FORMAL OPINION 93-002

STATEMENT OF FACTS

A local financial institution (the "Bank") seeks to contract with local attorneys to provide an arrangement whereby clients may obtain financing for legal fees. Under the terms of the fee financing plan submitted to the Committee (the "Plan"), the Bank would approve a loan to the client and advance funds to the attorney on behalf of the client. The loan would be secured by a promissory note with the client as borrower. The Bank would charge the attorney eight percent of the amount of the note. As a marketing strategy, the Orange County Bar Association, by contractual agreement with the Bank, would endorse the Plan in exchange for a percentage of the profits generated. In the event that the client disputed the quality or quantity of legal services rendered, the Bank would require the attorney to buy back the disputed portion of the note. If the attorney refused to do so, the Bank could withhold funds due the attorney in connection with a similar financing arrangement with a different client.

Applicable Rules: California Rules of Professional Conduct ("CRPC") 3-300, 3-310, 4-200, 1-400, 1-320; California Business and Professions Code section 6068, subdivision (e) (regarding confidentiality), and CRPC 3-700(D)(2).

QUESTION PRESENTED

May an attorney offer a fee financing plan whereby clients obtain financing for legal fees through an independent financial institution at a typical consumer interest rate?

SUMMARY

A fee financing plan does not in itself constitute a violation of the California Rules of Professional Conduct ("CRPC"). However, such a plan must contain certain procedural safeguards in order to comply with ethical rules regarding conflicts of interest (CRPC 3-300, 3-310), fixing of fees (CRPC 4-200), solicitation of business and advertising (CRPC 1-400), division of fees (CRPC 1-320), confidentiality (Bus. & Prof. Code, § 6068(e)), and termination of representation (CRPC 3-700(D)(2); see generally Board of Governors of the State Bar of California Policy Statement, April 20, 1967 [fee financing plans deemed permissible if ethical safeguards are implemented].) Specifically, fee financing plans must contain non-recourse provisions which cover disputed fees; attorneys must have the option to buy back a note at any time; attorneys must be prohibited from passing bank-assessed service charges along to any individual client; the plan must include a mandatory arbitration clause; advertising of the plan may not be done by any individual attorney; all advertisements must be approved by the Committee; attorneys may not encourage clients to participate in the plan; and client confidences must be carefully maintained.

ANALYSIS

A. Conflict of Interest

Rule 3-300. Conflict of Interest (in pertinent part):

> A member shall not . . . knowingly acquire . . . an ownership, possessory, security, or other pecuniary interest adverse to a client, unless . . .
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> (A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and
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> (B) The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and
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> (C) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.

Rule 3-310. Avoiding the Representation of Adverse Interests (in pertinent part):

> (B) A member shall not accept or continue representation of a client without providing written disclosure to the client where:
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> * * *
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> (3) The member has or had a legal, business financial, professional, or personal relationship with another person or entity the member knows or reasonably should know would be affected substantially by resolution of the matter . . . .

Under the terms of the Plan, if a client defaulted on a note or disputed certain legal fees, the attorney would be required to buy back the disputed portion of the note from the Bank after twenty-five days. This mandatory buy-back provision appears to violate conflict of interest rules. For, if such a mandatory buy-back occurred, it is likely the client's inability or refusal to pay legal fees then due his attorney would cause a conflict of interest between the attorney and his client. To avoid this situation,

it is imperative that the financing Plan be without recourse. The Bank must be prohibited at all times from requiring the attorney to buy back the note; the Bank's only recourse must be against the client. Moreover, the Bank must have no say in the choice of attorney, no control over the litigation, and the attorney must not co-sign or guaranty the note nor act on behalf of the Bank in collection attempts. CRPC 3-310(f).

The Plan's recourse provision is also problematic because it could prejudice the interests of a third party client also participating in the Plan. According to the Plan, if an attorney did not buy back the disputed portion of his client's note, the Bank could offset the amount owed on the note against any other funds due the attorney under notes relating to other clients participating in the Plan. Thus, if an attorney refused to buy back Client A's note, the Bank could withhold funds due the attorney in connection with Client B's note. This situation would create an unacceptable conflict of interest between the attorney and Client B, thereby impairing the attorney's representation of Client B. In fact, by participating in the Plan, the attorney would, in effect, be providing the Bank a security interest in Client B's legal fees. Such a financing arrangement could not be characterized as "fair and reasonable" to Client B. For these reasons, the Plan's recourse provision is unacceptable.

Last, in a situation where a note is in default or legal fees are disputed, the attorney must have the option to buy the note back from the Bank in order to protect his relationship with the client or the Bank. In voluntarily buying back a note, however, the attorney must exercise care to avoid the same potential conflicts of interest with the client accompanying a mandatory buy-back. There is no such optional buy-back provision in any of the Plan documents presented to the Committee.

B. Fixing of Fees

Rule 4-200. Fixing of Fees (in pertinent part):

> (A) A member shall not enter into an agreement for, charge, or collect an illegal or unconscionable fee.

The amount of legal fees charged by an attorney should be based entirely upon the quality and quantity of work performed. However, in fee financing plans, an attorney may be tempted to pass along to the client any added fees or charges imposed on the attorney by the Bank. Although an attorney, because of participation in the Plan, may have to increase overall billing rates or fees across the board, individual clients participating in the Plan should not incur any additional charges not imposed on non-participating clients. The attorney must simply absorb these Bank finance charges as the cost of benefitting from the acquisition of additional clients who would not otherwise be able to pay legal fees up front.

C. Disputed Fees

Any fee disputes between a client participating in the Plan and his attorney should be submitted to mandatory arbitration by the local bar association at no cost to the client. Such a mandatory arbitration clause provides the necessary protection to a client who disputes the amount of fees or the quality of services obtained during representation, but is indebted to a disinterested financial institution. The proposed Plan lacks such an arbitration provision.

D. Solicitation of Business and Advertising

Rule 1-400. Advertising and Solicitation (in pertinent part):

> A solicitation shall not be made by or on behalf of a member or law firm to a prospective client with whom the member or law firm has no family or prior professional relationship, unless the solicitation is protected from abridgment by the Constitution of the United States or by the Constitution of the State of California. Moreover, a 'solicitation' means any communication: (1) concerning the availability for professional employment of a member or a law firm in which a significant motive is pecuniary gain; and (2) which is (a) delivered in person or by telephone, or (b) directed by any means to a person known to the sender to be represented by counsel in a matter which is a subject of the communication.

A central ethical imperative in structuring fee financing plans is to avoid abuses associated with advertising and solicitation. The San Diego Bar Association ("SDBA") addressed such concerns in its formal opinion 1983-1. Although the SDBA proposed the following four safeguards in the context of credit card financing, it is the opinion of the Committee that such safeguards are also applicable to fee financing plans.

> First, all publicity relating to such plans is subject to state or local bar ethics committee approval. Second, publication of a directory indicating participating attorneys is prohibited. Third, [the Bank] may not issue promotional material to attorneys, 'except possibly a small insignia to be tactfully displayed in the attorney's office . . . .' Fourth, [while a lawyer's client may participate in the Plan, a lawyer] must not encourage [client] participation . . . .

E. Division of Fees

Rule 1-320. Division of Fees (in pertinent part):

> Financial Arrangements With Non-Lawyers
>
> Neither a member nor a law firm shall directly or indirectly share legal fees with a person who is not a lawyer . . . .

(Rule 1-320 also includes exceptions not relevant to the instant issue.)

Under the terms of the Plan, an attorney would pay the Bank a service charge equal to eight percent of the amount borrowed by the attorney's client. However, this eight percent fee would not constitute a division of legal fees with the Bank. The payment of such a fee would be deemed a separate business transaction between the attorney and the Bank, to wit, a finance charge for services rendered.

F. Confidentiality

While the California Rules of Professional Conduct do not contain rules concerning confidentiality, section 6068, subdivision (e), of the California Business and Professions Code states:

> It is the duty of an attorney to . . . maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client.

In any fee financing plan, although the financial institution would require certain client information for administrative purposes, an attorney has an ethical duty to carefully maintain client confidences. Accordingly, any fee financing agreement should provide that "information given the Bank is to be held in strictest confidence except to the extent necessary to effect collection of the loan." In the proposed Plan, there is no such confidentiality clause.

G. Termination of Representation

Rule 3-700 (D)(2). Termination of Representation (in pertinent part):

> A member whose employment has been terminated shall . . . promptly refund any part of a fee paid in advance that has not been earned.

If the attorney-client relationship is terminated, the attorney still possesses unused client funds advanced by the Bank and there is no dispute that the funds belong to the client, such funds should be immediately returned to the client. Should there be a dispute over the ownership of the funds upon termination of the attorney-client relationship, such dispute should be resolved under the mandatory arbitration provisions discussed above.

CAUTIONARY NOTE

Opinions rendered by the Professionalism and Ethics Committee are given as an uncompensated service of the Orange County Bar Association. Opinions are advisory only and no liability whatsoever is assumed by the Committee or the Orange County Bar Association in rendering such opinions. Opinions are relied upon at the risk of the user. Opinions of the Committee are not binding in any manner upon any courts, the State Bar of California, the Board of Governors, any of the disciplinary committees, the Orange County Bar Association or the individual members of the Committee.

In using these opinions you should be aware subsequent judicial opinions and revised rules of professional conduct may have dealt with the areas covered by these ethics opinions.