Ohio Board of Professional Conduct

OPINION 2021-02
Issued April 9, 2021
Withdraws Adv. Op. 2001-03

Loan from Financial Institution to Advance Costs and Expenses of Litigation

SYLLABUS: A law firm may obtain a loan from a financial institution to advance costs and expenses of litigation in a personal injury matter accepted on a contingent fee basis. The law firm may deduct the interest, fees, and costs of the loan from a client's settlement or judgment as an expense of litigation, provided certain conditions related to the lawyer's communication with the client and written contingent fee agreements are satisfied.

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SYLLABUS: A law firm may obtain a loan from a financial institution to advance costs and expenses of litigation in a personal injury matter accepted on a contingent fee basis. The law firm may deduct the interest, fees, and costs of the loan from a client's settlement or judgment as an expense of litigation, provided certain conditions related to the lawyer's communication with the client and written contingent fee agreements are satisfied.

QUESTION PRESENTED:

Is a law firm permitted to obtain a loan from a financial institution, use the money to advance costs and expenses of litigation in a personal injury matter accepted on a contingent fee basis, and then deduct the interest, fees, and costs of the loan from a client's settlement or judgment as an expense of litigation?

APPLICABLE RULES: Prof.Cond.R. 1.4 , 1.5, 1.6, 1.8, 2.1, and 5.4.

OPINION: A law firm inquires about obtaining a loan from a financial institution for use in advancing expenses in a client's personal injury litigation. The law firm would secure the loan, but not with the client's potential settlement or judgment. The law firm would make monthly payments of interest to the institution and would be obligated to repay the loan. The law firm's obligation to repay the loan would be triggered at the conclusion of the client's representation by settlement or final judgment.

At the outset of the representation, the lawyer would disclose the arrangement between the law firm and the financial institution. The lawyer and the client would enter into a contingent fee agreement that would include client approval of the loan agreement between the law firm and the financial institution. The contingent fee agreement would provide for the deduction of the interest, fees, and costs of the loan from the client's future settlement or judgment. At the conclusion of the representation, the client would receive a closing statement including all final figures.

OPINION: This opinion addresses the ethical propriety of a law firm borrowing funds to finance litigation, and does not address the lawyer's duties when a client enters into a non-recourse civil litigation contract pursuant to R.C. §1349.55. *See* Adv. Op. 2012-03. As an initial matter, lawyers are reminded that Prof.Cond.R. 1.5(c) requires all contingent fee agreements to be in writing. Among other requirements, the agreement must be signed by the attorney and the client, detail the methods by which the fees and expenses are to be determined and deducted, and a signed closing statement must be provided to the client. Prof.Cond.R. 1.5(c)(1) & (2).

Law Firm Obtaining a Loan to Advance Litigation Expenses

Obtaining a Loan to Advance Litigation Expenses

A lawyer is prohibited from providing financial assistance to a client in connection with pending or contemplated litigation. Prof.Cond.R. 1.8(e). However, lawyers are permitted to advance the expenses of litigation and to allow a client's repayment of expenses to be contingent on the outcome of the matter. Prof.Cond.R. 1.8(e)(1). Examples of expenses that may be advanced include court costs, expenses of medical examination, and costs of obtaining and presenting evidence. Prof.Cond.R. 1.8, cmt. [10]. Prof.Cond.R. 1.8(e) does not address whether a lawyer may obtain a loan from a financial institution for use in advancing litigation expenses in personal injury litigation. Nor does the rule address whether interest, fees, and costs of a loan obtained by a lawyer may be deducted from the client's settlement or judgment.

Prof.Cond.R. 1.8(a), 1.8(f), 1.8(i), and 5.4(a), are implicated by the question raised. Prof.Cond.R. 1.8(a) prohibits a lawyer from entering into a business transaction with a client or knowingly acquiring an ownership, possessory, security, or other pecuniary interest adverse to a client unless several conditions are met. *See* Prof.Cond.R. 1.8(a)(1)-

(3). When a loan is not secured by the client's settlement or judgment, a law firm's or lawyer's decision to obtain a loan from a financial institution, for the purpose of paying court costs and expenses, does not involve the firm or lawyer in a business transaction with a client. The firm or lawyer will charge the client the same amount of interest, fees, and costs the firm was charged for the loan. Moreover, there is no indication that the firm or lawyer has any ownership or financial interest in the lending institution. Thus, there is no ownership, possessory, security interest, or pecuniary gain adverse to a client when the firm obtains a loan from a financial institution. In contrast, the arrangement is transformed into a business transaction between the client, the lawyer or law firm, and the financing company when a loan is obtained to pay legal fees and expenses of litigation and the financing company receives a security interest in the proceeds of the client's money judgment.

Support of the Board's view that the proposed transaction is not a business agreement between lawyer and client as contemplated by Prof.Cond.R. 1.8(a), is found in comment [1] that indicates ordinary fee agreements between lawyer and client are governed by Prof.Cond.R. 1.5 and not Prof.Cond.R. 1.8. Comment [10] to Prof.Cond.R. 1.8, Prof.Cond.R. 1.8(e) and Prof.Cond.R. 1.5(c) confirm that it is common for lawyers to advance costs and expenses, thus providing further support to the Board's view that this proposed course of action is closer to an ordinary fee agreement rather than a business transaction between lawyer and client. In the Board's opinion there is no substantial difference between a lawyer using his or her own funds to advance costs and expenses to a client and a lawyer seeking financing from a lending institution to accomplish the same goal.

Prof.Cond.R. 1.8(i) contains a prohibition that, "[a] lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation * * * ." Under the proposed facts, the law firm is not securing the loan with a client's settlement or judgment. Rather, the lawyer is obligated to repay the loan regardless of the outcome of the litigation. Therefore, the lawyer and the law firm are not obtaining a proprietary interest in any one specific cause of action and assume all risk for the underlying financing. With several exceptions not applicable here, Prof.Cond.R. 5.4(a) prohibits a law firm from sharing legal fees with a nonlawyer. When a law firm obtains a loan in which repayment is not tied to a percentage of the legal fee generated by the lawyer and

the loan is not secured by a client's settlement or judgment, there is no sharing of legal fees with a nonlawyer. Finally, Prof.Cond.R. 1.8(f) requires special safeguards if a lawyer intends to accept compensation for representing a client from someone other than the client. Here, the act of borrowing funds to advance costs and expenses on behalf of a client is not compensation to the lawyer for his or her legal services. The lawyer's fees are independent of those costs or expenses.

Deducting Interest, Fees, and Costs of a Loan from a Client's Settlement or Judgment

The Board finds the deduction of interest, fees, and costs of a loan from the client's settlement or judgment to be permissible under the Rules of Professional Conduct. Interest, fees, and costs of a loan obtained by a law firm for this purpose are a client's expenses of litigation. *See* Az. Ethics Op. 01-07 (2001); Ga. St. Bar Op. 05-5 (2007); Il. St. Bar Assn., Op. 94-6 (1994) (affirmed 2010); Mich. St. Bar Op. RI-336 (2005)(amended 2008); Nev. St. Bar, Formal Op. 36 (2007); N.Y. St. Bar Op. 754 (2002); Utah St. Bar Op., 02-01 (2002); and W.Va. Op. 2016-01 (2016). Depending on a lawyer's financial position, a lawyer may need to obtain a loan from a financial institution to advance the litigation expenses. As a fiduciary for the client, the lawyer must be mindful to borrow only the amount reasonably necessary to fund the litigation.[1] Further, the lawyer must use due diligence in searching for the loan terms most beneficial to the client, to include comparison of available rates, fees and costs from multiple reputable lenders. It is the lawyer's duty to negotiate appropriate and reasonable loan terms.

Additional Obligations of Lawyers Related to Obtaining Loans to Advance Costs and Expenses

When taking on a case that requires a lawyer to seek financing to advance costs and expenses, the lawyer owes significant duties to the client. The disclosure due to the client must be robust and stated in terms understandable to the client. A lawyer must explain the circumstances to the extent reasonably necessary to allow the client to make

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[1] Readers are reminded that Prof.Cond.R. 1.5(a) requires lawyers to refrain from charging or collecting a clearly excessive fee. Moreover, Prof.Cond.R. 1.5(b) indicates that any change in the basis or rate of expenses is subject to Prof.Cond.R. 1.5(a) and shall be promptly communicated to the client. As circumstances of the litigation change, lawyers must continue to monitor the reasonableness of the costs and expenses and the interest charged to the client. If some portion of the loan is not used to fund the client's litigation, the lawyer should not charge any interest incurred as a result of the unused portion to the client.

informed decisions regarding the representation. Prof.Cond.R. 1.4(b). Simply telling the client the lawyer intends to seek financing or providing the client with a copy of the loan documentation will not satisfy the Prof.Cond.R. 1.4(b) requirement of explanation. In order for the client to make an informed decision, the lawyer must (1) inform the client about the loan terms, including the identity of the lender, the rate of interest, and any expected costs associated with financing, (2) disclose the material risks and disadvantages to the client, (3) identify any reasonable alternatives available to the client, (4) explain to the client the lawyer's role in the transaction, and (5) explain any potential conflicts of interest that may arise.

When the fee is contingent, as is the case here, the written fee agreement must be signed by the lawyer and client and contain many required terms. Prof.Cond.R. 1.5(c)(1). The basis or rate of the lawyer's fees and expenses for which the client will be responsible must be communicated with the client before or within a reasonable time after commencing representation. Prof.Cond.R. 1.5(b). The lawyer must include in the written fee agreement (1) the method by which the lawyer's fee will be determined, including the percentages of fees that will accrue once the case has reached any particular stage of litigation, (2) the fact that costs and expenses, including the interest, fees, and costs of the loan, will be deducted from the recovery, (3) whether such costs and expenses will be deducted before or after the contingent fee is calculated, and (4) notify the client of any expenses for which the client will be liable, whether or not the client is the prevailing party. Prof.Cond.R. 1.5(c)(1). At the conclusion of representation, and prior to or at the time of disbursing any funds, the lawyer must provide to the client a closing statement detailing how the compensation was determined and any costs and expenses deducted. Prof.Cond.R. 1.5(c)(2). Both the lawyer and the client must sign the written closing statement. *Id*.

Finally, a lawyer must guard against undue influence and improper disclosure of client confidences when working with a financial institution to obtain a loan. Lawyers are required to exercise independent professional judgment in representing clients and must not reveal information relating to the representation without client consent. Prof.Cond.R. 1.6 and 2.1. Although the loan is not secured by the client's settlement or judgment, a finance company may pressure a lawyer to provide confidential information related to the representation, such as how much longer the case is expected to continue,

or may seek to influence the resolution of the matter for the benefit of the financial institution when the trigger to repayment is conclusion of the matter.