MEMORANDUM

TO: The Attorney Ethics Advisory Committee
FROM: Philip Casey Grove
DATE: May 11, 2021
RE: Ethics Opinion File No. EO-20-003

Recommendation: Do not Change EO-20-003

This memorandum concerns EO-20-003 and the public comments submitted addressing it. For a quick refresher, EO-20-003 considers the ethical concerns and implications of lawyers and/or law firms engaging in alternative fee-financing relationships with clients and lenders in consumer bankruptcy practices.

The factual scenario at issue in the opinion is as follows. An Arizona bankruptcy practice funds its operations through a fee-financing relationship with a lender. Under the terms of the arrangement, the lender provides the practice with advances on a line of credit on a per-case basis, eventually advancing 75% of the total amount of fees payable in connection with each case. In exchange, the lender retains 25% of the legal fees to cover financing and collection-management services, and the practice assigns the accounts receivable to the lender. The advances on the line of credit are with recourse to the practice, and the practice provides the lender with personal, financial-related information to facilitate the lender's collection activities. EO-20-003 concludes that such arrangements are not *per se* unethical but present several ethical concerns that must be carefully navigated to avoid violating the ERs.

INTRODUCTION

EO-20-003 was open for public comment from February 9, 2021, to May 10, 2021, and the Committee received two comments during this period from a Mr. Shane Betts. In his first comment, Mr. Betts raised the following concerns: (1) that fee financing might be used in situations such as personal-injury and other uniquely personal claims; (2) that permitting attorneys to assign their accounts receivable to a lender would "complicate any attempt by the client to terminate an attorney they do not trust"; and (3) that there is a danger that bankruptcy clients will be taken advantage of by attorneys "tempted to butter over the agreement to ensure they are paid."

In his second comment, Mr. Betts again raises the point that fee-financing arrangements such as the one contemplated in EO-20-003 might make it difficult for

clients to terminate their attorney because the fees are pre-financed/guaranteed by the lender. Moreover, Mr. Betts asserts that: (1) allowing bankruptcy clients to incur debt and accepting a discounted fee from the lender rather than just charging the client less is not doing "what is 'best for a client'"; and (2) there is a risk that attorneys will "engage in otherwise unethical behavior and claim that it is because of the [third] party with an interest in the claim." This memorandum addresses each point in turn.

1. Personal-Injury Alternative Litigation Financing

Mr. Betts asserts that EO-20-003 could authorize fee financing in personal injury and other unassignable claims and this would amount to "trafficking in other people's injuries." As initial matter, although the principles outlined in EO-20-003 are likely applicable in other contexts, the facts presented to the Committee focused on the use of fee financing in the consumer bankruptcy context, which presents its own unique considerations. *See* EO-20-003 Op. at 14–15 (discussing duty of candor to the bankruptcy court). Without a distinct fact pattern to analyze, it would be difficult for the Committee to opine on the ethical considerations surrounding fee financing in the context of other areas like personal-injury law.

I note, however, that alternative-litigation financing in the person-injury context already appears to be common in the United States, although I was unable to find sources discussing its prevalence in Arizona specifically. Steven Garber, Rand Institute for Civil Justice, Law, Finance and Capital Markets Program, *Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns* 8–12 (2010); Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 Vt. L. Rev. 615, 624–28 (Spring 2007). Thus, EO-20-003 will not change the landscape of fee financing in those spheres, and may, in fact, serve as a useful baseline to assess ethical questions arising out of personal-injury fee financing should a question be presented to the Committee on the topic.

2. Terminating the Attorney-Client Relationship

Next, Mr. Betts asserts that fee financing will make it more difficult for clients to terminate their attorney in the event they are dissatisfied with the attorney's performance. Mr. Betts states that authorizing fee-financing

> will make it instead of the attorney telling the client there is a $500-1,000 fee for terminating him/her (financial disincentive to terminate the attorney client relationship) if he/she does a terrible job; there is instead a $500-1,000 financing fee for terminating services.

EO-20-003 did not address any ethical considerations surrounding firing an attorney in a fee-financing arrangement because that was not a question presented by the ethics

opinion request or by the fact pattern offered to the Committee. Without details concerning a specific fee agreement or a scenario involving the termination of an attorney, the Committee is not in a good position to opine on this issue.

That being said, nothing in EO-20-003 can be read to change the general ethical principles surrounding termination of the attorney-client relationship. Ethical Rule ("ER") 1.16, comment 4, makes clear that "[a] client has a right to discharge a lawyer at any time, with or without cause, subject to liability for payment for the lawyer's services." *See also State Farm Mut. Ins. v. St. Joseph's Hosp.*, 107 Ariz. 498, 501 (1971) ("[T]he law is clear in Arizona that a client has the absolute right to terminate the attorney-client relationship at any time with or without cause."). Thus, it would be unethical for an attorney to enter into a fee-financing arrangement with a lender and a client that purported to limit the client's ability to discharge the attorney. *See* Ariz. Ethics Op. 94-02.

As for the "disincentive" fee mentioned by Mr. Betts, such a charge would likely be unethical unless it: (1) is made in payment for the lawyer's services, ER 1.16, cmt. 4; or (2) is part of a retainer or non-refundable fee. In either scenario, the overall amount paid by the client to the attorney must remain reasonable. ER 1.5(a). An attorney has no right to "more than a quantum meruit recovery" when he/she has not substantially or fully performed under the fee agreement. *See* Ariz. Ethics Op. 94-02. Even under a fee agreement characterized as "non-refundable" or "earned on receipt," an attorney may still be required to give a client a refund should that fee turn out to be unreasonable under the circumstances. *See* Ariz. Ethics. Op. 99-02. An attorney cannot avoid these obligations by simply assigning his/her or right to recovery to a third party, and any fee-financing arrangement must reflect that fact.

Because the discharge of an attorney involved in a fee-financing arrangement with a client and a lender is not presented in EO-20-003, I recommend no changes based upon Mr. Betts' assertions here. However, given the ethical rules and prior Arizona Ethics Opinions addressing terminating the attorney-client relationship and the payment of fees in that scenario, the Committee and the State Bar are well-equipped to address the issue if/when it is presented.

3. Acting in the Client's Best Interest/Avoiding Manipulation

In both comments, Mr. Betts asserts that fee-financing arrangements in the consumer-bankruptcy context are not what is "best for a client" because such arrangements may ultimately leave the client in a similarly bad or worse position following the representation by saddling him/her with a debt to the lender for the attorney's services. Mr. Betts also contends that there is a high risk of an attorney manipulating the client into a fee-financing arrangement because "people going bankrupt . . . are [possibly] not the wisest people" and the attorney will want to "ensure

they are paid." Finally, Mr. Betts argues that an attorney should charge a client less if he/she is willing to accept a heavily discounted fee from a lender.

As a matter of public policy, Mr. Betts criticisms are valid. As highlighted in EO-20-003, the United States Trustee and the American Bankruptcy Institute share Mr. Betts concerns regarding the dangers presented by fee-financing arrangements and other systems that attorneys and lenders have developed to get payment for providing bankruptcy-related representation and services. EO-20-003 Op. at 8–9. On the other hand, others have noted that under the current state of the law within the bankruptcy system, such arrangements are often the only means through which a debtor seeking the benefits of bankruptcy can acquire representation. *Id.*; *see also In re Hazlett*, No. 16-30360, 2019 WL 1567751, at *5-7 (Bankr. D. Utah Apr. 10, 2019).

Nevertheless, the Committee's role is not to make public policy decisions concerning the bankruptcy system, or to adopt the overly paternalistic notion that individuals facing financial troubles are incapable of making free and informed choices. Instead, its purpose in this context is to provide attorneys with the guidance necessary to ensure that their conduct concerning fee-financing arrangements complies with the Arizona Rules of Professional Conduct. In the context of the scenario presented in EO-20-003, the opinion attempts to accomplish this objective by requiring that attorneys: (1) inform the client and the bankruptcy court of the details of a fee-financing arrangement in a clear, unbiased manner, EO-20-003 Op. at 11–12, 14–15; (2) address any potential conflicts of interests arising from the arrangement, *id.* at 13–14; and (3) prevent abuses by any third-party involved in the arrangement, *id.* at 11–13. The opinion also specifically addresses Mr. Betts concerns regarding an attorney accepting a heavily discounted fee from a lender by requiring that the total fee for the attorney's services remains reasonable. *Id.* at 10–11. By imposing these requirements, the opinion seeks to allow potential bankruptcy clients to consider fee-financing arrangements without fear of undue influence or manipulation by their attorney or the lender.

Because the opinion takes a significant step towards addressing the concerns raised by Mr. Betts here, I recommend no changes to EO-20-0003.

4. Using a Third-Party as a Cover for Unethical Behavior

Finally, Mr. Betts argues that "allowing a financial company in will make it so the attorney can engage in otherwise unethical behavior and claim that is because of the [third] party with an interest in the claim."

However, nothing in EO-20-0003 can be read to say that an attorney's ethical obligations to a client are somehow diminished by his/her involvement in a fee-financing arrangement. Indeed, the opinion does the exact opposite by imposing numerous requirements on an attorney wishing to offer or enter a fee-financing relationship with a

client. The opinion also makes clear that: (1) the attorney must maintain his/her "independence of professional judgment" at all times, meaning an attorney cannot claim their behavior was due to the influence or actions of a third party; and (2) the attorney can be held responsible for any conduct by a nonlawyer violating the ethical rules if the attorney ordered or approved that conduct. Therefore, I recommend no changes to EO-20-003 based on Mr. Betts' argument here.

CONCLUSION

Because the concerns raised by Mr. Betts are either inappropriate to address under the request presented to the Committee or are already discussed by EO-20-0003, I recommend no changes to the opinion.