THE PHILADELPHIA BAR ASSOCIATION
PROFESSIONAL GUIDANCE COMMITTEE
Opinion 2013-8
(March 2014)

The inquirer is a personal injury attorney who is often asked by clients for an advance on a contingent fee recovery. He is aware that providing such an advance would violate Pennsylvania Rule of Professional Conduct (the "Rules") 1.8(e). The inquirer has asked another personal injury attorney, B ("B") to provide lawsuit funding for his clients, and B has agreed to do so. When a client asks for an advance, or asks about going to one of the litigation advance payment companies, the inquirer refers that client to B, who provides an advance to the inquirer's client based solely on the inquirer's representations that the case has sufficient value to cover what B will be advancing.

B now has asked that the inquirer provide the same type of funding on the same basis for B's clients.

The inquirer states that there is no articulated or implied *quid pro quo* with B for providing this service to each other's clients, and that the inquirer will continue to refer his clients to B for funding even if B never refers a client to the inquirer. The benefit to the inquirer's clients of using B is that the inquirer is never required to turn over documents or information about the claim, which raises concerns about the attorney-client privilege and confidentiality endemic to third-party funding.

The inquirer states that he has attempted to disclose as much as possible to the borrowing client in advance of entering into the transaction with B. However, the Committee notes that the inquirer does not state that he explains the other available options for funding and their relative merits and disadvantages to the client.

The inquirer submitted a three part Lawsuit Funding Agreement which clients who would be obtaining advances would be required to execute. The inquirer asks for the Committee's review to determine if the proposed arrangement (above) and the actual agreement "have addressed the ethical issues that arise in the scenario we are proposing."

The agreement has three parts. The first delineates the parties to the agreement and includes the purpose, the purchase price for the advance, the amount purchased, the client's right to cancel, and a series of required conditions that the client agrees to in entering the agreement, one of which is that the client agrees to always be represented by an attorney in the claim of which part is being sold to the funding lawyer.

The second part is called "Attorney and Law Firm Acknowledgement" to be completed by the attorney who is representing the client in the underlying action and by the client. The third part is a "Schedule of Amount Purchased ("SOAP") to be executed by the client alone.

Integral to the Committee's analysis is a detailed examination of the agreement. The agreements conflate the roles of the referring attorney and the purchaser of the client's proceeds, often purporting to incorporate "advice" that the referring attorney has given to the client. More specifically, the review revealed that the agreement's three sections are internally inconsistent and confusing even to a sophisticated reader. For example, in part 1 of the agreement, the purchasing attorney imposes a fee of $250.00 "for the time to prepare this document and for the time required to fulfill the terms of this agreement," noting that the fee is in addition to the fees due to the client's lawyer in the underlying matter; however, the third part of the agreement, (the "SOAP") shows not only that $250.00 fee but also a $200.00 "origination fee" to the purchasing attorney and a $250.00 fee to "my attorney," (presumably the referring attorney who also is handling the client's case) not listed on the schedule but described in the last paragraph of that section.

Part 1 of the agreement requires the client to "SWEAR UNDER PENALTY" (which is not defined) to various stipulations relating to the transaction and in addition includes a list of twelve "miscellaneous" legal provisions relating to enforcement, fees and other matters, as well as eight other "additional disclosures and additional fees" paragraphs. These include: the funding law firm charges the client selling its claim a fee of $250.00; the annual percentage rate in the agreement is 25%; two paragraphs relating to client's awareness of availability of other sources of funding and the fact that client's attorney recommended this source only; and a statement that "your attorney recommends that you consult with an attorney who is independent of [purchasing attorney's] office before you sign this agreement" despite the payment of $250.00 to the referring attorney.

There are several Rules which impact this inquiry.

Rule 1.0. **Definitions.**

...

(e) ''Informed consent'' denotes the consent by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

Rule 1.1. **Competence.**

A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

Rule 1.2. **Scope of Representation and Allocation of Authority Between Client and Lawyer.**

(a) Subject to paragraphs (c) and (d), a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued ...

(d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any pro-

posed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

Rule 1.4. **Communication.**

(a) 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;
(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished; …
(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Rule 1.6. **Confidentiality of Information.**

(a) A lawyer shall not reveal information relating to representation of a client unless the client gives informed consent, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraphs (b) and (c).

Rule 1.7. **Conflict of Interest: Current Clients.**

(a) Except as provided in paragraph (b), 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 the lawyer's responsibilities to ... a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client; ...

(4) each affected client gives informed consent.

Rule 1.8. **Conflict of Interest: Current Clients: Specific Rules.**

(a) 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 in a manner that can be reasonably understood by the client;
(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and
(3) the client gives informed consent in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

Rule 1.15 **Safekeeping Property, provides in part that,**

(e) Except as stated in this Rule or otherwise permitted by law or by agreement with the client or third person, a lawyer shall promptly deliver to the client or third person any property, including but not limited to Rule 1.15 Funds, that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding the property; Provided, however, that the delivery, accounting and disclosure of Fiduciary Funds or property shall continue to be governed by the law, procedure and rules governing the requirements of Fiduciary administration, confidentiality, notice and accounting applicable to the Fiduciary entrustment.

Rule 4.1 **Truthfulness in Statements to Others.**

In the course of representing a client a lawyer shall not knowingly:

(a) make a false statement of material fact or law to a third person; ...

Rule 8.4 **Misconduct.**

It is professional misconduct for a lawyer to:

(a) 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.

In Opinion 99-4, this Committee addressed "whether it is permissible, under the [Rules] for an attorney to borrow funds on behalf of his/her client (rather than borrowing only the amount of his/her fee) on a short term basis, i.e. 14 to 30 days, from a third-party funding facilitator, pending receipt of settlement funds from an insurance company." The opinion concludes that "The proposed arrangement is ethical providing that two conditions are met. First, the advantages and disadvantages, including the financial ramifications to both the client and the attorney, must be fully disclosed to the client. Second, the Rules regarding attorney-client confidentiality must be followed." Significantly, the opinion notes:

> Additionally, if the attorney transacts business on a regular basis with the loan company, he or she may receive more favorable treatment in subsequent transactions causing a potential loss of objectivity on behalf of the current client. This and the other necessary disclosures will allow the client to assess the attorney's objectivity as to the advantages of the contemplated transaction.

(full text available at http://philadelphiabar.org/page/EthicsOpinion99-4?appNum=4)

In Formal Opinion 2005-100 (copy attached), the Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility ("PBA Committee") provided a global analysis on the issue of litigation financing which not only confirms the advice provided in the very limited circumstances of Philadelphia Opinion 99-4, but also provides an excellent framework for ana-

lyzing the ethical issues presented in the present inquiry. The PBA Committee opined that it is permissible for a lawyer to assist a client in securing litigation funding from a third party and analyzed the considerations and caveats associated with that view. "While the Committee concludes that a lawyer may assist a client in connection with such a transaction consistent with the lawyer's obligations under the Rules ... there are serious ethical issues that the lawyer must consider." The Rules cited include 1.1, 1.4, 1.6, 1.7, 1.8, 2.1 and 4.1. To the extent that the inquirer is recommending to clients that they enter into the agreement as presented, he may be directly violating the foregoing rules. In his alternative role as purchaser of the claims from clients of B, the inquirer may be violating the Rules through the conduct of another – Attorney B – which constitutes an independent violation of Rule 8.4(a).

Opinion 2005-100 first confirms the inquirer's understanding that under 1.8(e), it is unethical for a lawyer to provide financial assistance in the form of living expenses on behalf of a client. There is no Rule which prohibits a lawyer from assisting a client in obtaining financial assistance from a third party to pay living expenses. However, the opinion incorporates the recommendations of other ethics committees which have considered these arrangements and "strongly caution lawyers to consider the legality of the proposed arrangement, evaluate whether the transaction is in the client's best interest, comply with conflict of interest rules, and safeguard client confidentiality and the lawyer-client privilege."

Applying that framework to this inquiry, a number of concerns are apparent, both as to (1) the appropriateness of inquirer's recommending to his clients that they engage in such arrangements and (2) the permissibility of serving on the purchasing side of the agreements.

A lawyer's duty to provide competent representation under Rule 1.1, as well as independent representation under Rule 2.1, is discussed in 2005-100:

> In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but also to other considerations such as moral, economic, social and political factors that may be relevant to the client's situation.

It also mentions that "Loyalty and independent judgment are essential elements in the lawyer's relationship to a client." Rule 1.7, Comment [1].

Competent and independent representation are particularly required in the circumstances of the present inquiry, where the lawyer is not only involved in the selection of the financing company, but actually directs the client solely to one source of funding and recommends execution of a confusing agreement which exposes the client to potentially damaging consequences. The inquirer has to be willing to provide more than the very superficial advice via disclosures in part one of the agreement in order for the client to be adequately informed about his or her choices.

As 2005-100 points out:

> … ordinarily the client would not be knowledgeable about available choices among financing institutions, or be able to make an informed judgment between alternative financing proposals. …
>
> Potential arrangements between a client and a financing institution must be carefully scrutinized, especially in light of the fact that the client may be in great need of money and may not fully appreciate and understand the impact of the proposed transaction, and because many cash providers take the position that such arrangements are exempt from the usury laws. If the lawyer determines that the transaction constitutes a usurious loan under state usury law and is thus illegal, the lawyer may not assist the client beyond advising the client of the lawyer's opinion. *See* Rule 1.2(d).

If the rate of interest in the arrangements in the present inquiry is usurious, then the referring lawyer's involvement (and receipt of a fee) would be impermissible.

The mutuality of this transaction raises additional concerns. Even in the absence of a specified *quid pro quo*, because it does not appear that either the inquirer or B even considers utilizing other funding sources, a conflict exists between their personal interests (be they financial or otherwise) and those of the clients being referred. 2005-100 also cautions against engagement in exclusive arrangements between funders and lawyers and non-exclusive arrangements, like this one, "wherein those select lawyers are given preferential rates, for the reasons that such arrangements could lead to favoring the financing institution over the interests of the client, thereby impairing the ability of the lawyer to exercise independent judgment."

2005-100 also cites the high interest rate of such transactions as creating an additional conflict in the substantive representation:

> The lawyer's interest in the timing of settlement or trial may differ from that of a client who has accepted a cash advance. Once a cash advance is furnished, the client's share is subject to substantial, and mounting reduction with the passage of time. The different "time cost of money" may mean that the lawyer is ethically required to weigh discovery and trial scheduling taking into consideration the very high "time cost of money" imposed on client.

The corollary of competent representation is the duty of communication, required by Rule 1.4(b), to "explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation." The inquirer does not state that he explores with the client other options as to litigation funding or available social services which may be, in a particular case, more advantageous. Instead, the inquirer recommends B as the appropriate source of assistance. It does not appear that the inquirer has a practice of discussing the impact of signing the agreement (including the SOAP) submitted for review.

Specifically, such a discussion would necessarily include the fact that the agreement places the client in legal jeopardy in that it requires the client to make certain statements "under penalty," but does not state the nature of the penalty. It would address the fact that entering into the SOAP

might jeopardize the client's financial interests, in that it provides that the inquirer is to pay directly to purchaser any money that is owed under the SOAP "before transferring any money to client or client's estate, heirs or assigns." Neither the agreements nor the inquirer appear to consider or to provide an explanation as to whether any other obligations of the client relating to the litigation, such as medical providers' bills, or liens from insurance subrogees or DPW, or unrelated obligations, such as child support arrears, will be paid prior to reimbursement of the loan, and, if not, the potential consequences to the client of non-payment.

Additionally, in personal injury matters, to permit the client to obtain necessary medical treatment, an attorney will often provide a guarantee or assignment to a client's medical provider providing for payment of bills from the client's recovery. If the inquirer will not make such a commitment because the client has entered into a funding agreement, then the client must be made aware that the client's ability to obtain treatment (and possibly to maximize recovery) will be limited by entering into this agreement. If the inquirer has made a commitment to a provider to pay bills from the proceeds of the claim, then upon receipt of the proceeds, should there be a recovery not sufficient to meet both the medical expenses and the purchased proceeds, the inquirer will have placed himself in the untenable position of being required to distribute the same proceeds to both the purchaser and the provider, which raises a concern under Rule 1.15(e).

2005-100 identifies yet another issue that must be addressed in such explanations:

> Cash providers assume that counsel's full fee and expenses are primary to any interest of the cash provider. The cash provider might agree to reduce the cost to the client (monthly percentage charge), in return for an improved position regarding security in the settlement process. Must such alternative fee arrangements be disclosed for informed consent? Similar conflicts may arise in determining what cash to take up front in any structured settlement.

Also significant to this inquiry is the stricture of 2005-100 as to independence and avoidance of misconduct through the acts of another under Rule 8.4(a), by engaging in conduct which would be impermissible if engaged in by either one independently:

> "The lawyer and the financing company must be completely separate and independent ..."

Although the inquirer states that reciprocity is not mandatory, in view of the fact that the inquirer does not explore other options with the client, but rather refers clients only to B for this service, (as does B when he refers his clients to the inquirer for funding), the fact that the inquirer receives a $250.00 fee for this referral, and thus benefits by it, causes the Committee to caution that the arrangement proposed by the inquiry could clearly give rise to a reasonable belief that it is a way to avoid the strictures of Rule 8.4(a).

It is clear that it is permissible to arrange for third-party funding of litigation in order for a client to have immediate access to money. Thus, in and of itself, the inquirer's referral of clients to another attorney who offers such funding is not unethical. However, the arrangement proposed by the inquirer, as presently structured, raises so many concerns as to violations of the inquirer's

duties under the Rules, that the Committee finds the particular scenario and use of the agreement described in this inquiry to be unethical. If the inquirer addressed the concerns raised above relating to the substance of the agreements, truly assists his client in making an informed choice about his or her best course of action, and merely offered this arrangement as ***a non-exclusive*** option, with full disclosure, the ethical problems could be eliminated.

CAVEAT: The foregoing opinion is advisory only and is based upon the facts set forth above. The opinion is not binding upon the Disciplinary Board of the Supreme Court of Pennsylvania or any other Court. It carries only such weight as an appropriate reviewing authority may choose to give it.

Opinion 99-8
(February 2000)

The inquiry is whether it is permissible under the Pennsylvania Rules of Professional Conduct (the "Rules") for an attorney to provide substantive information about a personal injury client's claim to a third-party lender which is considering providing funds to the client during the pendency of the personal injury case. Repayment of the funds would be contingent upon the successful resolution of the client's case, i.e., the loan would be repaid only if the client secured a recovery. The lender would compensate the lawyer for the time spent in providing the information about the strengths and weaknesses of the client's case (and periodic updates) on an hourly basis, with a maximum aggregate fee of $250. As indicated below, assuming full disclosure to the client of the advantages and disadvantages of this transaction to the client including, in particular, the risk of waiver of the attorney-client privilege (and the potential ramifications thereof), as well as the attorney's financial interest in the additional fee from the lender, the contemplated transaction does not violate the current Rules.

As an initial matter, the Committee directs the inquirer's attention to Rule 1.6 which addresses issues relating to confidentiality of client information. This Rule, and the related concerns about the attorney-client privilege, presents the most serious ethical concern prompted by this inquiry. The importance of consultation with the client about the possible risk of loss of not only client confidentiality but also of the attorney-client privilege as a result of supplying assessment-type information to the potential lender cannot be underestimated. The inquirer is well advised to document carefully the client's assent to the disclosure and, even then, to make it clear to the lender that the disclosures will be restricted as much as possible--perhaps even limited to only that information which would be discoverable without intrusion upon the privilege.

Rule 1.7(b), which prohibits a lawyer from representing a client if that representation may be materially limited by another client's interests (i.e., if the lender is considered to be a client of the lawyer's for this limited purpose) or the lawyer's own interests, requires the attorney to disclose to the client any benefit that he/she may receive from the contemplated transaction. Thus, if the attorney is to receive a fee from the lender (however modest), this is a benefit to the attorney that must be adequately disclosed to the client. Additionally if on a regular basis, the attorney provides legal services or conducts business with the loan company, this fact should be disclosed pursuant to Rules 1.7 and 1.8. To the extent this arrangement may be considered to be one involving the lawyer's multiple representation of the personal injury client and the lender, both clients must be fully informed of the scope of the lawyer's responsibilities to the other client, as well as how they may conflict with each other (i.e., the impact on the personal injury client's right to confidentiality), and waivers of the potential conflicts should be secured.

Rule 1.8(b) ("A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client consents after consultation") requires that the driving force and apparent result of this transaction be to place the client in an arguably better position than he/she would be without the loan arrangement for which the lawyer's compensated input is a requisite. Any advantage to the attorney from such an arrangement must be secondary, and fully disclosed.

If the lender is not considered to be a client of the attorney for a limited purpose (thus triggering the Rule 1.7 analysis above), Rule 1.8(f) would require full disclosure to and knowledgeable consent of the client in order for the lender to pay the attorney for the services rendered in providing the loan to the client.

In view of the fact that the lawyer will be supplying information that a lender intends to use in evaluating whether to make a loan to the lawyer's client, the lawyer's liability risks to both the lender and the borrower are unmistakable. From an ethical standpoint, the Committee notes the lawyer's Rule 4.1 obligations to refrain from making false statements of fact or law.

The Committee also notes, in conjunction with Rule 1.8(f), the possible role of Rule 5.4(c) and the importance of a lawyer maintaining his or her professional independence in representing the personal injury client.

In closing, the Committee brings the inquirer's attention to its recently issued Opinion 99-4 which addresses a somewhat similar tri-partite financial arrangement undertaken in connection with a client's pending personal injury claim.

Opinion 91-9
(May 1991)

The Committee has been asked whether an attorney (the *Inquirer*) may refer a contingent fee personal injury client to a finance company which may loan funds to the client based on the finance company's evaluation of the strength of the client's case, where the Inquirer's only connection to the transaction, other than the referral itself, is an agreement to pay the finance company out of the proceeds of a settlement or verdict, if any.

Under Rule 1.8(e) of the Rules of Professional Conduct, an attorney shall not provide financial assistance to a client in connection with pending or contemplated litigation, subject to certain exceptions which are not applicable to this inquiry. In addition, Rule 1.8(a) prohibits an attorney from entering into a business transaction with a client or acquiring a security or other pecuniary interest adverse to a client, and Rule 1.8(j) prohibits an attorney from acquiring a proprietary interest in a client's cause of action, both of which Rules are subject to certain exceptions not applicable here. Thus, an attorney generally may not loan funds directly to a client, nor may an attorney indirectly do so through a finance company in which such attorney has an interest.

If the Inquirer does not have an ownership or financial interest in the finance company and is not being paid any fee or other compensation by the finance company, it is the Committee's opinion that the referral itself does not violate Rules 1.8(a), (e) which states that an attorney *should exercise independent professional judgment* in representing a client, which judgment could be affected by any significant relationship between the Inquirer and the finance company.

The Inquirer states in the inquiry that the finance company will evaluate the strength of the client's case. The Committee cautions the Inquirer to keep in mind the provisions of Rule 1.6, which prohibit an attorney from revealing information relating to the representation of the client without the client's consent after consultation. The Inquirer, therefore, must not disclose information regarding the client's case to the finance company, unless the client consents after consultation, as that term is defined in the Terminology section preceding the Rules of Professional Conduct. The Committee also suggests that the Inquirer consider whether the attorney/client privilege may be waived as a result of any such disclosure and whether the finance company's evaluation is discoverable in the client's case.

Finally, the Inquirer states in the inquiry that there will be an agreement to pay the finance company out of the proceeds of a settlement or verdict. If that agreement is in the form of an irrevocable written assignment directly from the client to the finance company, there should not be a problem under the Rules at the time of payment. *See* Rule 1.15(b).