The Professional Ethics Committee
For the State Bar of Texas
Opinion No. 576

December 2006

QUESTION PRESENTED

May a lawyer who represents a client in a contingent fee personal injury case enter into an agreement with a lending company owned by non-lawyers under the terms of which the lending company would agree to reimburse the lawyer for litigation expenses in the case as incurred and the lawyer would agree to repay, in the event of a recovery in the lawsuit, the amounts advanced plus a funding fee equal to a fixed percentage of any amount recovered in the case but subject to an agreed maximum?

STATEMENT OF FACTS

A lawyer represents a client on a contingent fee basis in a personal injury case. Because the client cannot afford to fund the litigation expenses necessary to prosecute the lawsuit, the lawyer must advance all such expenses. A lending company owned by non-lawyers has offered to fund the litigation expenses in the case for the promise of a funding fee contingent on the client's recovery in the lawsuit. The agreement between the lending company and the lawyer would call for the lending company to reimburse the lawyer for litigation expenses actually incurred and for the lawyer to repay the amounts advanced for expenses plus a funding fee equal to a fixed percentage of any amount recovered (net of litigation expenses but not legal fees) when and if the client recovered in the lawsuit. The maximum amount of the funding fee would be limited by a cap equal to a specified multiple of the litigation expenses incurred in the case. For example, under an agreement where the funding fee percentage was 1% and the cap amount was equal to two times the litigation expenses, if the client's recovery net of expenses was $1,000,000 and the litigation expenses were $50,000, then the funding fee that the lawyer would be obligated to pay to the lending company would be $10,000 (1% of $1,000,000) and the agreed cap would not limit the amount of the funding fee.

The agreement would be solely between the lawyer and the lending company. The client would not be a party to the contract and would not owe money or have any other obligations to the lending company. The agreement would provide that the lending company would have no special rights to any of the proceeds of the lawsuit, such as a lien or security interest in the client's portion of the recovery or in the lawyer's contingent fee. Instead, the agreement would provide that the obligation to pay the lending company would be merely the general unsecured obligation of the lawyer. The agreement would provide further that the funding fee would not be charged to the client as an expense. In the example above, the litigation expenses advanced would be repaid from the proceeds of the recovery, but the $10,000 funding fee would be paid by the lawyer (presumably, but not necessarily, from his portion of the contingent fee). Additionally, the agreement between the lawyer and the lending company would require full disclosure to the client of the agreement and consent from the client for the lawyer to enter into the agreement. The agreement would also require the lawyer to maintain independence of judgment as to all aspects of the lawsuit and control of the litigation. The lending company

would not be permitted to have any control of the lawsuit or contact with the client and would not be permitted access to any confidential information except as was necessary to determine the expenses to be reimbursed and the amount of the client's ultimate recovery.

DISCUSSION

Whether the proposed arrangement constitutes a fee-sharing agreement with a non-lawyer is the primary concern here. Rule 5.04(a) of the Texas Disciplinary Rules of Professional Conduct clearly prohibits lawyers from sharing legal fees with non-lawyers. Rule 5.04(a) provides that, with exceptions not here relevant, "A lawyer or law firm shall not share or promise to share legal fees with a non-lawyer . . . ." The principal reasons for this prohibition are to prevent solicitation by lay persons of clients for lawyers and to avoid encouraging or assisting non-lawyers in the practice of law. See Comment 1 to Rule 5.04(a).

Recently, in a context similar to the one presented here, this Committee, citing Rule 5.04(a), determined that the Texas Disciplinary Rules would be violated by a lawyer who agreed, as a term of a loan agreement with a finance company that was loaning the lawyer money for litigation expenses in a contingent fee case, to pay to the finance company a percentage of his contingency fee in addition to the principal and interest on the loan. Professional Ethics Committee Opinion 558 (May 2005). There, the lawyer's agreement with the non-lawyer finance company plainly called for paying to a non-lawyer a specific portion of the lawyer's fee, unquestionably the very practice forbidden by Rule 5.04(a).

In a different context, this Committee approved in Opinion 481 (January 1994) an arrangement under which a client paid for legal services by borrowing monies equal to the legal fee from a for-profit finance company, which paid the lawyer directly 90% of the funds borrowed by the client. The finance company retained the remaining 10% and additionally charged lawyers a fee to participate in the program. Recognizing the principal reasons for the prohibition on fee splitting as set forth in Comment 1 to Rule 5.04(a) and noting that the finance company did not solicit clients for any participating lawyer and that it did not perform any legal services, the Committee expressed its belief that under these circumstances ". . . the retention by the finance corporation of a reasonable portion of the amount borrowed by the client is properly viewed as [a] finance arrangement rather than a fee-splitting arrangement subject to the prohibition."

The proposed arrangement here is similar to the fee-splitting arrangement rejected in Opinion 558 rather than the finance arrangement approved in Opinion 481. The funding fee in the circumstances here addressed would be tied directly to the amount of the recovery in the underlying litigation just as was the payment to the finance company in Opinion 558. The amount of the recovery in a lawsuit is largely determined by the lawyer's knowledge, skill, experience and time expended. See American Bar Association Standing Committee on Ethics and Professional Responsibility Formal Opinion 94-389 (December 5, 1994). By tying the proposed funding fee to a percentage of the recovery, the lending company would be directly benefiting from the lawyer's knowledge, skill, experience and time expended to the detriment of the lawyer, who would be solely responsible for paying the funding fee. This would be tantamount to fee splitting.

Finally, this result is consistent with the policy considerations underlying Rule 5.04(a). In Opinion 467 (November 1990), this Committee ruled that a law firm's office lease with a non-lawyer landlord that provided for rent that could be a percentage of the law firm's gross receipts constituted an agreement to share legal fees with a non-lawyer in violation of Rule 5.04(a). The

Committee reasoned that a percentage rental agreement is prohibited for lawyers because an arrangement under which a non-lawyer landlord could receive a percentage of legal fees earned by a law firm would create an incentive for the landlord to refer legal business to the law firm, a result that Rule 5.04(a) is intended to prevent. Similarly, the proposed arrangement here would create an incentive for the lending company to refer cases to lawyers using its services.

CONCLUSION

Under the Texas Disciplinary Rules of Professional Conduct, a lawyer who represents a client in a contingent fee personal injury case may not enter into an agreement with a lending company owned by non-lawyers under the terms of which the lending company would agree to reimburse the lawyer for litigation expenses in the case as incurred and the lawyer would agree, in the event of a recovery in the case, to repay the lending company the amount advanced by the lending company and to pay a funding fee equal to a specified percentage of the amount recovered in the case net of expenses but subject to an agreed maximum.

Opinion Number 558
May 2005

QUESTION PRESENTED

May a lawyer borrow money for case expenses from an independent lending company and agree to pay the lender a percentage of the lawyer's contingency fee?

STATEMENT OF FACTS

A lawyer proposes, with the client's informed consent, to borrow money from a lending company for case expenses (court costs, litigation and expert witness expenses, and reasonably necessary medical and living expenses). The lending company is owned by non-lawyers. In addition to interest on the loan, the lawyer proposes to pay the lender a percentage of the lawyer's contingency fee in the case. The contingency fee agreement between the lawyer and client complies with all applicable rules governing such agreements. The fee percentage paid the lawyer is not influenced by the financing arrangements secured by the lawyer. The lawyer will pay all amounts due to the lending company and the client's recovery will not be affected by the percentage of the contingency fee paid by the lawyer to the lender.

DISCUSSION

The proposed arrangement constitutes an agreement to share legal fees with a non-lawyer. Rule 5.04(a) of the Texas Disciplinary Rules of Professional Conduct specifically provides that, with limited exceptions, a lawyer may not agree to share legal fees with a non-lawyer:

> "A lawyer or law firm shall not share or promise to share legal fees with a non-lawyer ...."

Comment 1 to Rule 5.04 notes that the principal reasons for the limitations on fee sharing are to prevent solicitation by lay persons of clients for lawyers and to avoid encouraging or assisting non-lawyers in the practice of law. The exceptions to the general prohibition on fee sharing that are recognized in subparagraphs (1), (2) and (3) of Rule 5.04(a) (following the statement of the general rule quoted above) are not applicable to the facts considered in this Opinion. Accordingly, the proposed arrangement for the lawyer to pay the lender a portion of a contingency fee would violate Rule 5.04(a).

The conclusion reached in this Opinion is consistent with other Opinions of the Committee that have considered the scope of Rule 5.04(a). In Opinion 493 (February 1994), the Committee determined that a lawyer could not divide legal fees with non-lawyer professionals with whom the lawyer shared office space and expenses. In Opinion 510 (December 1994), the Committee determined that Rule 5.04(a) did not generally prohibit a lawyer from participating in a contingency fee agreement with a client who also signed a contingency fee contract with a non-lawyer investigator. In Opinion 552 (August 2004), the Committee determined that Rule 5.04(a) prohibits payment of a percentage of a legal fee to a third-party auditor.

CONCLUSION

It is a violation of Rule 5.04(a) of the Texas Disciplinary Rules of Professional Conduct

for a lawyer to agree to pay a percentage of the lawyer's contingency fee to a finance company or other lender in connection with obtaining a loan.

Opinion 481
January 1994
Tex. Comm. on Professional Ethics, Op. 481, V. 57 Tex. B.J. 87 (1994)

QUESTION PRESENTED

Under the Texas Disciplinary Rules of Professional Conduct, may a law firm participate in an arrangement under which clients are offered the opportunity to pay for part or all of legal services by borrowing from a for-profit finance corporation, not owned by any participating lawyer, which pays the lawyer at least 90% of the amount borrowed by the client?

STATEMENT OF FACTS

A law firm proposes to enter into the following arrangement with a for-profit finance corporation, which is not owned to any extent by any lawyer practicing with the firm: the law firm will pay a non-refundable fee to the finance corporation to allow the firm to participate in the program. The finance corporation will supply training to the law firm's staff and explanatory materials and agreement forms that may be used by the law firm and its clients. In no case will the finance corporation recommend any lawyer or law firm participating in the arrangement to any potential client. The arrangement offered to clients will be for the finance corporation to advance directly to the lawyer an amount in full payment of an agreed legal fee for services that the lawyer represents in writing to the finance corporation will be performed. The finance corporation will pay to the law firm at least 90% of the amount of the agreed legal fee. In the event of an unresolved dispute between the client and the lawyer relating to the services and the fee, the law firm is obligated under the agreement with the finance corporation to pay back to the finance corporation the amount received by the law firm with respect to the disputed fee and then to deal directly with the client as to the services and the fee.

DISCUSSION

This Committee in Opinion 349 (October 1969), 23 *Baylor Law Review* 891 (Winter 1972), ruled that it was not unethical for a lawyer to accept payment by means of a credit card. The opinion did not discuss the fact that, in any credit card payment, the lawyer receives an amount that is less than 100% of the amount paid by the client.

In Opinion 435 (October 1986 *Texas Bar Journal* 1015), the Committee ruled that an attorney's participation in a barter arrangement was not permissible if the attorney paid anything of value to an exchange and the exchange made the attorney's name available to other members of the exchange.

In Opinion 467 (May 1991 *Texas Bar Journal* 513), the Committee ruled that a law firm's office lease that provides for rent that might be a percentage of the law firm's gross receipts constitutes an impermissible sharing of legal fees with a nonlawyer.

In this case, the proposed arrangement with the finance corporation appears to involve the division of a legal fee between a lawyer and the finance corporation. Rule 5.04(a)[fn1] provides that, with exceptions not here relevant, "A lawyer or law firm shall not share or promise to share legal fees with a non-lawyer . . . ." However, provided the limitations specified below are respected, the Committee does not believe that this arrangement constitutes a fee-sharing arrangement that is subject to the prohibition. As stated in Comment 1 to Rule 5.04(a), "The principal reasons for these limitations are to prevent solicitation by lay persons of clients for lawyers and to avoid encouraging or assisting nonlawyers in the practice of law." In this case the finance corporation does not in any way solicit clients for any participating lawyer. Moreover the

finance corporation does not perform any legal services. In these circumstances, the Committee believes 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 subject to the prohibition.

Any arrangement for the finance of legal services must comply with requirements of the Texas Disciplinary Rules of Professional Conduct concerning permissible levels of legal fees, disclosure of client confidences, and the safeguarding of client funds.

Under Rule 1.04(a), a fee for legal services must not be an "unconscionable fee," which term is defined to mean that "a competent lawyer could not form a reasonable belief that the fee is reasonable." In the financing arrangement at issue, there is a risk that an unconscionable fee might be charged to the client if the percentage (or the amount yielded by the percentage) retained by the finance corporation were so large as to make the total fee paid by the client, including the amount retained by the finance corporation, unconscionable.

To enforce this standard, the Committee believes that, in order for the proposed arrangement to be permissible, there must be disclosure to each client as to the percentage of the gross fee that is retained by the finance corporation. The client using the arrangement will thus be informed as to the extent to which the law firm is willing to receive "up front" a lesser amount for the legal service than the client is borrowing from the finance corporation. In addition, in view of the limits of Rule 1.04, the Committee expresses no opinion as to any arrangement under which a law firm would receive less than 90% of the total amount borrowed by a client under the arrangement.

Because information on legal fees paid by a client to a lawyer may constitute "confidential information" under Rule 1.05, the client must consent, after consultation with the law firm, to disclosures of client information to the finance corporation that will be necessary under the arrangement. See Opinion 464 (November 1989 *Texas Bar Journal* 1198), which holds that a lawyer may not sell delinquent accounts receivable to a factoring company unless the client has previously consented to the disclosure of confidential information incident to such sale of accounts receivable.

Since, under the arrangement, the law firm may receive payment from the finance corporation (based on the client's borrowing) before the completion of the services for which the payment is received, the law firm must comply with Rule 1.14 with respect to safeguarding, in a "trust" or "escrow" account, amounts that are received from the finance corporation and that have not yet been earned by the law firm.

CONCLUSION

An arrangement under which a client borrows from a finance corporation, not owned by any participating lawyer, to pay for a law firm's legal services and at least 90% of the amount borrowed is remitted by the finance corporation to the law firm is not prohibited by the Texas Disciplinary Rules of Professional Conduct provided that (1) the finance corporation in no case recommends lawyers to potential clients, (2) the amount retained by the finance corporation is disclosed to the client, (3) the gross amount borrowed by the client does not amount to an unconscionable fee for the law firm's services, (4) the client consents to necessary disclosure of confidential information in connection with the arrangement, and (5) the law firm places in a trust or escrow account all amounts received under the arrangement that have not yet been earned.

Opinion 465
October 1990
Tex. Comm. on Professional Ethics, Op. 465, V. 54 Tex. B.J. 76 (1991)

QUESTIONS PRESENTED

1. May an attorney ethically own an interest in a lending institution which loans money to personal injury clients of the attorney?

2. May an attorney borrow money from a lending institution for case expenses (court costs, expenses of litigation or administrative proceedings, or reasonably necessary medical and living expenses) for a personal injury client, and ethically charge, or pass on, to the client, as a part of case expense, the out-of-pocket interest or finance charges of the lending institution?

DISCUSSION

In both inquiries, we assume as fact:

(a) The attorney is engaged by the client on a contingent fee basis which fully complies with the mandates of Rule 1.04, and particularly Subsection (d) thereof, of the Texas Rules of Professional Conduct, and the Comments under such Rule;

(b) The attorney (and/or his firm) does not own or control the lending institution to the extent that the lending institution only makes loans to clients of the attorney, and no conflict of interest as prohibited by Rule 1.06 of the Texas Rules of Professional Conduct, or the Comments under such Rule, exists;

(c) The relationship between the attorney and the lending institution is not used to secure or continue the employment of the attorney by the client, or in any manner which violates the provisions of Rules 7.02 or 7.03 of the Texas Rules of Professional Conduct, or the Comments under such Rules;

(d) No communication or advertising of the attorney's services exist in violation of Rule 7.01 of the Texas Rules of Professional Conduct, or the Comments under such Rule;

(e) Any subject transaction with the client in which the attorney is involved, whether: [1] indirectly under Question I; or, [2] directly under Question II, is not done or accomplished in any manner which violates the Conflict of Interest concepts of, or constitutes a prohibited Transaction under, Rule 1.08 of the Texas Rules of Professional Conduct, and particularly Subsections (a), (d), (e), and (h) thereof, and the Comments under such Rule; and, further, that the requirements of such Rule are followed;

(f) The attorney does not conduct himself in any manner which violates Rule 8.04 of the Texas Rules of Professional Conduct, and particularly Subsections (a) (3) and (8) thereof, and the Comments under such Rule; and,

(g) The interest charges of the lending institution are fair, reasonable, customary and at a lawful rate.

It is noted that neither Question presented asks about the propriety of an attorney himself or herself charging the client interest on monies personally loaned to, or advanced for, the client by the attorney; consequently, that matter is not addressed by this opinion.

CAVEAT

A reading of each and all of the above specifically referenced Rules of Professional Conduct, and the Comments thereunder, is necessary to a proper understanding of the following conclusions.

CONCLUSIONS

1. Under the specific facts assumed above, an attorney may properly own an interest in a lending institution which loans money to personal injury clients of the attorney;

2. Under the specific facts assumed above, an attorney may properly borrow money from a lending institution for case expenses for a personal injury client, and charge, or pass on, to the client the actual out-of-pocket interest or finance charges of the lending institution.