

RI-356

October 26, 2012

SYLLABUS

A lawyer's practice of referring clients to a third party lender to finance payment of the lawyer's fees through a system involving automatic debits to the client's account on predetermined dates that precludes the client's ability to stop payment or assert any defenses to payment, irrespective of the status of the lawyer's representation of the client at the time of each debit, is subject to MRPC 1.8(a) and constitutes the provision of financial assistance to a client in derogation of MRPC 1.8(e).

The third party lender's contractual right to sue the lawyer's client for a dishonored debit while the lawyer's representation of the client is ongoing places the lawyer in an unwaivable conflict with the client.

References: MRPC 1.8(a)(1), (2), and (3), 1.8(e)(1) and (2), and 7.1(a); RI-159, RI-168, RI-321, and RI-335.

TEXT

A lawyer asks whether an arrangement proposed by a third party lender to provide financing to the lawyer's clients for the payment of the lawyer's fees is ethical.

Under the proposed lending scheme, when a client is unable to pay a quoted fee for legal services, the lawyer refers the client to the third party lender in order to finance all or a portion of the fee. The third party lender provides the lawyer with a "Payment Authorization" form to be completed by the client and a machine to be used to process checks received from the client. As an example, a client who is able to pay \$1,000 of a quoted \$2,500 fixed fee for representation in a criminal matter would write a check made payable to the lawyer in the amount of \$1,000 plus the finance fee and service charge quoted by the third party lender.¹ Upon receipt of the initial check, the lawyer facilitates the client's completion of the "Payment Authorization," instructing the client to make out several additional, postdated checks collectively representing the remaining \$1,500 plus finance fees and services charges, each made payable to the lawyer. The lawyer runs the checks through the machine provided by the third party lender, thereby enabling the third party lender to debit the client's bank account for the amount of each check on the date of each check.

The third party lender debits the client's bank account for the amount of each check when the amount becomes due based on the date on the check. If the client defaults due to insufficient funds in the account at the time the funds are sought to be debited, the third party lender has the right to pursue the client to collect; language in the "Payment Authorization" includes the client's agreement to waive defenses, to forgo the ability to stop payment on the checks, and to continue payments to the lawyer irrespective of any breach by the client of the agreement with the third party lender.

Conceivably, the third party lender could be suing the lawyer's client to collect on the debt owed to it while the lawyer is still providing legal services and receiving payments from the third party lender based on the client's agreement with the third party lender. Additionally, because there is no provision in the "Payment Authorization" for premature termination of the lawyer-client relationship, the client, in executing the agreement, agrees to continue payments even if the lawyer-client relationship is terminated.

A lawyer may not participate in the proposed lending scheme for several reasons.

Michigan's conflicts of interest rules combine provisions that require evaluation of whether competing interests require disclosure, client consent or forbearance from representation, with a series of more objective dictates. Among the more objective dictates is MPRC 1.8(e), which provides:

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 shall ultimately be the responsibility of the client; and

(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of a client.

In the facts presented the lawyer is not directly making a loan to the client; however, this Committee has previously construed the phrase "provid[ing] financial assistance to a client" more broadly than circumstances where money passes directly from the lawyer's hands to the client's hands. In Informal Opinion RI-321, this Committee viewed with skepticism a proposed arrangement between a lawyer representing civil tort plaintiffs and a venture capital company that, in exchange for acquiring an interest in the clients' litigation, would advance cash payments for living expenses to the tort claimants. Like the scheme proposed here, the lawyer in RI-321 would facilitate the transaction by referring the clients to the venture capital company, assuring that the appropriate paperwork was executed, and providing whatever documentation was required by the venture capital company with regard to the particulars of the litigation being pursued on the clients' behalf. Also consistent with the scheme proposed here, the participating client was required to waive all legal defenses to the payments required of the clients in the agreement as a condition of receiving the money. As neither exception set forth in paragraphs (1) or (2) of Rule 1.8(e) was applicable, the lawyer's participation in the loan process was deemed to be the unethical provision of financial assistance to the client. We believe the same conclusion is warranted here as well.

Additionally troubling is the required submission of postdated checks that are immediately converted to automatic drafts on the client's account, without any provision for a refund, reversal, or stop payment, and without regard to whether, at the time the debit is made, the lawyer-client relationship remains intact. The Committee is hard-pressed to envision how such an agreement would be "fair and reasonable to the client," as that phrase is used in MRPC 1.8(a)(1).² Assume, for the sake of argument, that during the course of the representation the lawyer-client relationship is terminated because the lawyer discovers a previously unidentified conflict based upon representation of a former client and must withdraw, or the client rejects the lawyer's advice with regard to a settlement offer and seeks to hire another lawyer. By having waived any ability to cease or contest continued payments to the lawyer under the terms of the "Payment Authorization," the client must continue to pay and may be financially unable to secure new counsel, unless the lawyer appropriately identifies a portion of the monies paid as unearned fees and refunds them.³

By facilitating the client's contractual relationship with the third party lender under the terms described in the "Payment Authorization," the lawyer would knowingly acquire a pecuniary interest adverse to the client—namely, the right to continue to receive payments through the automatic debits, regardless of the status of the lawyer's representation of the client at the time of the payments. Under those circumstances, MRPC 1.8(a) must be met. This arrangement is distinguishable from the credit card arrangement discussed and approved in Informal Opinion RI-168, where payments were not automatically made by the credit card company but, instead, relied upon invoices received from the lawyer as services were rendered.⁴

Finally, the Committee notes the ethical impropriety of a circumstance where the third party lender sues the lawyer's client to collect payment when a client's automatic debit is dishonored for insufficient funds while the lawyer-client relationship is ongoing. This Committee has previously opined that a lawyer cannot simultaneously represent a client and pursue collection of unpaid legal fees and costs by either suing the client directly or by assigning the client's debt to a third party.⁵ Considering that the third party lender would be seeking to collect on money advanced for the lawyer's fees, we find this scheme indistinguishable from the circumstances deemed unethical in these earlier opinions.

In summary, a lawyer's practice of referring clients to a third party lender to finance payment of the lawyer's fees through a system that would involve automatic debits to the client's account on predetermined dates that precludes the client's ability to stop payment or assert any defenses to payment, irrespective of the status of the lawyer's representation of the client at the time of each debit, is subject to MRPC 1.8(a) and constitutes the provision of financial assistance to a client in derogation of MRPC 1.8(e).⁶ Additionally, the possibility that the third party lender's contractual right to sue the lawyer's client for a dishonored debit while the lawyer's representation of the client is ongoing places the lawyer in an unwaivable conflict with the client. This analysis is consistent with earlier opinions discussing a lawyer's collection efforts directly or through means of a third party while simultaneously continuing to represent the client.

¹ The third party lender charges a finance fee on the entire amount of the lawyer's fee, even though the client is not using the lender's services to finance the initial \$1,000 paid to the lawyer. Whether the scheme complies with applicable usury and/or other lending laws is beyond the scope of this opinion.

2 MRPC 1.8(a) provides:

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 a client unless:

- (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner that can be reasonably understood by the client;
- (2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and
- (3) the client consents in writing thereto.

3 This opinion does not discuss any issues that might be addressed within the fee agreement between the lawyer and client, such as when a fee is earned, as such issues are beyond the scope of the question posed.

4 Informal Opinion RI-168 describes the proposed arrangement this way:

Under the program, the credit card company agrees to pay the client's legal fees as soon as they are invoiced by the lawyer. In return, the lawyer agrees to assign to the credit card company the right to collect the fees from the client. The credit card company assumes the risk that the client will not pay.

5 Informal Opinions RI-159, RI-168, and RI-335.

6 Nothing in the facts as presented suggests that either of the exceptions set forth in paragraphs (1) or (2) of MRPC 1.8(e) applies.