BORROWING AND LENDING WITH CLIENTS

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Neither a borrower nor a lender be,

For loan oft loses both itself and friend,

And borrowing dulleth edge of husbandry.

Hamlet Prince of Denmark Act I, scene iii

While insufficient to save Hamlet from his tragically ordained fate, Shakespeare's words are sound advice for lawyers. Although more prosaically phrased than the Shakespearean proscriptions, Rule 1.8(a) and (e), Minnesota Rules of Professional Conduct ("MRPC"), set forth the applicable ethical standards for Minnesota lawyers on borrowing and lending with clients. Rule 1.8(a) proscribes business transactions (e.g. loans) with a client unless the terms of the transaction are fair and reasonable, and understandable to the client. In addition, the client must be given the opportunity to seek independent counsel in the transaction and must consent in writing.[Ftn 1] Rule 1.8(e) forbids a lawyer from providing financial assistance to a client in connection with pending litigation, with certain exceptions.[Ftn 2]

The harms which Rule 1.8 is designed to prevent, as it relates to lawyers' borrowing and lending, are abundantly evident in two recent Minnesota lawyer discipline decisions. The first case, *In re Wyant,* involved unprecedented financial losses to clients of the firm as a result of loans solicited by lawyers for the firm.[Ftn 3] The second case, *In re Hartke,* involved inappropriate borrowing and lending by the attorney in connection with several clients.[Ftn 4]

Neither a borrower

The *Wyant* case presents an almost incredible tale of a law firm over the edge. Over a period of 10 years, clients of the firm lent a total of over $1.4 million to: (1) the firm; (2) the two partners; and (3) a corporation in which the partners were part owners. Over $1.2 million remains unpaid. Wyant is disbarred. His partner has been placed on disability status by the Supreme Court.[Ftn 5] As the referee in the disciplinary case described, "At some point Wyant & Morgeson ceased operating as a law firm seeking to provide legal services to its clients and became a mining operation seeking to extract capital from its clients' assets."

The client loans to the firm illustrate the wholly inappropriate nature of the loans solicited by the firm and why they were not fair and reasonable business transactions. The loans were unsecured. No written consents were obtained. The lawyers did not provide the clients with adequate information on which to base an assessment of the risks of making a loan to the firm. The lawyers did not tell the clients about the firm's precarious financial condition, *e.g.* its lack of profitability, its negative net worth, that it was relying on client loans for its operating expenses, and the large number of clients lending money to the firm. The lawyers did not tell the clients of the tremendous amount of debt for which Wyant was personally obligated thereby rendering his guarantee worthless. The lawyers did not indicate that the firm's interests were potentially adverse to the clients'. The lawyers did not advise the clients to seek independent legal advice. Even if the loans had been repaid, the failure to disclose pertinent financial information, provide necessary documentation and adequate security for the loans would have made the transactions here a violation of Rule 1.8(a).[Ftn 6]

So why did the clients make the loans? Many but not all of the clients were business persons, not unfamiliar with lending transactions. Shouldn't they have known better? The reasons are varied. All of the clients relied on their faith in their lawyers and the representation that the loans were solid investments. At first, that seemed to be true, as the loans were repaid. What the clients did not know, however, was that the loans were repaid with the proceeds of other client loans. This increased the client's level of trust when approached with requests for new loans. Needless to say, the lawyers were not on an equal playing field with the clients in these transactions.

Borrowing money from a client in violation of Rule 1.8(a) was also a problem in *In re Hartke*. Hartke settled a personal injury action on behalf of a client for $25,000. The client's portion of the money ($10,000) could not be immediately disbursed, to comply with notice to the uninsured motorist carrier. To provide the client with funds, Hartke and the client went to the bank where the client signed a collateral assignment of the proceeds to Hartke. Hartke used the settlement check to obtain a $23,000 loan to himself, $5,000 of which he gave to the client. He deposited the rest into his business account, which covered an overdraft in the account.

The bank cashed the settlement check after 30 days, paid off Hartke's loan, and deposited the remaining funds into his business account. Despite the deposit of the client's money, Hartke's business account did not have enough money in it for several months to pay the client the remaining $5,000 owed to her.[Ftn 7] The loan from the client was impermissible under Rule 1.8(a) because the client did not understand the transaction, she had no chance to consult independent counsel, and there was no separate disclosure or consent other than the assignment of proceeds signed at the bank.

nor a lender be

Lending money to clients was an additional problem for Hartke. Prior to settling the litigation for the above client, Hartke made at least 18 personal loans to her, totaling $1,677. For 13 of the loans there was no written documentation. He made a series of personal loans to a second client totaling $3,450, again without formal documentation. The undocumented loans created an imbalance of power between attorney and client and confusion as to what was owed, *e.g.*, one of the loans was made when Hartke actually held funds belonging to the client in trust. He lent money to a third client while an uninsured motorist claim was pending. Hartke claimed that the loans were permitted under Rule 1.8(e). The Court disagreed, finding that the direct personal loans fell within none of the exceptions provided in the rule.

Compare then, a case of first impression in the Florida Supreme Court, which, on "humanitarianism" grounds, dismissed disciplinary charges against a lawyer for providing money and clothing to a client.[Ftn 8] The lawyer, Taylor, represented an indigent mother and child in a medical malpractice case. The lawyer changed firms midway through the litigation, and the client decided to come too. At the lawyer’s prior firm, the firm's "medical group" had advanced money to the client each month by virtue of loan documents signed by the client. Repayment to the "medical group" was to come from the proceeds of the lawsuit.

Taylor approached the senior partner at his new firm to see whether the firm would be able to continue the financial support. The senior partner rejected the request for monthly payments, noting ethical concerns, but was sufficiently concerned about the client's financial status that he signed a check for $200 on the firm's account to the client for basic necessities. Taylor also provided some used clothing to the client's child.

In the disciplinary proceeding against Taylor, the referee found that while the money provided to the client was called a "loan," there was no expectation of repayment on the part of the firm and the money and clothing were not provided as a condition for continued representation. He found that Florida Rule 4-1.8(e) does not bar all financial assistance given during the attorney/client relationship, but that "the ethical concerns surrounding the prohibition against attorneys providing financial assistance to clients have consistently focused upon preventing attorneys from promising their clients financial assistance in order to establish or maintain employment."[Ftn 9]

loan guarantees

Ethical prohibitions forbidding lawyers from providing financial assistance to clients have their roots in the Middle Ages, and the law's condemnation of champerty.[Ftn 10] As common law in this country developed, courts allowed lawyers to provide financial assistance to clients for expenses not related to litigation (*i.e.* living expenses), but only if the client remained ultimately responsible for repayment of the loan and the loan was made after the commencement of the attorney-client relationship. In 1954, the ABA departed from the common law approach, and in ABA Formal Opinion 288 prohibited loans for living expenses, on various grounds including that attorneys would obtain an interest in the subject matter of the litigation and such loans would create a conflict of interest. When the ABA adopted the Model Code in 1969, it essentially codified Opinion 288.[Ftn 11]

Minnesota, as all but a few other states, does not allow direct loans to clients for living expenses.[Ftn 12] Rule 1.8(e)(3), MRPC, does, however, allow a lawyer to "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." While this may appear to be a distinction without a difference, as the lawyer's financial risks are the same as lender or guarantor, the rationale for the difference is sound. The guarantor approach reduces some of the problems associated with direct loans for living expenses, by: 1) eliminating some of the psychological imbalance of power that would attend a direct transfer of funds from lawyer to client; 2) reducing the client's feeling of indebtedness and reluctance to control the litigation; and 3) by involving the third party banker or lender, increasing the likelihood that the client has carefully considered the ramifications of the decision to accept the loan and to pursue the claim.[Ftn 13]

The Minnesota approach has other safeguards to minimize the potential for conflicts. The client must remain ultimately liable for repayment of the loan, regardless of the outcome of the litigation. In addition, the promise of financial assistance cannot have been made prior to the commencement of the representation. While perhaps not a perfect solution, Minnesota's approach to financial assistance to clients allows lawyers to act in a humanitarian fashion if the situation requires, and yet avoid troubling conflicts with the representation.[Ftn 14]

NOTES

1 *Rule 1.8(a), MRPC, provides: (a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless: (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client; (2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and (3) the client consents in writing thereto.*

2 *Rule 1.8(e), MRPC, provides: (e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that: (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 client may pay court costs and expenses of litigation on behalf of the client; and (3) 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.*

3 In re Wyant, *C3-94-519 (Minn. June 23, 1995) (disbarred).*

4 In re Hartke, *C5-86-1996 (Minn. April 14, 1995) (indefinite suspension -- three-year minimum).*

5 In re Morgeson, *C3-94-1668 (Minn. February 10,1995).*

6 *Wyant also borrowed money personally from three clients, all of which was repaid, but which was found to violate Rule 1.8(a) because of the same type of problems described as to the loans to the firm.*

7 *The loan, obviously, wasn't the only problem with the client transaction. Depositing the money into his business account instead of his trust account and using the money for a purpose other than that specified by the client also resulted in a finding of misappropriation in violation of Rules 1.15 and 8.4, MRPC.*

8 The Florida Bar v. Taylor, *648 So.2d 1190 (Fla. 1994).*

9 Id. *at 1192.*

10 *Note, "Guaranteeing Loans to Clients under Minnesota's Code of Professional Responsibility,"* 66 Minn. Law L. Rev. *1091 (1982).*

11 Id. *at 1099.*

12 Id. *at 1101.*

13 Id. *at 1110 -1111. Florida Rule 4-1.8(e) does not authorize the guarantor approach.*

14 See also, *J.J. Vassen, "The Case for Allowing Lawyers to Advance Client Living Expenses," 80* Illinois Bar J. *16 (1992).*