sharing in violation of Model Rule 5.4(a)<sup>22</sup> because the financing or subscription fee is basically an administrative fee that is deducted from the payment to the lawyer.<sup>23</sup> This is akin to a merchant fee that credit card companies charge.<sup>24</sup> It is settled that lawyers' payment of credit card merchant fees does not constitute impermissible fee-sharing.<sup>25</sup> Additionally, the prohibition on fee-sharing is intended to protect a lawyer's "professional independence of judgment."<sup>26</sup> As previously explained, a legal fee financier has no direct financial interest in the outcome of the matter, and thus no incentive to influence the lawyer's professional judgment. In short, this is not a situation to which the Model Rule 5.4(a) prohibition on fee-sharing is meant to apply.

Finally, although not among the fee financing scenarios of which the Committee has been made aware, it is conceivable that a lawyer might acquire an ownership or other financial interest in a finance company or brokerage, or wish to form such a business. If a lawyer did so and referred a client to that entity, the lawyer would be entering into a business transaction with the client or would be acquiring a security or pecuniary interest adverse to the client, or both. In those situations, the lawyer would need to comply with Model Rule 1.8(a). Compliance with Rule 1.8(a)

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<sup>22</sup> *Id.* See also MODEL RULES R. 5.4(a) (2018) (stating that a lawyer or law firm "shall not share legal fees with a nonlawyer" except in circumstances not pertinent here).

<sup>23</sup> See Pa. Bar Ass'n, Comm. on Legal Ethics & Prof'l Responsibility Op. 94-30 (1994), 1994 WL 928021, at \*1-2 (discussing a fee financing service in which the amounts charged to the lawyer were for the collection of fees rather than for legal services rendered); Sup. Ct. of Tex., Prof'l Ethics Comm. Op. 481, 1994 WL 848496, at \*1 (stating that "the retention by the finance corporation of a reasonable portion of the amount borrowed by the client is properly viewed as finance arrangement rather than a fee-splitting arrangement").

<sup>24</sup> See Fla. Ethics Op. 16-2, *supra* note 3, 2016 WL 8648795, at \*2 (reasoning that legal fee financing is not impermissible fee sharing because it is a form of credit plan and Florida ethics rules permit lawyers to accept payments through credit plans, which include credit cards); Or. Ethics Op. 2005-133, *supra* note 5, at \*3 (describing a fee financing plan in which the finance company deducts a 10% service fee from every payment to the lawyer as analogous to the client's use of a credit card to pay legal fees).

<sup>25</sup> See, e.g., 2010 N.C. State Bar Formal Op. 4 (2010), 2010 WL 4730432, at \*3 (discussing fee sharing under Rule 5.4(a) in connection with a barter exchange and stating that "[t]he use of credit cards to pay for legal services has long been allowed, although credit card banks routinely charge a 'discount fee' that is a percentage of the legal fee charged to the credit card"); Phila. Bar Ass'n, Prof'l Guidance Comm. Op. 00-10 (2000), 2000 WL 33173001, at \*1 (stating that "allowing clients to use credit cards to pay legal fees and expenses does not constitute a violation of the Rules of Professional Conduct").

<sup>26</sup> MODEL RULES R. 5.4 cmt. 1 (2018).

would require the lawyer to (1) ensure that the terms and transaction are fair and reasonable to the client, and fully disclose and transmit the terms and an explanation of the transaction to the client in a manner that the client could reasonably understand; (2) advise the client of the desirability of seeking independent legal advice regarding the transaction and afford the client a reasonable opportunity to do so; and (3) obtain the client's informed written consent to the transaction's essential terms and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

### **III. Conclusion**

Lawyers may participate in the fee financing arrangements described in Part I of this opinion provided they comply with Model Rules 1.2(c), 1.4(b), 1.5(a), 1.6, 1.7(a)(2), and 1.9(a). They may further acquire an interest in or form a finance company or brokerage and thereafter refer clients to that entity provided that they comply with Model Rule 1.8(a).

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