Utah Ethics Opinions

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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. (fn1) 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. (fn2) 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. (fn3)

However, once a security interest in the recovery of contingent fees from a particular case is granted, Rule 5.4 is implicated. (fn5)

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."

Rule Cited:

5.4