

L.E.O. 2016-01

PROPRIETY OF ATTORNEYS OBTAINING LOANS FROM THIRD PARTY LENDERS TO ADVANCE LITIGATION COSTS AND WHETHER COSTS AND INTEREST ASSOCIATED WITH THE LOAN CAN BE CHARGED TO CLIENT

INTRODUCTION

The Lawyer Disciplinary Board (Board) received a request for a formal legal ethics opinion addressing the ethical propriety of attorneys obtaining loans from a third party lender to advance litigation costs in contingent fee litigation, and whether attorneys could then charge the costs and interest on such loans to clients.¹ Many disciplinary authorities have addressed this issue.² The opinions addressing this issue found that the Rules of Professional Conduct do not prohibit attorneys from obtaining a loan from a third party lender (either a bank or other type of financial lender) to fund litigation costs and expenses and that the interest associated with the loan may be charged to the client provided that certain conditions are met.

¹ Because of the specificity of the request to the Board, the L.E.O. does not address the issue of “alternative litigation funding” wherein the entity lending money to either the client or the attorney gains a financial stake in the litigation in exchange for the investment of money in a matter.

² The Lawyer Disciplinary Board found Opinion 2001-3 issued by the Supreme Court of Ohio’s Board of Commissions on Grievances and Discipline to be instructive on these matters. *See also* State Bar of Arizona, Ethics Opinion, 01-07 (2001); State Bar of Florida, Formal Advisory Op. 86-2 (1986); State Bar of Georgia, Formal Op. 05-5-1 (2005); Illinois State Bar Ass’n, Opinions 92-9 (1993), 94-6 (1994); Maine Board of Overseers of the Bar, Opinion 177 (2001); Massachusetts Bar Ass’n Ethics Op. 83-7 (1983); Michigan Standing Committee on Professional Ethics, RI-336 (2005, amended 6/27/08); Missouri, Office of Chief Disciplinary Counsel, Informal Opinions, 970016, 970066, 20030022; State Bar of Nevada Standing Committee on Ethics and Professional Responsibility, Formal Opinion 36 (2007); New Jersey Sup Ct, Advisory Comm. Op. 603 (1987); New York State Bar Ass’n, Ethics Op. 754 (2002); North Carolina State Bar, Formal Ethics Op. 12 (2006); Supreme Court of Tennessee Board of Professional Responsibility, Advisory Ethics Op. 98-A-659 (1989); Utah State Bar, Ethics Advisory Opinions, 97-11 (1998), 02-01 (2002); Washington State Bar Ass’n, Advisory Op. 1960 (2001).

Based upon a review of these opinions and applicable West Virginia Rules of Professional Conduct³, this Board finds that a lawyer or law firm may obtain a loan from a third party lender to advance the costs and expenses of litigation in a contingent fee matter and that the attorney's costs and interest associated with the loan may be deducted from the client's portion of the settlement or judgment provided that certain conditions, prescribed under the Rules of Professional Conduct, are met. This opinion will address this matter in two parts: (1) the propriety of a lawyer or law firm obtaining a loan from a third party lender to advance litigation costs and (2) whether the lawyer or law firm can deduct interest, fees and costs of the loan from a client's settlement or judgment. A final section will discuss any remaining considerations under the Rules of Professional Conduct.

DISCUSSION

1. Propriety of a lawyer or law firm obtaining a loan from a third party lender to advance litigation costs

The Rules of Professional Conduct permit lawyers to advance the expenses of litigation and allow a client's repayment of expenses to be contingent on the outcome of the matter. Rule 1.8(e) of the West Virginia Rules of Professional Conduct provides that "[a] lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter;...." Comment 10 of Rule 1.8(e) indicates that a lawyer may lend a client court costs and litigation

³ By Order entered September 29, 2014, the West Virginia Rules of Professional Conduct were amended, effective January 1, 2015.

expenses, including the expenses of medical examination and the costs of obtaining and presenting evidence, “because these advances are virtually indistinguishable from contingent fees and help ensure access to the courts.”

The Board, however, acknowledges that this rule does not indicate whether a lawyer may obtain a loan from a third party lender in order to advance these costs and expenses. Moreover, there are other prohibitions within Rule 1.8 of the Rules of Professional Conduct which need to be addressed when considering the issue. Rule 1.8(i) generally prohibits a lawyer, except under certain limited circumstances not necessarily applicable to this L.E.O., from “acquir[ing] a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client,” Comment 21 indicates that this rule has “its basis in common law champerty and maintenance and is designed to avoid giving the lawyer too great an interest in the litigation.” A lawyer may not secure the lawyer’s obligation to repay the loan with a client’s settlement or judgment since the lawyer is obligated to repay the loan regardless of the outcome of the client’s case. A lawyer using a client’s settlement or judgment to secure a loan could also be in violation of Rule 5.4(a), which provides, in part, that “[a] lawyer or law firm shall not share legal fees with a nonlawyer, except [under circumstances, again, not applicable herein].”⁴ This scenario also implicates Rule 1.8(a)

⁴ While we wish to make it clear that this opinion does not address “alternative litigation funding” or the propriety of a lawyer entering into non-recourse loans for litigation expenses, other jurisdictions have addressed this issue and we include the following as a cautionary statement. “Once a security interest in the recovery of contingent fees from a particular case is granted, Rule 5.4 is implicated. [For] upon 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.

which provides, in part, that “[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 client”⁵ The loan transaction does not involve the client when the loan the lawyer obtains is not secured by the client’s settlement or judgment. It is a transaction solely between the lawyer or law firm and the third party lender.⁶ Therefore, the Board finds that the West Virginia Rules of Professional Conduct do not prohibit a lawyer or law firm from obtaining a loan from a third party lender to advance the lawyer’s actual litigation costs and expenses in a personal injury matter.

Now that the Board has determined that the Rules of Professional Conduct do not prohibit a lawyer or law firm from obtaining a loan from a third party lender, not secured by the client’s settlement or judgment, is the lawyer required to advise the client about the loan? The answer is yes. Rule 1.8(f) provides that “[a] lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client gives informed consent; and (2) there is no interference with the lawyer’s independence of professional

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.” Utah State Bar, Ethics Advisory Opinion, 97-11, ¶ 5 (1998); *See also* State Bar of Nevada Standing Committee on Ethics and Professional Responsibility, Formal Opinion 36, p. 4 (2007) (“Where loan is not contingent on litigation success but is a conventional recourse loan that must be repaid irrespective of the outcome of the litigation it financed, courts and bar associations have generally approved such arrangements.”)

⁵ The lawyer’s acquisition of an interest in a client’s matter may also be a concurrent conflict of interest under Rule 1.7(a)(2) which provides, in part, that “...a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: (2) there is a significant risk that the representation of one or more clients will be materially limited ... by a personal interest of the lawyer.”

⁶ The Board issues no opinion on whether Truth in Lending or other consumer protection laws are applicable to the issue presented herein.

judgment or with the client-lawyer relationship; and (3) the information relating to the relationship is protected as required by Rule 1.6.”

Therefore, in a situation where the attorney wants to obtain a loan to advance litigation costs, the attorney must discuss with the client the attorney’s request to obtain a loan to fund litigation costs and must obtain the client’s written informed consent to obtain the loan. Rule 1.4(a) provides, in pertinent part, that “[a] lawyer shall: (1) promptly inform the client of any decision or circumstance with respect to which the client’s informed consent, as defined in Rule 1.0(e), is required by these Rules;”⁷ Rule 1.4(b) provides that “[a] lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.”

2. The propriety of deducting interest fees and costs of a loan from a client’s settlement or judgment.

The Board finds that the Rules of Professional Conduct do not prohibit a lawyer or law firm from deducting the loan’s interest fees and costs from a client’s settlement or judgment. However, the Board advises that before a lawyer or law firm can charge the loan’s costs and interest to the client, the lawyer must meet certain conditions provided for in the Rules of Professional Conduct. The lawyer must take care that the terms of the loan, including the amount borrowed, the interest rate and costs of the loan must be appropriate and reasonable pursuant to Rule 1.5(a) which provides, in part, that “[a] lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for

⁷ Rule 1.0(e) states that “‘Informed consent’ denotes 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 reasonably available alternatives to the proposed course of conduct.”

expenses....” If a lawyer chooses to obtain a loan and the client gives informed consent, the terms of the loan must be disclosed to the client and must be agreed upon by the client. At a minimum, the client should be advised of how and when the attorney will finance the advances, the name of the third party lender, and the expected costs associated with the financing, including the rate of interest. These requirements can be accomplished in a written retainer agreement or in a subsequent written addendum.⁸ Under Rule 1.5(b), “[t]he scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client in writing, or within a reasonable time after commencing the representation,.... Any changes in the basis or rate of the fee or expenses shall also be communicated to the client in writing.” Rule 1.5(c) provides, in pertinent part, that

[a] fee may be contingent on the outcome of the matter for which the service is rendered, A contingent fee shall be in writing signed by the client and shall state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of a settlement, trial or appeal, litigation or other expenses to be deducted from the recovery, and whether such expenses are to be deducted before or after the contingent fee is calculated. The agreement must clearly notify the client of any expenses for which the client will be liable whether or not the client is the prevailing party. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

⁸ Under the revised Rules of Professional Conduct, effective January 1, 2015, written retainer agreements are required in all representations, not just contingent fee matters, unless the lawyer is charging a regularly represented client on the same basis or rate. *See* Rule 1.5(b) of the Rules of Professional Conduct.

The costs must be the attorney's actual costs and interest charged, *i.e.*, no "upcharge" is permitted. The lawyer or law firm must not profit from the loan or have an interest in the financial institution or lender making the loan. The attorney should also use a financing arrangement that allocates interest and other costs to specific clients. The attorney should not use a single line of credit to finance advances on behalf of numerous clients and estimate how interest should be allocated among those clients.⁹

3. **Additional Considerations under the Rules of Professional Conduct**

If a loan is obtained to advance litigation costs, the attorney must not permit the third party lender to interfere with the attorney/client relationship under Rule 5.4 of the Rules of Professional Conduct,¹⁰ and the attorney must take care to remember his or her obligations under Rule 1.6 of the Rules of Professional Conduct. Rule 5.4(c) provides that "[a] lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal service for another to direct or regulate the lawyer's professional judgment in rendering such legal services." Rule 1.6(a) provides, in part, that "[a] lawyer shall not reveal information relating to representation of a client unless the client gives informed consent,"¹¹

⁹ See Maine Overseers of the Bar, Opinion 177 (12/14/01), *Advancing Litigation Costs Through Lines of Credit*

¹⁰ See also Rule 1.8(f)(2), as stated above.

¹¹ It should be noted that a few jurisdictions have addressed the issue of the confidentiality of an attorney's communications and/or documents with a third party lender. See, e.g., *Leader Techns., Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373 (D. Del. 2010) (compelling disclosure of documents shared with financing companies during discussions about potential financing); see also *Abrams v. First Tenn. Bank Nat'l Ass'n*, No. 3:03-cv-428, 2007 WL 320966, at *1 (E.D. Tenn. Jan. 30, 2007); see also Nate Raymond, *Litigation Funders Face Discovery Woes*, Nat'l L.J., Feb. 21, 2011 (reporting that in at least one case, the initial conversations between a funding company and the client were not protected from disclosure by the attorney client privilege).

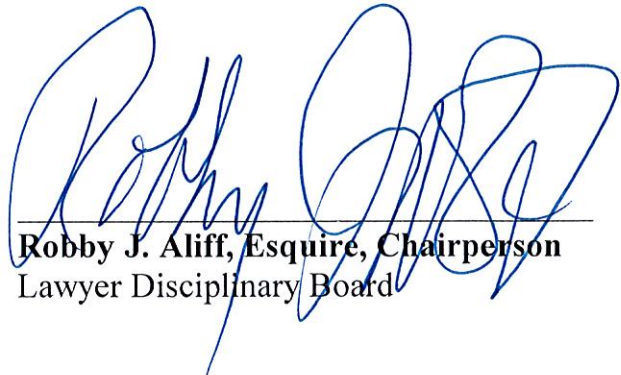
CONCLUSION

The West Virginia Lawyer Disciplinary Board finds that a lawyer or law firm may obtain a loan from a third party lender to advance the costs and expenses of litigation in a contingent fee matter¹² and that the attorney's actual costs and interest associated with the loan may be deducted from the client's portion of the settlement or judgment provided that certain conditions, prescribed under the Rules of Professional Conduct, are met. The client must be informed in writing, of the terms of the loan, the name of the lender, the amount borrowed, the interest rates to be applied to the amount borrowed, and any associated costs, and must provide informed consent. The lawyer may not secure the loan with the client's settlement or judgment and the terms of the loan, including the amount, costs and interest to be assessed must be reasonable. The lawyer may accomplish this in the written retainer agreement signed by the client or in a written addendum to the retainer agreement. The contingent fee agreement must inform the client of the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of a settlement, trial or appeal, litigation or other expenses to be deducted from the recovery, and whether such expenses, including those associated with a loan the lawyer obtained to advance litigation costs and expenses, are to be deducted before or after the contingent fee is calculated. The written retainer agreement must clearly advise the client of any expenses for which the client will be liable, whether or not the client is the prevailing

¹² It is also recognized that the type of third party litigation funding discussed herein might be utilized in other types of attorney client fee arrangements that are not contingency in nature. This LEO should apply equally to non-contingency claims as well.

party. Finally, upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

APPROVED by the Lawyer Disciplinary Board on the 7th day of October, 2016, and
ENTERED this 7th day of October, 2016.



Robby J. Aliff, Esquire, Chairperson
Lawyer Disciplinary Board