NEW YORK STATE BAR ASSOCIATION
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# New York State Bar Association
# Committee on Professional Ethics

Opinion 1108 (11/15/16)

**Topic:** Financing legal fees in litigation, third-party funding

**Digest:** A lawyer representing clients in criminal defense matters may refer potential clients to third-party financing for the lawyer's legal fees and expenses, even though the lawyer pays certain fees to the lender in connection with that financing program and is informed by the lender whether the client has qualified for a loan and in what amount, as long as the lawyer obtains informed consent from the client and otherwise complies with Rule 1.8(f), and as long as the fees the lawyer pays to the lender do not constitute financial assistance to the client. If the lawyer is not advising on the risks and benefits of procuring such financing, the lawyer should so inform clients.

**Rules:** 1.2(c), 1.4(b), 1.8(e) & (f)

## FACTS

1. The inquirer is a sole practitioner exclusively engaged in criminal defense work. Some potential clients ask for payment plans to pay the inquirer's legal fees and expenses. The inquirer would like to refer such clients to a particular third-party financing company.

2. The inquirer would either give potential clients a link to the financing company or post the link on his website, which would lead clients to the financing company's loan application forms. The inquirer might also put a banner on the website indicating that potential clients can finance the fees for legal representation. If a client completes the application, the financing company would decide whether to lend the client money and on what terms. The loan funds would be disbursed directly to the client, but the inquirer would be provided with a "portal" on which to find out whether a potential client had applied for a loan, and when and in what amount funds were disbursed to the client. The financing company's website advertises maximum lines of credit of varying lengths in amounts ranging from $10,000 to $25,000, with interest rates ranging from 10.9% to 29.99%, depending on the borrower's credit score. The loans would be based on the creditworthiness of the client (and any co-signer) and would not be non-recourse (i.e., the client would be responsible to repay the loan whether or not the client prevailed in the case).

3. In order to participate in these programs, the inquirer would pay fees to the financing company of several hundred dollars either in the form of one-time "registration fees" or in the form of monthly "subscription fees."

**QUESTION**

4. May a lawyer bring a third-party lender to the attention of potential clients by giving the link directly to clients or by posting the link on the lawyer's website, in order to assist potential clients in obtaining funding for legal fees and expenses?

**OPINION**

5. This Committee has previously opined that a lawyer may refer clients to third-party sources to finance legal fees under certain conditions, including that (1) the confidentiality of client information provided to the lawyer is maintained, (2) the lawyer does not own an interest in the financing company, (3) the lawyer does not receive any referral fee (except under certain circumstances), and (4) the transaction is not illegal. N.Y. State 769 (2003); N.Y. State 666 (1994). *See also* N.Y. City 2011-2 (addressing issues raised by non-recourse litigation financing arrangements).[1]

6. The proposed financing arrangements here raise three particular issues that we discuss below.

[1] As in those opinions, we express no opinion as to whether the proposed financing here would be a violation of usury or other laws. If the lawyer knows that the financing arrangements are illegal, the lawyer must not facilitate them. See N.Y. Rules of Professional Conduct (the "Rules") Rule 1.2(d) (a lawyer shall not "assist a client, in conduct that the lawyer knows is illegal"); N.Y. City 2011-2; N.Y. State 769 (2003). Under New York law, charging interest rates of more than 16% per year on loans to an individual of less than $250,000 constitutes civil usury. N.Y. Gen. Oblig. L. § 5-501(1), (6); N.Y. Banking L. § 14-a. Charging interest or taking any money or other property as interest on a loan of any money, at a rate exceeding 25% per year is a criminal offense. N.Y. Penal L. § 190.40. Some lenders take a position that a non-recourse extension of credit is not a loan. See *Odell v. Legal Bucks, LLC*, 665 S.E.2d 767, 777 (N.C. Ct. App. 2008 ("[A] transaction in which the borrower's repayment of the principal is subject to a contingency is not considered a loan because the terms of the transaction do not necessarily require that the borrower repay the sum lent"); *Plaintiff Funding Corporation d/b/a LawCash v. Echeverria,* No. 1014040/2005 (N.Y. Sup. Ct. 2005) (declaratory judgment that contract was valid and not covered by New York's usury statutes). It is our understanding that the loans at issue here are based on the creditworthiness of the client and are not non-recourse. Although any illegality might be on the part of the lender and not the client, the lawyer's providing of the information about the lender might be viewed as a recommendation of the transaction and the lawyer's payment of registration or subscription fees might be viewed as participation in the loan transaction.

Advice on financing alternatives and related conflicts of interest

7. The first issue is the extent to which the inquirer should or must advise the client on the costs and benefits of the financing arrangements and the alternatives. In N.Y. State 769, which dealt with non-recourse litigation financing in which a financing company takes an interest in the proceeds of litigation, we noted that a lawyer facilitating such a transaction should ensure that the client is informed of relevant considerations. N.Y. City 2011-2 cautioned that the lawyer may have a personal conflict of interest in rendering such advice where, for example, "the client cannot afford to commence or continue litigation absent a third party advance of the lawyer's fees," because of the lawyer's personal interest in being paid.

8. This situation is different, and these concerns are considerably diminished, because these are *not* non-recourse loans. In non-recourse litigation financing, the financing company generally needs to know a great deal about the litigation in order to determine whether to take the lending risk, and the involvement of the financing company with the litigation raises significant legal questions on which clients generally need advice. By contrast, the financing at issue here is a relatively straightforward lending transaction based on ordinary commercial terms. Further, the lawyer's involvement here is less than in the typical case of non-recourse litigation financing.

9. Nonetheless, the lawyer does owe the client a certain level of disclosure. Rule 1.8(f) says:

> A lawyer shall not accept compensation for representing a client, or anything of value related to the lawyer's representation of the client, from one other than the client unless:
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> (1) the client gives informed consent;
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> (2) there is no interference with the lawyer's independent professional judgment or with the client-lawyer relationship; and
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> (3) the client's confidential information is protected as required by Rule 1.6.

Here, while the money advanced is a loan, it is closely tied to the representation. For all practical purposes, the lawyer is accepting fees "from one other than the client" (the lender). Moreover, although the funds are not paid directly to the lawyer, the lender informs the lawyer when the funds are disbursed, presumably to help ensure that the lawyer gets paid. When the lender gives the lawyer information about disbursement, that information is something "of value" that triggers Rule 1.8(f). As part of obtaining the client's "informed consent" to the funding arrangement pursuant to Rule 1.8(f)(1), the lawyer should ordinarily ensure that the client understands the pros and cons of the funding arrangement and understands that the client may have alternatives to obtaining funds from this particular litigation funding company.

10. However, if a potential client might believe that the lawyer is exercising professional judgment in recommending a funding source appropriate for that particular client, or if the client might believe that lawyer has evaluated the loan terms, the lawyer should ensure that the client understands the limited role the lawyer is playing. As provided in Rule 1.2(c): "A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances [and] the client gives informed consent . . . ." Rule 1.2(c) is consistent with N.Y. State 769, where we said that a lawyer may limit the scope of the engagement to exclude advice with respect to litigation financing. We stated:

> The lawyer should consider that an unsophisticated client may reasonably assume that by facilitating the [non-recourse litigation financing] transaction, the lawyer is also endorsing the entering into of the proposed transaction and/or the terms thereof. To address this possibility, the lawyer must either disclaim such responsibility, see N.Y. City 2001-3 ("[T]he scope of a lawyer's representation of a client may be limited in order to avoid a conflict"), or advise the client of the costs and benefits of the proposed transaction, as well as possible alternative courses of action.

Similarly here, the inquirer may limit the scope of the engagement to exclude advising on financing options. For example, the lawyer could state on the website near the link to the financing company's application page, and in the initial discussion with the client about financing, that the lawyer has not evaluated the loan terms and is not recommending the loan or advising clients on whether the loan is appropriate for any particular client.

Disclosure to lawyer of loan status

11. The second issue we address is raised by the proposal for the funding company to give the lawyer access to a portal to inform the lawyer whether a potential client has applied for and whether and in what amount the funding company has extended a loan. This portal presumably is important to the lawyer because the lawyer's purpose in referring the client to the financing source is to provide a source of funds for the lawyer to be paid, so the lawyer needs to know whether the funds are available. This provision does not concern the lawyer's disclosure to a third party of client confidential information, so it does not implicate Rule 1.6 or other Rules regulating confidentiality. Nevertheless, a client's financial and banking affairs usually are protected by privacy laws. Because a potential client might believe that dealings with the third-party financing company will be kept confidential, the lawyer should inform the client that the finance company will give the lawyer access to information about the status of the loan application and timing and amount of the loan. *See* Rule 1.4(b) ("A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation").

Fee payments by lawyer

12. The lawyer's payment of "registration fees" or "subscription fees" raises questions under Rule 1.8(e), which prohibits advancing or guaranteeing financial assistance to clients in litigation matters, with certain exceptions. That Rule provides:

> While representing a client in connection with contemplated or pending litigation, a lawyer shall not advance or guarantee financial assistance to the client, except that:
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> (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter;
>
> (2) a lawyer representing an indigent or pro bono client may pay court costs and expenses of litigation on behalf of the client; and
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> (3) a lawyer, in an action in which an attorney's fee is payable in whole or in part as a percentage of the recovery in the action, may pay on the lawyer's own account court costs and expenses of litigation. In such case, the fee paid to the lawyer from the proceeds of the action may include an amount equal to such costs and expenses incurred.

In this case, none of the exceptions applies. Paying registration or subscription fees does not involve contingent fees or advancing of costs and expenses of litigation that are repayable only upon success, so Rule 1.8(e)(1) and (3) do not apply. *See generally* Rule 1.5(d) (barring contingent fees in criminal defense matters). The inquirer advises that the clients who inquire about payment plans do not qualify to be represented by a public defender, so we assume that they are not "indigent" within the meaning of Rule 1.8(e)(2).

13. Whether the registration or subscription fees constitute "financial assistance" to the client depends on the purpose of the registration or subscription fees. If these fees compensate the financing company for the risk of lending to the attorney's potential clients, the lawyer's payment of the fees would appear to be financial assistance to the clients: the fees may be seen as in the nature of "points" that mortgage companies charge or as a way for the finance company to charge extra interest. On the other hand, if the purpose of the fees is to pay for the "portal" by which the lawyer can track the financing status of potential clients, that is something in which the client has no particular interest, and the financing company's fees would not be financial assistance to clients. We do not have sufficient facts to resolve this factual question definitively, so we opine only that if the fees do constitute financial assistance to clients in obtaining financing, the lawyer is barred from participating in the programs unless the lender waives the fees or the client pays the fees.

**CONCLUSION**

14. A lawyer may bring a third-party financing program to the attention of clients to assist them in funding the lawyer's legal fees and expenses, as long as the fees the lawyer pays to the lender do not constitute financial assistance to the client and the lawyer complies with the other conditions set forth herein.

(30-16)