A Look at Making Loans to Clients

by
Kenneth L. Jorgensen, First Assistant Director, and
Candice M. Hojan, Senior Assistant Director
Minnesota Office of Lawyers Professional Responsibility

Reprinted from *Minnesota Lawyer* (July 1, 2002)

A number of lawyer discipline cases involve loans from a client to the lawyer— loans that often are not repaid due to the lawyer's straitened financial circumstances. See e.g., *In re Wyant*, 533 N.W.2d 397 (Minn. 1995). Fewer cases involve loans from the lawyer to the client, but this too can result in professional discipline.

Lawyers are generally prohibited from providing direct financial assistance to clients in connection with pending or contemplated litigation. See e.g., Rule 1.8(e), Minnesota Rules of Professional Conduct (MRPC). The rule does, however, provide two exceptions to the general prohibition against direct financial assistance. The most well-known exception permits lawyers to advance litigation costs and expenses and make the repayment of those expenses contingent upon the outcome of the litigation. MRPC Rule 1.8(e)(1). A lesser-known exception permits lawyers to assist clients in obtaining a loan, but only under very limited circumstances. Rule 1.8(e)(3) provides: "[A] lawyer may guarantee a loan reasonably needed to enable the client to withstand delay in litigation that would otherwise put substantial pressure on the client to settle a case because of financial hardship rather than on the merits, provided the client remains ultimately liable for repayment of the loan without regard to the outcome of the litigation and, further provided, that no promise of such financial assistance was made to the client by the lawyer, or by another in the lawyer's behalf, prior to the employment of that lawyer by that client."

Lawyers run afoul of this rule most often because they fail to note the distinction between direct client lending and guaranteeing client loans. See e.g., *In re Hartke*, 529 N.W.2d 678, 682 (Minn. 1995) (lawyer disciplined for, among other things, making a series of 13 loans totaling $1,677 to one client, a series of personal loans to a second client totaling more than $3,400, and a loan to a third client whose uninsured motorist claim was pending).

The clear language of the rule limits the financial assistance exception *only* to loan guarantees, and does not authorize direct client lending by the lawyer. Moreover, it limits the circumstances in which lawyers may guarantee loans to those where the loan is "reasonably needed to enable a client to withstand

delay in litigation that would otherwise put substantial pressure on the client to settle a case because of financial hardship rather than on the merits."

Finally, the rule prevents lawyers from using the loan guarantee option as a client marketing or solicitation tool by: (1) prohibiting lawyers, or others on their behalf, from promising loan guarantees prior to being employed by the client; and (2) prohibiting the lawyer from making repayment of the loan contingent upon the outcome of the litigation.

The loan guarantee exception authorized by Rule 1.8(e)(3) represents a departure from ethics rules across the nation. The ABA Model Rules, and most states adopting the model rules, prohibit lawyers from providing any form of financial assistance in pending litigation beyond advancing litigation costs and expenses. The Minnesota loan guarantee exception originated in 1981 as an amendment to DR 1-103(B) of the former Minnesota Code of Professional Responsibility and was carried forward when the Minnesota Supreme Court adopted Minnesota's version of the ABA Model Rules in 1985.

The loan guarantee exception attempts to strike a delicate balance between the common law's condemnation of champerty (i.e., lawyers purchasing client causes of action) and the reality that impoverished plaintiffs may be forced to accept less than value settlement offers due to the inherent delays associated with litigation.

Few quarrel about the litigation effects caused by the typical financial inequities between injured clients and defendants or insurers. Many lawyers, however, question whether the continued prohibition against direct client lending for necessary living expenses actually harms clients. They argue that lawyers are oftentimes willing to make direct client loans at interest rates below those offered by lending institutions. They also contend that lawyers may be more willing to postpone or renegotiate repayment obligations in the event the client's litigation is unsuccessful.

While both of these arguments have some validity, there are sound policy reasons behind limiting direct financial assistance to loan guarantees. The restriction reduces the possibility that the client's indebtedness to the lawyer due to a direct loan will interfere with the client's control and decisions concerning the litigation. A direct loan may also cause the client to feel psychologically wedded to the lawyer and impede or adversely affect the client's freedom to discharge counsel who lacks diligence or is incompetent. See e.g., Note, "Guaranteeing Loans to Clients under Minnesota's Code of Professional Responsibility," 66 Minn. L. Rev. 1091, 1110 (1982).

Finally, the loan guarantee requirement enhances the likelihood that the client will be protected by

existing legal lending requirements and formalities. A number of lawyer discipline cases involving loans between lawyers and clients revolve around violations stemming from the lawyer's failure to comply with disclosure requirements and/or other legal lending obligations. See e.g., *In re Fraley,* 621 N.W.2d 727 (Minn. 2001); *In re Weiblen,* 439 N.W.2d 27 (Minn. 1989); and *In re Harry Ray I,* 368 N.W.2d 924 (Minn. 1985).

Loan guarantees, as opposed to direct lending, also eliminate the need for lawyer compliance with the strict ethical standards applied to business transactions with clients. See e.g., Rule 1.8(a), which requires: (1) written notice to the client that advice of counsel concerning the loan should be considered; (2) that the loan terms be fair and reasonable to the client and fully disclosed in writing; (3) that the client consent to the transaction in a separate document which discloses whether the lawyer is looking out for the client's interests, the nature of the lawyer's conflicting interests, and the foreseeable risks to the client from any conflict. See also *In re Admonition in Panel No. 87-22,* 425 N.W.2d 824 (Minn. 1988) (attorney disciplined for failing to disclose conflict of interest in making loan to nonlitigation client even though court found no impropriety in the loan itself).

Minnesota lawyers are indeed afforded more opportunity to give financial assistance to clients in litigation matters. Nonetheless, this greater license is not without its specific limitations. Both the manner in which the assistance can be provided (client loan guarantees) and the circumstances under which financial assistance is appropriate (necessary to withstand delay in litigation) are expressly limited in the rule. Lawyers who desire to help clients in this fashion should be familiar with the professional obligations associated with client financial aid.