Formal Advisory Opinion No. 05-5

STATE BAR OF GEORGIA
FORMAL ADVISORY OPINION NO. 05-5
Approved And Issued On February 13, 2007 Pursuant To Bar Rule 4-403
By Order Of The Supreme Court Of Georgia Thereby Replacing FAO No. 92-1
Supreme Court Docket No. S06U0798

QUESTION PRESENTED:

1) Ethical propriety of a law firm obtaining a loan to cover advances to clients for litigation expenses;

2) Ethical considerations applicable to payment of interest charged on loan obtained by law firm to cover advances to clients for litigation expenses.

OPINION:

Correspondent law firm asks if it is ethically permissible to employ the following system for payment of certain costs and expenses in contingent fee cases. The law firm would set up a draw account with a bank, with the account secured by a note from the firm's individual lawyers. When it becomes necessary to pay court costs, deposition expenses, expert witness fees, or other out-of-pocket litigation expenses, the law firm would obtain an advance under the note. The firm would pay the interest charged by the bank as it is incurred on a monthly or quarterly basis. When a client makes a payment toward expenses incurred in his or her case, the amount of that payment would be paid to the bank to pay down the balance owed on his or her share of expenses advanced under the note. When a case is settled or verdict paid, the firm would pay off the client's share of the money advanced on the loan. If no verdict or settlement is obtained, the firm would pay the balance owed to the bank and bill the client. Some portion of the interest costs incurred in this arrangement would be charged to the client. The contingent fee contract would specify the client's obligations to pay reasonable expenses and interest fees incurred in this arrangement.

The first issue is whether it is ethically permissible for lawyers to borrow funds for the purpose of advancing reasonable expenses on their clients' behalf. If so, we must then determine the propriety of charging clients interest to defray part of the expense of the loan.

In addressing the first issue, lawyers are generally discouraged from providing financial assistance to their clients. Rule 1.8(e) states:

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; or

(2) a lawyer representing a client unable to pay court costs and expenses of litigation may pay those costs and expenses on behalf of the client.

Despite that general admonition, contingent fee arrangements are permitted by Rule 1.5(c), which states:

(1) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. A contingent fee agreement shall be in writing 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 settlement, trial or appeal, litigation and other expenses to be deducted from the recovery, and whether such expenses are to be deducted before or after the contingent fee is calculated.

(2) Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the following:

(i) the outcome of the matter; and,

(ii) if there is a recovery, showing the:

(A) remittance to the client;
(B) the method of its determination;
(C) the amount of the attorney fee; and
(D) if the attorney's fee is divided with another lawyer who is not a partner in or an associate of the lawyer's firm or law office, the amount of fee received by each and the manner in which the division is determined.

The correspondent's proposed arrangement covers only those expenses which are permitted under Rule 1.8(e). Paragraph (e) of Rule 1.8 eliminates the former requirement that the client remain ultimately liable for financial assistance provided by the lawyer and further limits permitted assistance to cover costs and expenses directly related to litigation. See Comment (4) to Rule 1.8.

The arrangement also provides that when any recovery is made on the client's behalf, the recovery would first be debited by the advances made under the note, with payment for those advances being made by the firm directly to the bank. The client thus receives only that recovery which remains after expenses have been paid. The client is informed of this in correspondent's contingent fee contract, which states that "all reasonable and necessary expenses incurred in the representation of said claims shall be deducted after division as herein provided to compensate attorney for his fee."

In the case where recovery is not obtained, however, the lawyers themselves are contractually obligated to pay the amount owed directly to the bank. Correspondent's proposed contract as outlined in the request for this opinion does not inform the client as to possible responsibility for such expenses where there is no recovery. It is the opinion of this Board that Rules 1.5(c) and 1.8(e), taken together, require that the contingent fee contract inform the client whether he is or is not responsible for these expenses, even if there is no recovery.

Although the client may remain "responsible for all or a portion of these expenses," decisions regarding the appropriate actions to be taken to deal with such liability are entirely within the discretion of the lawyers. Since this discretion has always existed, the fact that the lawyers have originally borrowed the money instead of advancing it out-of-pocket would seem to be irrelevant, and the arrangement is thus not impermissible.

The bank's involvement would be relevant, however, were it allowed to affect the attorney-client relationship, such as if the bank were made privy to clients' confidences or secrets (including client identity) or permitted to affect the lawyer's judgment in representing his or her client. See generally, Rule 1.6. Thus, the lawyer must be careful to make sure that the bank understands that its contractual arrangement can in no way affect or compromise the lawyer's obligations to his or her individual clients.

The remaining issue is whether it is ethically permissible for lawyers to charge clients interest on the expenses and costs advanced via this arrangement with the bank. As in the first issue, the fact that the expenses originated with a bank instead of the law firm itself is irrelevant, unless the relationship between lawyer and bank interferes with the relationship between lawyer and client. Assuming it does not, the question is whether lawyers should be permitted to charge their clients interest on advances.

In Advisory Opinion No. 45 (March 15, 1985, as amended November 15, 1985), the State Disciplinary Board held that a lawyer may ethically charge interest on clients' overdue bills "without a prior specific agreement with a client if notice is given to the client in advance that interest will be charged on fee bills which become delinquent after a stated period of time, but not less than 30 days." Thus, the Board found no general impropriety in charging interest on overdue bills. There is no apparent reason why advanced expenses for which a client may be responsible under a contingent fee agreement (whether they are billed to the client or deducted from a recovery) should be treated any differently. Thus, we find no ethical impropriety in charging lawful interest on such amounts advanced on the client's behalf.[1]

In approving the practice of charging interest on overdue bills, the Board held that a lawyer must comply with "all applicable law[1] . . . and ethical considerations."

The obvious intent of Rule 1.5(c) is to ensure that clients are adequately informed of all relevant aspects of contingent fee arrangements, including all factors taken into account in determining the amount of their ultimate recovery. Since any interest charged on advances could affect the ultimate recovery as much as other factors mentioned in Rule 1.5(c), it would be inconsistent to permit lawyers to charge interest on these advances without revealing the intent to do so in the fee contract. Thus, we conclude that it is permissible to charge interest on such

advances only if (i) the client is notified in the contingent fee contract of the maximum rate of interest the lawyer will or may charge on such advances; and (ii) the written statement given to the client upon conclusion of the matter reflects the interest charged on the expenses advanced in the matter.

1. The opinion makes specific mention of O.C.G.A. 7-4-16, the Federal Truth in Lending and Fair Credit Billing Acts in Title I of the Consumer Credit Protection Act as amended (15 USC 1601 et seq.). We state no opinion as to the applicability of these acts or others to the matter at hand.